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For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁷

Florence E. Harmon,

Acting Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-59135; File No. SR-ISE-2008-85]

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Approving a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Purchase by International Securities Exchange Holdings, Inc., of an Ownership Interest in Direct Edge Holdings, Inc.

December 22, 2008.

I. Introduction

On November 7, 2008, the International Securities Exchange, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change in connection with corporate transactions (the "Transactions") in which, among other things: (1) The parent company of ISE, International Securities Exchange Holdings, Inc. ("ISE Holdings"), will purchase an ownership interest in Direct Edge Holdings LLC ("Direct Edge") by contributing cash and the marketplace currently operated by ISE Stock Exchange, LLC ("ISE Stock Exchange") for the trading of U.S. cash equity securities; and (2) Direct Edge's wholly-owned subsidiary, Maple Merger Sub LLC ("Merger Sub") will operate the marketplace as a facility of ISE. The proposed rule change was published for comment in the **Federal Register** on

November 17, 2008.³ The Commission received no comments regarding the proposal. On December 17, 2008, ISE filed Amendment No. 1 to the proposal.⁴ This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

Currently, ISE Stock Exchange operates, under the ISE's rules and as a "facility," as defined in Section 3(a)(2) of the Act,⁵ of ISE, a marketplace for the trading of U.S. cash equity securities by Equity Electronic Access Members ("Equity EAMs") of ISE (the "Facility").⁶ Direct Edge wholly owns and operates Direct Edge ECN LLC ("DE ECN"), a registered broker-dealer, electronic communications network ("ECN"), and Equity EAM that submits limit orders to the Facility for display and execution. As part of the Transactions to be entered into by ISE, ISE Holdings, Direct Edge, and other parties: (1) ISE Holdings will purchase a 31.54% ownership interest in Direct Edge; and (2) ISE Stock Exchange will merge with and into Merger Sub, a Delaware limited liability company and wholly-owned subsidiary of Direct Edge, with Merger Sub as the surviving entity. Following the closing of the Transactions, ISE Holdings will own 31.54% of Direct Edge, Direct Edge will own all of the equity interests of Merger Sub, Merger Sub will operate the Facility as a facility of ISE, and Direct Edge will continue to own and operate

³ See Securities Exchange Act Release No. 58918 (November 7, 2008), 73 FR 67909 ("Notice").

⁴ Amendment No. 1: (1) Corrects minor errors in the text of the Merger Sub LLC Agreement and the DE Operating Agreement (as defined below); and (2) revises ISE Rule 312(a) to clarify that ISE will enter into a plan with a non-affiliated self-regulatory organization ("SRO") pursuant to Rule 17d-2 under the Act to relieve ISE of regulatory responsibilities for Direct Edge ECN with respect to common rules of ISE and the unaffiliated SRO, and ISE will enter into a regulatory services contract with a non-affiliated SRO to perform regulatory responsibilities for Direct Edge ECN for unique ISE rules. Because Amendment No. 1 is technical in nature, the Commission is not required to publish Amendment No. 1 for comment.

⁵ 15 U.S.C. 78c(a)(2). Under Section 3(a)(2) of the Act, the term "facility," when used with respect to an exchange, includes "its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service."

⁶ See Securities Exchange Act Release No. 54399 (September 1, 2006), 71 FR 53728 (September 12, 2006) (File No. SR-ISE-2006-45) (order approving the Facility). An Equity EAM is an Electronic Access Member authorized by ISE to trade on the ISE Stock Exchange. See ISE Rule 2100(c)(6).

DE ECN, which intends to continue to submit limit orders to the Facility for display and execution.

As limited liability companies, ownership in Direct Edge and in Merger Sub is represented by limited liability membership interests. The holders of such interests are referred to as "Members."⁷ Following the closing of the Transactions, Direct Edge will be the sole member of Merger Sub. The Members of Direct Edge and their respective ownership interests will be: ISE Holdings (31.54%); Citadel Derivatives Group LLC (19.9%); The Goldman Sachs Group, Inc. (19.9%); Knight/Trimark, Inc. (19.9%); and the ISE Stock Exchange Consortium Members (collectively 8.76%).⁸

As the self-regulatory organization ("SRO") for the Facility, ISE will have regulatory responsibility for the activities of the Facility.⁹ In the current proposal, ISE seeks the Commission's approval of: (1) The Limited Liability Company Agreement of Merger Sub ("Merger Sub LLC Agreement"), which establishes the governance structure of

⁷ With respect to Merger Sub, "Member" means Direct Edge, which initially will be the sole member of Merger Sub, and any Additional Members admitted pursuant to Section 4.3 of the Merger Sub LLC Agreement. The admission of Additional Members is subject to ISE's authority under Section 1.6 of the Merger Sub LLC Agreement, and each Additional Member must become a party to the Merger Sub LLC Agreement. See Merger Sub LLC Agreement, Sections 4.3(a) and (c). In addition, no Person, other than Direct Edge, may acquire an ownership interest of more than 20% of Merger Sub without the Commission's approval. See Merger Sub LLC Agreement, Sections 7.2(a) and (b). With respect to Direct Edge, "Member" means any Person (i) executing the DE Operating Agreement as a Member of DE on the effective date of the Transactions (the "Effective Date"); (ii) admitted as a Member as of the Effective Date upon the effectiveness under Delaware law of the merger of ISE Stock Exchange with and into Merger Sub; or (iii) subsequently admitted as an additional or substitute member of Direct Edge. For as long as Direct Edge controls Merger Sub and the Facility is a facility of a national securities exchange, no Person may own more than 40% of Direct Edge and no ISE member (including Equity EAMs) may own more than 20% of Direct Edge without the Commission's approval. See DE Operating Agreement, Sections 12.1(a) and (b).

