

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59133)

Order Granting Application for a Temporary Conditional Exemption Pursuant to Section 36(a) of the Exchange Act by the International Securities Exchange, LLC Relating to the Acquisition by International Securities Exchange Holdings, Inc. of an Electronic Communications Network

December 22, 2008

I. Introduction

On December 3, 2008, the International Securities Exchange, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Rule 0-12¹ under the Securities Exchange Act of 1934 (“Exchange Act”), an application for an exemption under Section 36(a)(1) of the Exchange Act² from the rule filing requirements of Section 19(b) of the Exchange Act³ with respect to the acquisition by International Securities Exchange Holdings, Inc. (“ISE Holdings”), the parent of ISE, of an equity interest in Direct Edge Holdings, LLC (“DE Holdings”).⁴ DE Holdings is the sole owner of Direct Edge ECN LLC (“DECN”), a registered broker-dealer and electronic communications network (“ECN”). This order grants the request for temporary exemptive relief, subject to the satisfaction of certain conditions, which are outlined below.

II. Application for Temporary Conditional Exemption from Section 19(b) Rule Filing Requirements

On December 3, 2008, the ISE requested that the Commission grant a temporary exemption, subject to certain conditions, under Section 36 of the Exchange Act from the rule

¹ 17 CFR 240.0-12.

² 15 U.S.C. 78mm(a)(1).

³ 15 U.S.C. 78s(b).

⁴ See letter from Michael J. Simon, General Counsel and Secretary, ISE, to Florence Harmon, Acting Secretary, Commission, dated December 3, 2008 (“Exemption Request”).

filing procedures of Section 19(b) of the Exchange Act in connection with ISE Holdings' acquisition of an equity interest in DE Holdings and the operation of DECN as a facility of ISE.⁵

According to the Exemption Request, on August 22, 2008, ISE Holdings, DE Holdings, ISE Stock Exchange, LLC ("ISE Stock"), a Delaware limited liability company that operates a marketplace for the trading of U.S. cash equity securities by Equity Electronic Access Members ("Equity EAMs") of ISE (the "Facility"),⁶ and certain other parties entered into a Transaction Agreement whereby, among other things: (1) ISE Holdings will purchase a 31.54% equity interest in DE Holdings, the sole owner of DECN, a registered broker-dealer and ECN; and (2) ISE Stock will merge into Maple Merger Sub, a wholly-owned subsidiary of DE Holdings ("Merger Sub"), which will operate the Facility following the closing of the transaction (the "Closing"). After the Closing, the Facility will continue to be a facility of ISE.

DECN's current relationship with ISE is limited to participating in ISE as an Equity EAM of ISE, and DECN displays its limit orders on the Facility in the same manner as other ECNs that display their limit orders on the Facility. Neither ISE Holdings nor ISE currently has an ownership interest in DECN. After the Closing, DECN will continue to operate as an ECN and to submit limit orders to the Facility for display and execution.

Following the Closing, DECN also will become a facility, as defined in Section 3(a)(2) of the Exchange Act, of ISE because it will be an affiliate of ISE used for the purpose of effecting and reporting securities transactions. Specifically, (1) DECN will continue to operate as an ECN and will continue to submit its limit orders to the Facility for display and execution;⁷ and (2)

⁵ See Section 3(a)(2) of the Exchange Act, 15 U.S.C. 78c3(a)(2) (definition of "facility").

⁶ ISE Stock operates the Facility under the rules of the ISE as a facility, as defined in Section 3(a)(2) of the Exchange Act, of ISE.

⁷ In its Exemption Request, ISE stated that it would be impracticable for DECN to display its limit orders other than on the Facility. See Exemption Request at 3.

DECN will become an affiliate of ISE through ISE Holdings' equity interest in DE Holdings. Because DECN will be a facility of ISE, ISE would be obligated, under Section 19(b) of the Exchange Act, to file with the Commission proposed rules governing the operation of DECN's systems and subscriber fees. In its Exemption Request, ISE states that if the Commission does not grant the exemption, ISE will be forced to terminate DECN's operations upon Closing because DECN may not operate as a facility of ISE without the ISE's filing with the Commission proposed rules governing the operation of DECN's systems and subscriber fees.⁸ ISE also stated that it would be unduly burdensome and inefficient to require DECN's operating rules to be separately subjected to the Section 19(b) rule filing and approval process because DECN would operate only temporarily as a facility of ISE while the Commission considers the Form 1 Applications, as discussed below.