⁸ The ISE Stock Exchange Consortium Members are: Bear Rex, Inc.; DB US Financial Markets Holding Corporation; Canopy Acquisition Corporation; IB Exchange Corp.; LabMorgan Corporation; Merrill Lynch L.P. Holdings, Inc.; Nomura Securities International, Inc.; Sun Partners LLC; and VCM Capital Markets, LLC.

⁹ ISE represents that it will continue to have adequate funds to discharge all regulatory functions related to the Facility. ISE represents, further, that Merger Sub, the operator of the Facility, will not be entitled to any revenue generated in connection with penalties, fines, and regulatory fees that ISE may assess against ISE Members in connection with trading on the Facility. Rather, all regulatory fines, penalties, and fees assessed against and paid by ISE Members to ISE in connection with trading on the Facility will remain with ISE. See Notice, *supra* note 3.

¹⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Merger Sub, the entity that will operate the Facility; (2) the Third Amended and Restated Limited Liability Company Operating Agreement of Direct Edge (“DE Operating Agreement”), which establishes the governance structure of Direct Edge, the sole owner of Merger Sub; (3) amendments to the Bylaws and Certificate of Incorporation of ISE Holdings (respectively, the “ISE Holdings Bylaws” and “ISE Holdings Certificate”) that revise certain provisions in the ISE Holdings Bylaws and ISE Holdings Certificate to include other national securities exchanges (in addition to ISE) that ISE Holdings may control, directly or indirectly, and their facilities; and (4) amendments to ISE Rules 312, “Limitation on Affiliation between the Exchange and Members,” and 2108, “Order Routing and Route Out Facility,” that are designed to address ISE’s and Merger Sub’s affiliation with DE ECN following the closing of the Transactions.¹⁰ As discussed more fully below, the Merger Sub LLC Agreement, the DE Operating Agreement, and the ISE Holdings Certificate and ISE Holdings Bylaws, as amended, include, among other things, provisions that are designed to maintain the independence of the self-regulatory functions of ISE and other national securities exchanges that may be controlled by ISE Holdings, and to facilitate the ability of ISE, other national securities exchanges that may be controlled by ISE Holdings, and the Commission to fulfill their regulatory and oversight obligations under the Act.

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ In particular, the Commission finds that the proposal is consistent with Section 6(b)(1) of the Act,¹² which requires a national securities exchange to be so organized and have the capacity 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.

The Commission also finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹³ which 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, and are not designed to unfairly discriminate between customers, issuers, brokers, or dealers.

A. Merger Sub’s Operation of the Facility

The Commission believes that the proposal is consistent with Section 6(b)(1) of the Act in that upon establishing Merger Sub as the operator of the Facility and entering into the relationship with Direct Edge described above, ISE should remain so organized and have the capacity to be able to carry out the purposes of the Act. The Commission notes that it has previously approved a similar structure with respect to the operation of an exchange facility.¹⁴

The Commission believes that Merger Sub can be approved as the operator of the Facility because ISE will continue to be the SRO for the Facility, and because Merger Sub, a wholly-owned subsidiary of Direct Edge, should conduct the Facility’s business operations in a manner that is consistent with the regulatory and oversight responsibilities of ISE.¹⁵

Neither Merger Sub nor Direct Edge will carry out any regulatory functions.

¹³ 15 U.S.C. 78f(b)(5).

¹⁴ See Securities Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (File No. SR-PCX-00-25) (order approving the establishment of Archipelago Exchange (“ArcaEx”) as a facility of PCX Equities, Inc., a subsidiary of the Pacific Exchange, Inc. (“PCX”)) (“ArcaEx Order”). At the time the Commission issued the ArcaEx Order, Archipelago Holdings LLC’s wholly-owned subsidiary, Archipelago Exchange LLC, operated the ArcaEx facility, and PCX held a 10% ownership interest in Archipelago Holdings LLC. As noted above, ISE Holdings will purchase a 31.54% ownership interest in Direct Edge, which will be the sole owner of the Facility operator, Merger Sub.

¹⁵ As the SRO, ISE will have regulatory responsibility for the Facility.

However, because Merger Sub will operate the Facility—and Direct Edge will be the sole owner of Merger Sub—all of the activities of Merger Sub and Direct Edge must be consistent with, and not interfere with, ISE’s self-regulatory obligations. In this regard, Section 10.2(d) of the Merger Sub LLC Agreement provides that Merger Sub and its Members, and their officers, directors, agents, and employees agree to comply with the federal securities laws and the rules and regulations thereunder; to cooperate with the Commission and with ISE pursuant to its regulatory authority and the provisions of the Merger Sub LLC Agreement; and to engage in conduct that fosters and does not interfere with Merger Sub, the Facility, and ISE’s ability 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 mechanisms of a free and open market and a national market system; and, in general, to protect investors and the public interest.

Likewise, Section 14.2 of the DE Operating Agreement provides that Direct Edge and its officers, Managers,¹⁶ employees, and agents shall be deemed to agree to comply with the federal securities laws and the rules and regulations thereunder and to cooperate with the Commission and ISE pursuant to, and to the extent of, their respective regulatory authority. In addition, for as long as Direct Edge controls Merger Sub, Direct Edge’s Managers, officers, employees, and agents will give due regard to the preservation of the independence of the self-regulatory function of ISE, as well as to its obligations to investors and the general public, and will not take any actions that would interfere with the effectuation of any decisions by the ISE’s Board of Directors (“ISE Board”) relating to ISE’s regulatory functions, including disciplinary matters, or which would interfere with ISE’s ability to carry out its responsibilities under the Act.¹⁷

The Merger Sub LLC Agreement and the DE Operating Agreement include additional provisions that make special accommodations for ISE as the SRO of the Facility to facilitate ISE’s ability to oversee the Facility. For example, the

¹⁶ “Managers” are members of Direct Edge’s Board of Managers.

¹⁷ See DE Operating Agreement, Section 14.1.

¹⁰ Although neither Direct Edge nor ISE Holdings is an SRO, certain provisions of the DE Operating Agreement and the ISE Holdings Certificate and ISE Holdings Bylaws are rules of an exchange if they are stated policies, practices, or interpretations (as defined in Rule 19b-4 of the Act) of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Act and Rule 19b-4 thereunder. Accordingly, ISE filed the DE Operating Agreement and the proposed changes to the ISE Holdings Certificate and ISE Holdings Bylaws with the Commission.

¹¹ In approving the proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(1).

Merger Sub LLC Agreement sets forth ISE's authority with respect to any action, transaction, or aspect of an action or transaction that relates to ISE's regulatory functions or responsibilities by requiring ISE's affirmative vote before such action or transaction, or aspect thereof, can be authorized, undertaken, or effective.¹⁸ The Merger Sub LLC Agreement also provides that, for as long as Merger Sub operates the Facility, if ISE determines that an action is necessary or appropriate for ISE to fulfill its regulatory functions or responsibilities, ISE will have the right to direct that such action be taken by or on behalf of Merger Sub without regard to any other party.¹⁹ The Merger Sub LLC Agreement further provides that ISE will receive notice of certain planned or proposed changes to Merger Sub and the Facility, which ISE must affirmatively approve prior to implementation.²⁰ In addition, ISE will have access to information through provisions such as Section 10.3(b) of the Merger Sub LLC Agreement, which allows Merger Sub's officers, directors, employees, advisors, and agents to disclose confidential information to the Commission and to ISE.

With respect to Direct Edge, under Section 7.1(a)(1) of the DE Operating Agreement, ISE Holdings is entitled to designate three of the 11 Managers of Direct Edge's Board of Managers ("DE Board"). In addition, for as long as the Facility is a facility of ISE, one of the Managers designated by ISE Holdings to the DE Board must be a member of the ISE Board or an officer or employee of ISE nominated by the ISE Board.²¹ Further, ISE will have access to information through provisions such as Section 11.2(a) of the DE Operating Agreement, which allows Direct Edge's Members, Managers, officers, employees, and agents to disclose to the Commission and ISE confidential information in Direct Edge's possession pertaining to the self-regulatory function of ISE with respect to Merger Sub.

In addition, Section 7.7(i) of the DE Operating Agreement states that no provision of Section 7.7, which requires supermajority and majority votes of the DE Board or, in certain cases, a vote of the Unit holders of Direct Edge,²² with

respect to certain significant actions, will apply where the application of the provision would interfere with the effectuation of any decisions by the ISE Board relating to ISE's regulatory functions, including disciplinary matters, or the structure of the market that ISE regulates, or would interfere with the ISE's ability to carry out its responsibilities under the Act or to oversee the structure of the market that the ISE regulates, as determined by the ISE Board, which functions or responsibilities will include the ability of ISE as an SRO 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 mechanisms of a free and open market and a national market system; and, in general, to protect investors and the public interest.

These provisions of the Merger Sub LLC Agreement and the DE Operating Agreement reinforce the notion that the Facility, as a facility of an exchange, is not solely a commercial enterprise; it is an integral part of an SRO registered pursuant to the Act and, as such, is subject to obligations imposed by the Act. In addition, because the Facility will be a facility of ISE, ISE's obligations under the Act extend to its members' activities on the Facility, as well as to the operation and administration of the Facility. Accordingly, the Commission believes that the provisions described above are consistent with the Act and enhance ISE's ability to carry out its self-regulatory responsibilities with respect to the Facility.

B. Changes in Control of Merger Sub and Direct Edge

The Commission believes that the restrictions in the Merger Sub LLC Agreement and the DE Operating Agreement on direct and indirect changes in control of Merger Sub, which will operate the Facility, and Direct Edge, which will wholly own Merger Sub, respectively, are sufficient so that ISE will be able to carry out its regulatory responsibilities and the Commission will be able to fulfill its responsibilities under the Act.

In this regard, the Merger Sub LLC Agreement identifies Direct Edge as the Sole Member of Merger Sub. A change to the Merger Sub LLC Agreement would need to be filed with the Commission if so required under Section 19(b) of the Act and Rule 19b-4 thereunder. In addition, under Section

7.2 of the Merger Sub LLC Agreement, a proposed transfer of ownership interests that would result in any Person (other than Direct Edge), alone or together with its Related Persons (as defined in the Merger Sub LLC Agreement), owning more than 20% of Merger Sub would not become effective until, among other things, the ISE filed a proposed rule change with the Commission pursuant to Section 19(b) of the Act and the Commission approved the proposal.²³

Further, Section 7.2(d) of the Merger Sub LLC Agreement requires Merger Sub to inform the Commission in writing at least ten days prior to the closing of any transaction that would result in a Person's percentage ownership interest, either alone or together with its Related Persons, in Merger Sub meeting or crossing the threshold level of 5% or the successive percentage ownership interest levels of 10% and 15%. The Commission believes that this approach is consistent with the Act in that it is analogous to the ongoing reporting requirements of Form 1,²⁴ the application for, and amendments to the application for, registration as a national securities exchange. Exhibit K of Form 1 requires any exchange that is a corporation or partnership to list any persons that have an ownership interest of 5% or more in that exchange;²⁵ and Rule 6a-2(a)(2) under the Act²⁶ requires an exchange to update its Form 1 within ten days after any action that renders inaccurate the information previously filed in Exhibit K.