In its Exemption Request, ISE noted that DECN's average daily "touched" volume in U.S. listed equity securities accounts for 10% of the average daily U.S. traded volume in such securities.⁹ Accordingly, ISE believes that the termination of DECN's operations potentially could harm investors, disrupt the functioning of an orderly market, and eliminate a point of access to the markets.¹⁰

ISE noted, further, that DE Holdings has been engaged with the Commission in the filing of two Form 1 applications (the "Form 1 Applications") to register two of DE Holdings' wholly-owned subsidiaries (the "Exchange Subsidiaries") as national securities exchanges.¹¹ According

⁸ See Exemption Request at 3.

⁹ Average daily touched volume includes trades matched on DECN and orders routed to other market centers for execution. See Exemption Request at note 4 and accompanying text.

¹⁰ See Exemption Request at 3.

¹¹ See Exemption Request at 2.

to ISE, DECN intends to file a “Cessation of Operations Report” with the Commission and to cease operations as an ECN shortly following any Commission approval of the Form 1 Applications.¹² Also, according to the ISE, approval of the Form 1 Applications would allow the Exchange Subsidiaries to operate in place of DECN.¹³ Because DECN would cease to operate as an ECN if the Commission approves the Form 1 Applications, ISE expects that DECN would operate as a facility of ISE for a relatively brief period of time.¹⁴

ISE has asked the Commission to exercise its authority under Section 36 of the Exchange Act and grant the ISE a temporary, 180-day exemption from the Section 19(b) rule filing requirements that would apply to DECN as a facility of ISE. The temporary exemption would commence immediately upon the Closing and would allow DECN to continue to operate following the Closing, subject to certain conditions, while DE Holdings prepares the Form 1 Applications. ISE believes that the temporary exemption will help to ensure an orderly transition from DECN to the proposed Exchange Subsidiaries.¹⁵

ISE stated, in addition, that the exemption will not diminish the Commission’s ability to monitor ISE and DECN. In this regard, ISE noted that to the extent that ISE makes changes to its systems, including the Facility, during the exemption period, or thereafter, it remains subject to Section 19(b) and thus obligated to file proposed rule changes with the Commission.¹⁶

¹² Id.

¹³ Id. If the Commission approves the Form 1 Applications, each of the Exchange Subsidiaries would be registered as a national securities exchange under Section 6 of the Exchange Act. In addition, following any Commission approval of the Form 1 Applications and the Exchange Subsidiaries’ commencement of operations as national securities exchanges, DE Holdings would no longer operate DECN as an ECN and the Facility would cease operations.

¹⁴ Id.

¹⁵ Id.

¹⁶ See Exemption Request at 3.

Further, in the Exemption Request, ISE committed to satisfying certain conditions, which are outlined below. For example, as a condition to the exemption, ISE will be required to submit proposed rule changes with respect to any material changes to DECN's functions during the exemption period.¹⁷ ISE noted, however, that neither ISE nor DECN anticipates any material changes to DECN's functionality during the exemption period.¹⁸

III. Order Granting Temporary Conditional Section 36 Exemption

In 1996, Congress gave the Commission greater flexibility to regulate trading systems, such as DECN, by granting the Commission broad authority to exempt any person from any of the provisions of the Exchange Act and to impose appropriate conditions on their operation.¹⁹ Specifically, NSMIA added Section 36(a)(1) to the Exchange Act, which provides that “the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of [the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”²⁰ In enacting Section 36, Congress indicated that it expected that “the Commission will use this authority to promote efficiency, competition and capital formation.”²¹ It particularly intended to give the Commission sufficient flexibility to respond to changing market and competitive conditions:

¹⁷ Id.

¹⁸ See Exemption Request at note 3.

¹⁹ 15 U.S.C. 78mm(a). Section 36 of the Exchange Act was enacted as part of the National Securities Markets Improvements Act 1996, Pub. L. No. 104-290 (“NSMIA”).