Exhibit K imposes no obligation on an exchange to report parties whose ownership interest in the exchange is less than 5%. Similarly, Section 7.2(d) of the Merger Sub LLC Agreement requires Merger Sub to notify the Commission of an interest in Merger Sub only when that interest reaches 5% or more. The Commission does not believe that the identity of a party that has less than a 5% interest in a facility of a national securities exchange is a "rule of the exchange" that must be filed pursuant to Section 19(b) of the Act and Rule 19b-4(b) thereunder.

With respect to Direct Edge, Exhibit C of the DE Operating Agreement lists the Members of Direct Edge and their

²³ See Merger Sub LLC Agreement, Section 7.2(a)-(c).

²⁴ 17 CFR 249.1.

²⁵ This reporting requirement applies only to exchanges that have one or more owners, shareholders, or partners that are not also members of the exchange. See Form 1, Exhibit K. Exhibit K applies only to the exchange itself, not to entities that operate facilities of the exchange.

²⁶ 17 CFR 240.6a-2(a)(2).

¹⁸ See Merger Sub LLC Agreement, Section 1.6(a).

¹⁹ See Merger Sub LLC Agreement, Section 1.6(a)(ii).

²⁰ See Merger Sub LLC Agreement, Section 1.6(b).

²¹ See DE Operating Agreement, Section 7.1(d).

²² Ownership interests in Direct Edge are represented by Units. A Member's Percentage Interest is the ratio of the number of Units held by the Member to the total of all of the issued and outstanding Units, expressed as a percentage. See DE Operating Agreement, Section 1.1.

Percentage Interests in Direct Edge. A change to Exhibit C of the DE Operating Agreement (as well as a change to any other provision of the DE Operating Agreement) would need to be filed with the Commission if so required under Section 19(b) of the Act and Rule 19b-4 thereunder.

In addition, under Section 12.1 of the DE Operating Agreement, no Person, other than ISE Holdings, either alone or together with its Related Persons (as defined in the DE Operating Agreement), may own, directly or indirectly, Units representing more than a 40% Percentage Interest²⁷ in Direct Edge, or vote Units representing more than a 20% Percentage Interest in Direct Edge, without an amendment to the DE Operating Agreement, which will not be effective unless it is filed with and approved by the Commission.²⁸ In addition, for as long as the Facility is a facility of ISE, no ISE Member, either alone or together with its Related Persons, may own, directly or indirectly, Units representing more than a 20% Percentage Interest in Direct Edge.²⁹

In conclusion, the Commission believes that Section 7.1 of the Merger Sub LLC Agreement and Section 12.1 of the DE Operating Agreement, together with the requirements of Section 19(b) of the Act and Rule 19b-4 thereunder, provide the Commission with sufficient authority over changes in control of Merger Sub and Direct Edge to enable the Commission to carry out its regulatory oversight responsibilities with respect to ISE and the Facility.

C. Regulatory Jurisdiction Over Merger Sub and Direct Edge

The Commission believes that the terms of the Merger Sub LLC Agreement and the DE Operating Agreement provide the Commission and ISE with sufficient regulatory jurisdiction over the controlling parties and the Members of Merger Sub to carry out the Commission's and ISE's responsibilities under the Act. For example, under

Section 10.2(b) of the Merger Sub LLC Agreement, each Member of Merger Sub acknowledges that, to the extent they are related to the business of Merger Sub or the Facility, the books, records, premises, officers, directors, agents, and employees of the Member will be deemed to be the books, records, premises, officers, directors, agents, and employees of ISE for purposes of and subject to oversight pursuant to the Act. In addition, the books, records, premises, officers, directors, agents, and employees of Merger Sub are deemed to be the books, records, premises, officers, directors, agents, and employees of ISE for purposes of, and subject to, oversight pursuant to the Act.³⁰ Furthermore, the Merger Sub LLC Agreement provides that Merger Sub's books and records shall be subject at all times to inspection and examination by the Commission and ISE.³¹

Similarly, Section 11.2(b) of the DE Operating Agreement provides that, to the extent they are related to the operation or administration of Merger Sub, the books, records, premises, officers, managers, agents, and employees of Direct Edge will be deemed to be the books, records, premises, officers, managers, directors, agents, and employees of ISE for the purpose of, and subject to, oversight pursuant to, the Act. In addition, for so long as Direct Edge shall control, directly or indirectly, Merger Sub, Direct Edge's books and records shall be subject at all times to copying by the Commission or ISE, provided that such books and records are related to the operation or administration of the Facility.³²

These provisions would enable the Commission to exercise its authority under Section 19(h)(4) of the Act³³ with respect to the officers and directors of Merger Sub and Direct Edge, as well as the officers and directors of Members of Merger Sub, because all such officers and directors—to the extent that they are acting in matters related to Merger Sub's activities—would be deemed to be

the officers and directors of ISE itself. Further, the records of any Member of Merger Sub—to the extent they are related to Merger Sub's activities—are subject to the Commission's examination authority under Section 17(b)(1) of the Act,³⁴ as these records would be deemed to be the records of ISE itself.

In addition, under the terms of Section 14.3 of the DE Operating Agreement, Direct Edge—and its officers, Managers, agents, and employees—will be deemed to irrevocably submit to the jurisdiction of the U.S. federal courts, the Commission, and ISE for purposes of any suit, action, or proceeding pursuant to the U.S. federal securities laws or the rules or regulations thereunder arising out of, or relating to, the activities of Merger Sub. In addition, Direct Edge—and its officers, Managers, agents, and employees—will be deemed to waive, and agree not to assert by way of motion, as a defense or otherwise in any suit, action, or proceeding, any claim that it or they are not personally subject to the jurisdiction of the U.S. federal courts, the Commission, or ISE; that the suit, action, or proceeding is in an inconvenient forum, or that the venue of the suit, action, or proceeding is improper; or that the subject matter of the suit, action, or proceeding may not be enforced in or by such courts or agency.³⁵ Section 10.2(c) of the Merger Sub LLC Agreement contains comparable provisions under which Merger Sub and its Members and their officers, directors, agents, and employees submit to the jurisdiction of the U.S. federal courts, the Commission, and ISE.

Moreover, under Section 14.2 of the DE Operating Agreement, Direct Edge agrees to cooperate with the Commission and with ISE pursuant to their respective regulatory authority. Similarly, under Section 10.2(d) of the Merger Sub LLC Agreement, Merger Sub and its Members agree to cooperate with the Commission and with ISE pursuant to its regulatory authority and the provisions of the Merger Sub LLC Agreement.

Finally, pursuant to Section 14.4 of the DE Operating Agreement, Direct Edge is required to take reasonable steps necessary to cause its current and prospective officers, Managers, employees, and agents to consent in writing to the application of the requirements of Section 11.2 of the DE Operating Agreement (relating to the disclosure of confidential information to

²⁷ A Member's Percentage Interest is the ratio of the number of Units held by the Member to the total of all of the issued and outstanding Units, expressed as a percentage. See DE Operating Agreement, Section 1.1.

²⁸ See DE Operating Agreement, Section 12.1(a) and (b). The ownership and voting limitations in Section 12.1(a) will not apply to ISE Holdings for as long as ISE is a wholly-owned subsidiary of ISE Holdings and ISE Holdings is subject to ownership and voting limitations comparable to those set forth in Section 12.1(a). See DE Operating Agreement, Section 12.1(a)(3). The comparable ownership and voting limitations for ISE Holdings are included in Article FOURTH, Section III of the ISE Holdings Certificate.

²⁹ See DE Operating Agreement, Section 12.1(a)(2).

³⁰ See Merger Sub LLC Agreement, Section 10.2(b).

³¹ See Merger Sub LLC Agreement, Section 10.2(a).

³² See DE Operating Agreement, Section 11.2(b).

³³ 15 U.S.C. 78s(h)(4). Section 19(h)(4) authorizes the Commission, by order, to remove from office or censure any officer or director of a national securities exchange if it finds, after notice and an opportunity for hearing, that such officer or director has: (1) Willfully violated any provision of the Act or the rules and regulations thereunder, or the rules of a national securities exchange; (2) willfully abused his or her authority; or (3) without reasonable justification or excuse, has failed to enforce compliance with any such provision by a member or person associated with a member of the national securities exchange.

³⁴ 15 U.S.C. 78q(b)(1).

³⁵ See DE Operating Agreement, Section 14.3.

the Commission and ISE) and Article XIV of the DE Operating Agreement (relating to the SRO function of ISE, including provisions relating to regulatory compliance, cooperation, and consent to jurisdiction) with respect to their activities relating to Merger Sub. Section 10.2(e) of the Merger Sub LLC Agreement applies a comparable requirement to Merger Sub and its Members.

The Commission also notes that, even in the absence of these provisions of the Merger Sub LLC Agreement and the DE Operating Agreement, Section 20(a) of the Act³⁶ provides that any person with a controlling interest in Merger Sub would be jointly and severally liable with and to the same extent that Merger Sub 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.

The Commission believes that, together, these provisions of the Merger Sub LLC Agreement and the DE Operating Agreement grant the Commission sufficient jurisdictional authority over Merger Sub, its Members, and Direct Edge. Moreover, ISE is required to enforce compliance with these provisions because they are "rules of the exchange" within the meaning of Section 3(a)(27) of the Act.³⁷ A failure on the part of ISE to enforce its rules could result in suspension or revocation of registration under Section 19(h)(1) of the Act.³⁸

D. Ownership and Voting Restrictions on Members of Merger Sub and Direct Edge

Section 7.2(a) of the Merger Sub LLC Agreement prohibits any Person (other than Direct Edge), either alone or together with its Related Persons, from directly or indirectly owning more than a 20% Percentage Interest in Merger Sub.³⁹ Although Section 7.2(b) permits Direct Edge and ISE to waive this limitation, so long as such waiver has been filed with and approved by the Commission, Section 7.2(c) precludes such a waiver if the Person or its Related Persons is an ISE Member. Further, Section 4.4(a) of the Merger Sub LLC Agreement prohibits any

Person (other than Direct Edge) from voting more than 20% of the Common Interests of Merger Sub. Although Section 4.4(b) allows Direct Edge and ISE to waive this limitation so long as the waiver has been filed with and approved by the Commission, Section 4.4(c) precludes such a waiver if the Person or its Related Persons is an ISE Member.

Under Section 12.1(a)(1) and (3) of the DE Operating Agreement, no Person (other than ISE Holdings, for so long as ISE Holdings is subject to ownership and voting limitations comparable to those set forth in Section 12.1(a) and ISE is a wholly owned subsidiary of ISE Holdings),⁴⁰ either alone or together with its Related Persons, may own, directly or indirectly, Units representing more than a 40% Percentage Interest in Direct Edge. In addition, for as long as the Facility is a facility of ISE, no ISE Member, either alone or together with its Related Persons, may own, directly or indirectly, Units representing more than a 20% Percentage Interest in Direct Edge.⁴¹ Further, under Section 12.1(a)(3), no Person (other than ISE Holdings, for so long as ISE Holdings is subject to limitations comparable to those set forth in Section 12.1(a) and ISE is a wholly owned subsidiary of ISE Holdings), either alone or together with its Related Persons, may vote Units representing more than a 20% Percentage Interest in Direct Edge. Under Section 12.1(b), the DE Board may waive the limitations in Sections 12.1(a)(1) and (3) by adopting an amendment to the DE Operating Agreement, which must be filed with and approved by the Commission.

The Commission believes that the ownership concentration and voting limitations contained in the Merger Sub LLC Agreement and the DE Operating Agreement are reasonable and consistent with the Act. It is common for members who trade on an exchange to have ownership interests in the exchange. However, a member's interest 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. A member that is also a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from diligently surveilling the member's conduct or from punishing any conduct that

violates the rules of the exchange or the federal securities laws. An exchange might also be reluctant to surveil and enforce its rules zealously against a member that the exchange relies on as its largest source of capital.

Accordingly, the Commission believes that the ownership concentration and voting limitations in the Merger Sub LLC Agreement and the DE Operating Agreement are designed to preserve the independence of ISE's self-regulatory functions and ISE's ability to fulfill its regulatory and oversight obligations.

E. Amendments to the ISE Holdings Certificate and ISE Holdings Bylaws

The ISE proposes to amend certain provisions of the ISE Holdings Certificate and ISE Holdings Bylaws in anticipation of Direct Edge's contemplated ownership and operation of two national securities exchanges. Because ISE Holdings will purchase a 31.54% equity interest in Direct Edge and possess certain contractual rights and obligations with respect to Direct Edge, ISE Holdings may, in the future, indirectly control these two national securities exchanges. Accordingly, ISE is revising certain provisions of the ISE Holdings Certificate and ISE Holdings Bylaws that relate solely to ISE, the sole registered national securities exchange currently controlled by ISE Holdings, to relate to any national securities exchange that is controlled, directly or indirectly, by ISE Holdings (a "Controlled National Securities Exchange"), or facility thereof.

These provisions, which apply for as long as ISE Holdings controls, directly or indirectly, a Controlled National Securities Exchange, or a facility thereof, include, among others: (1) Ownership and voting limitations that prohibit any Person (as defined in the ISE Holdings Certificate), alone or together with its Related Persons (as defined in the ISE Holdings Certificate), from owning, directly or indirectly, more than 40% of ISE Holdings or voting shares representing more than 20% of the voting shares of ISE Holdings, and prohibit members of a Controlled National Securities Exchange from owning more than 20% of ISE Holdings;⁴² (2) requirements that directors, officers, and employees of ISE Holdings give due regard to the preservation of the independence of the self-regulatory function of each Controlled National Securities Exchange,⁴³ submit to the jurisdiction of the U.S. federal courts, the Commission,

³⁶ 15 U.S.C. 78t(a).

³⁷ 15 U.S.C. 78c(a)(27).

³⁸ 15 U.S.C. 78s(h)(1).

³⁹ Ownership in Merger Sub is represented by Common Interests. See Merger Sub LLC Agreement, Section 5.1. A Percentage Interest is the ratio of Common Interests held by a Member of Merger Sub to the total of all issued and outstanding Common Interests, expressed as a percentage. See Merger Sub LLC Agreement, Section 2.1.

⁴⁰ The ownership and voting limitations applicable to ISE Holdings are set forth in Article FOURTH, Section III of the ISE Holdings Certificate.

⁴¹ See DE Operating Agreement, Section 12.1(a)(2).

⁴² See ISE Holdings Certificate, Article FOURTH, Section III.

⁴³ See ISE Holdings Bylaws, Section 1.5.

and each Controlled National Securities Exchange,⁴⁴ and cooperate with each such Controlled National Securities Exchange and the Commission pursuant to their respective regulatory authority;⁴⁵ (3) a provision that deems the books, records, premises, officers, directors, and employees of ISE Holdings to be the books, records, premises, officers, directors, and employees of each Controlled National Securities Exchange to the extent that they are related to, or involved in, the activities of the Controlled National Securities Exchange or facility thereof;⁴⁶ (4) a requirement that ISE Holdings and its officers, directors, employees, and agents maintain the confidentiality of confidential information pertaining to the self-regulatory function of each Controlled National Securities Exchange, although such information may be accessed by, and disclosed to, the Commission and the Controlled National Securities Exchange;⁴⁷ and (5) requirements that proposed changes to the ISE Holdings Certificate or ISE Holdings Bylaws be submitted to the board of each Controlled National Securities Exchange and, if necessary, filed with the Commission.⁴⁸

These requirements in the ISE Holdings Certificate and ISE Holdings Bylaws currently apply with respect to, and so long as, ISE Holdings controls, directly or indirectly, ISE. The Commission believes that the proposed changes are consistent with the Act because they extend these existing requirements in the ISE Holdings Certificate and ISE Holdings Bylaws to apply with respect to, and so long as, ISE Holdings controls, directly or indirectly, any Controlled National Securities Exchange, or facility thereof. Accordingly, if, in the future, the Commission approves any proposal or Form 1 application that results in ISE's controlling, directly or indirectly, a Controlled National Securities Exchange, the extension of these provisions to a Controlled National Securities Exchange, or facility thereof, should help the Controlled National Securities Exchange and the Commission to carry out their regulatory responsibilities with respect to the

Controlled National Securities Exchange.⁴⁹

ISE also proposes to apply to each Controlled National Securities Exchange and facility thereof Section 11.1(b) of the ISE Holdings Bylaws, relating to findings made by the Board of Directors of ISE Holdings (the "ISE Holdings Board") with respect to each Upstream Owner (as defined in Section 11.1(a) of the ISE Holdings Bylaws) in determining to waive the Ownership Limits and Voting Limits in Article FOURTH, Section III of the ISE Holdings Certificate. Specifically, ISE proposes to amend Section 11.1(b) to indicate that, in waiving the applicable Ownership Limits and Voting Limits to allow the ownership and voting of the capital stock of ISE Holdings by the Upstream Owners, the ISE Holdings Board has determined, with respect to each Upstream Owner, that: (i) Such waiver will not impair the ability of ISE Holdings and each Controlled National Securities Exchange, or facility thereof, to carry out its respective functions and responsibilities under the Act and the rules thereunder; (ii) such waiver is in the interests of ISE Holdings, its stockholders, and each Controlled National Securities Exchange, or facility thereof; (iii) such waiver will not impair the ability of the Commission to enforce the Act; (iv) neither the Upstream Owner nor any of its Related Persons are subject to any applicable "statutory disqualification" within the meaning of Section 3(a)(39) of the Act;⁵⁰ and (v) neither the Upstream Owner nor any of its Related Persons is a member of such Controlled National Securities Exchange.

The Commission believes that the ISE Holdings Board determinations required under Section 11.1(b) provide some assurance that the waiver of the applicable Ownership Limits and Voting Limits will not impair the ability of the Commission and the Controlled National Securities Exchange to discharge their respective responsibilities under the Act following ISE Holdings' acquisition of control of a Controlled National Securities Exchange. In connection with this requirement, at the time that ISE Holdings proposes to acquire control of a Controlled National Securities Exchange, the Commission expects ISE to include in a rule filing a representation that the ISE Holdings Board has made the determinations

required in Section 11.1(b) with respect to that Controlled National Securities Exchange.

F. Amendments to ISE Rules 312 and 2108

As discussed above, ISE Holdings will own 31.54% of Direct Edge, which will continue to own and operate DE ECN, a registered broker-dealer and Equity EAM of ISE that will continue to submit limit orders to the Facility for display and execution. As a result, ISE and Merger Sub will be affiliated with a member of ISE, DE ECN. Further, DE ECN will be a facility of ISE because (1) DE ECN will display limit orders on the Facility; and (2) DE ECN will become an affiliate of ISE through ISE's ownership interest in DE Holdings.

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest, and the potential for unfair competitive advantage.⁵¹ Recognizing this concern, the ISE adopted ISE Rule 312, which places limitations on the affiliation between the ISE and an ISE member.⁵² Because the affiliation between ISE and Merger Sub would be prohibited by current ISE Rule 312, ISE has requested that the Commission approve the relationships between DE ECN and ISE described above on a temporary basis for a period of one year, subject to

⁵¹ See, e.g., Securities Exchange Act Release No. 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (File No. SR-NASDAQ-2006-006) (order approving Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members). See also Securities Exchange Act Release Nos. 59010 (November 24, 2008), 73 FR 73373 (December 2, 2008) (File No. SR-NYSEArca-2008-130) (order approving NYSE Arca proposal to allow Archipelago Securities LLC, an NYSE Arca affiliated member, to route orders to NYSE Arca in its capacity as an order routing facility of NYSE Alternext U.S. LLC); 58681 (September 29, 2008), 73 FR 58285 (File No. SR-NYSEArca-2008-90) (order approving, among other things, conditions relating to the affiliation between NYSE Arca and Archipelago Securities, LLC); 59009 (November 24, 2008), 73 FR 73363 (December 2, 2008) (File No. SR-NYSEALTR-2008-07) (order approving proposal by NYSEALTR to use its broker-dealer affiliate, Archipelago Securities LLC, as its routing broker to route orders to an away market center when the market center is displaying the national best bid or offer); and ArcaEx Order, *supra* note 14.

⁵² See Securities Exchange Act Release No. 53705 (April 21, 2006), 71 FR 25260 (April 28, 2006) (order approving File No. SR-ISE-2006-04). Because ISE Rule 312(a) currently would prohibit Direct Edge's ownership of Merger Sub, ISE proposes to update ISE Rule 312(a) to provide that the ownership restrictions in ISE Rule 312(a) will not prohibit an ISE Member or non-member owner from acquiring or holding any equity interest permitted by the Merger Sub LLC Agreement. The Commission believes that this change is consistent with the Act because of the provisions in the Merger Sub LLC Agreement, as discussed above, that are designed to allow the Commission and the ISE to fulfill their regulatory and oversight obligations.

⁴⁴ See ISE Holdings Bylaws, Section 1.4.

⁴⁵ See ISE Holdings Certificate, Article TENTH.

⁴⁶ See ISE Holdings Certificate, Article TWELFTH.

⁴⁷ See ISE Holdings Certificate, Article ELEVENTH.

⁴⁸ See ISE Holdings Certificate, Article FOURTEENTH and ISE Holdings Bylaws, Section 10.1.

⁴⁹ In approving these proposed changes to the ISE Holdings Certificate and ISE Holdings Bylaws, the Commission makes no findings with respect to any Form 1 applications that Direct Edge may file.

⁵⁰ 15 U.S.C. 78c(a)(39).

several limitations and conditions to be incorporated in new paragraph (b) of ISE Rule 312.

Specifically, ISE Rule 312(b) provides that, for so long as ISE is affiliated with DE ECN or DE ECN is a facility of ISE:

- The Financial Industry Regulatory Authority, Inc. (“FINRA”), an SRO unaffiliated with ISE or any of its affiliates (a “non-affiliated SRO”), will carry out oversight and enforcement responsibilities as the designated examining authority designated by the Commission pursuant to Rule 17d-1 under the Act⁵³ with the responsibility for examining DE ECN for compliance with applicable financial responsibility rules;

- ISE will enter into a plan pursuant to Rule 17d-2 under the Act⁵⁴ with a non-affiliated SRO to relieve ISE of regulatory responsibilities for DE ECN with respect to rules that are common rules between ISE and the SRO;⁵⁵

- With respect to unique ISE rules,⁵⁶ ISE will enter into a regulatory services contract with a non-affiliated SRO to perform regulatory responsibilities for DE ECN;

- The regulatory services contract with the non-affiliated SRO will require ISE to provide the non-affiliated SRO with information, in an easily accessible manner, regarding all exception reports, alerts, complaints, trading errors, cancellations, investigations, and enforcement matters (collectively, “Exceptions”) in which DE ECN is identified as a participant that has potentially violated ISE or Commission rules, and shall require that the non-affiliated SRO provide a report to the Exchange quantifying Exceptions on not less than a quarterly basis;

- ISE, on behalf of Direct Edge, will establish and maintain procedures and internal controls reasonably designed to ensure that DE ECN does not develop or implement changes to its systems on the basis of nonpublic information obtained as a result of its affiliation with ISE until such information is available generally to similarly situated members of ISE in connection with the provision of inbound order routing to ISE;

- In the event that DE ECN acts as an introducing broker for subscribers of DE ECN who are not members of ISE, then DE ECN’s role as introducing broker is

limited to its role as introducing broker to DE ECN;⁵⁷

- DE ECN will not engage in any business other than operating as an ECN and other than acting as an introducing broker as described above; and

- The affiliation of DE ECN is subject to the foregoing conditions and is approved on a temporary basis, for a period not to exceed one year.

In addition, ISE proposes to modify ISE Rule 2108 to make clear that the books and records of DE ECN, as a facility of ISE, shall be subject to copying and inspection by ISE and the Commission, and, further, that the books, records, premises, officers, directors, agents, and employees of DE ECN shall be considered the books, records, premises, officers, directors, agents, and employees of ISE.

Although the Commission continues to be concerned about potential unfair competition and conflicts of interest between an exchange’s self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit DE ECN to display its limit orders on the Facility as an order delivery ECN,⁵⁸ subject to the conditions in ISE Rule 312(b), described above.⁵⁹ The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that the oversight of DE ECN by a non-

⁵⁷ Under Section 6 of the Act, as a facility of an SRO, access to ISE facilities like DE ECN is limited to ISE members, or those sponsored by such members. DE ECN intends to temporarily provide access to its system for DE ECN subscribers that are not members of ISE. Accordingly, ISE proposes to allow DE ECN subscribers who are not ISE members, or sponsored by ISE members, to continue to participate in DE ECN by allowing DE ECN to act as an introducing broker to DE ECN with respect to such subscribers.

⁵⁸ See ISE Rule 2107. An order delivery ECN submits quotations that are displayed on ISE, while simultaneously executing buy and sell orders for its customers.

⁵⁹ Several of the conditions ISE has proposed are similar to those the Commission recently approved in connection with exchange proposals to permit inbound order routing by an affiliated exchange member. See e.g., Securities Exchange Act Release Nos. 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008) (order approving File Nos. SR-Amex-2008-62 and NYSE-2008-60); 58681 (September 29, 2008), 73 FR 58285 (October 6, 2008) (order approving File No. SR-NYSEArca-2008-90); 58680 (September 29, 2008), 73 FR 58283 (October 6, 2008) (order approving File No. SR-NYSE-2008-76). The additional conditions proposed by ISE with regard to DE ECN clarify that DE ECN’s role on ISE is limited to operating as an ECN and as an introducing broker to DE ECN for DE ECN subscribers that are not ISE members.

affiliated SRO,⁶⁰ combined with the requirement that ISE provide the non-affiliated SRO with information regarding Exceptions relating to DE ECN and the requirement that the non-affiliated SRO provide a report quantifying the Exceptions on not less than a quarterly basis, will help to protect the independence of ISE’s regulatory responsibilities with respect to DE ECN. The Commission also believes that ISE Rule 312(b) is designed to ensure that DE ECN cannot use any information advantage it may have because of its affiliation with ISE. Furthermore, the Commission believes that ISE’s proposal to allow DE ECN to display its limit orders on the Facility as an order delivery ECN on a temporary basis will provide ISE and the Commission an opportunity to assess the impact of any conflicts of interest of allowing an affiliated member of ISE to display its limit orders on the Facility as an order delivery ECN and whether such affiliation provides an unfair competitive advantage.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁶¹ that the proposed rule change (File No. SR-ISE-2008-85), as modified by Amendment No. 1, is approved, and ISE Rule 312(b) is approved for a one-year period to expire on December 21, 2009.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶²

Florence E. Harmon,

Acting Secretary.

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⁶⁰ This oversight will be accomplished through a regulatory services contract between ISE and a non-affiliated SRO, and through a 17d-2 agreement between ISE and FINRA, as the non-affiliated SRO, as required by ISE Rule 312(b). See Securities Exchange Act Release No. 59134 (December 22, 2008) (File No. 4-574) (order declaring effective the 17d-2 agreement between ISE and FINRA with respect to DE ECN).

⁶¹ 15 U.S.C. 78s(b)(2).

⁶² 17 CFR 200.30-3(a)(12).

⁵³ 17 CFR 240.17d-1.

⁵⁴ 17 CFR 240.17d-2.

⁵⁵ Common rules are ISE rules that are substantially similar to the rules of the non-affiliated SRO.

⁵⁶ Unique ISE rules are ISE rules that are not common rules.