²⁰ 15 U.S.C. 78mm(a)(1).

²¹ H.R. Rep. No. 104-622, 104th Cong., 2^d Sess. 38 (1996).

The Committee recognizes that the rapidly changing marketplace dictates that effective regulation requires a certain amount of flexibility. Accordingly, the bill grants the SEC general exemptive authority under both the Securities Act and the Securities Exchange Act. This exemptive authority will allow the Commission the flexibility to explore and adopt new approaches to registration and disclosure. It will also enable the Commission to address issues relating to the securities markets more generally. For example, the SEC could deal with the regulatory concerns raised by the recent proliferation of electronic trading systems, which do not fit neatly into the existing regulatory framework.²²

In 2004, the Commission exercised its Section 36 exemptive authority to grant a temporary exemption, subject to certain conditions, from the Section 19(b) rule filing requirements in connection with the acquisition by The Nasdaq Stock Market, Inc. (“Nasdaq”) of Brut, LLC, the operator of the Brut ECN.²³ ISE’s requested relief for a temporary exemption from the Section 19(b) rule filing requirements in connection with ISE Holdings’ acquisition of an equity interest in DE Holdings is subject to certain conditions, as set forth below, that are substantially similar to the conditions included in the Nasdaq Order.

Section 19(b)(1) of the Exchange Act requires a self-regulatory organization (“self-regulatory organization” or “SRO”), including ISE, to file with the Commission its proposed rule changes accompanied by a concise general statement of the basis and purpose of the proposed rule change. Once a proposed rule change has been filed with the Commission, the Commission is required to publish notice of it and provide an opportunity for public comment. The proposed rule change may not take effect unless approved by the Commission by order, unless the rule change is within the class of rule changes that are effective upon filing pursuant to Section 19(b)(3)(A) of the Act.²⁴

²² S. Rep. No. 104-293, 104th Cong., 2^d Sess. 15 (1996).

²³ See Securities Exchange Act Release No. 50311 (September 3, 2004), 69 FR 54818 (September 10, 2004) (“Nasdaq Order”).

²⁴ 15 U.S.C. 78s(b)(3)(A).

Section 19(b)(1) of the Exchange Act defines the term “proposed rule change” to mean “any proposed rule or rule change in, addition to, or deletion from the rules of [a] self-regulatory organization.” Pursuant to Section 3(a)(27) and 3(a)(28) of the Exchange Act, the term “rules of a self-regulatory organization” means (1) the constitution, articles of incorporation, bylaws and rules, or instruments corresponding to the foregoing, of an SRO, and (2) such stated policies, practices and interpretations of an SRO (other than the Municipal Securities Rulemaking Board) as the Commission, by rule, may determine to be necessary or appropriate in the public interest or for the protection of investors to be deemed to be rules. Rule 19b-4(b) under the Exchange Act,²⁵ defines the term “stated policy, practice, or interpretation” to mean generally “any material aspect of the operation of the facilities of the self-regulatory organization or any statement made available to the membership, participants, or specified persons thereof that establishes or changes any standard, limit, or guideline with respect to rights and obligations of specified persons or the meaning, administration, or enforcement of an existing rule.”

The term “facility” is defined in Section 3(a)(2) of the Exchange Act, with respect to an exchange, to include “its premises, tangible or intangible property whether on the premises or not, any right to use 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.”

In its Exemption Request, ISE acknowledged that following the Closing, DECN will become a facility of ISE because it will be an affiliate of ISE used for the purpose of effecting

²⁵ 17 CFR 240.19b-4(b).

and reporting securities transactions.²⁶ Specifically, (1) DECN will continue to operate as an ECN and will continue to submit limit orders to the Facility, a facility of ISE, for display and execution; and (2) DECN will become an affiliate of ISE through ISE Holdings' equity interest in DE Holdings.²⁷ Absent an exemption, Section 19(b) of the Exchange Act and Rule 19b-4 thereunder would require ISE to file proposed rules with the Commission to allow ISE to operate DECN as a facility.

ISE noted in its Exemption Request that DE Holdings is preparing Form 1 Applications for the Exchange Subsidiaries and that DECN would cease operations as an ECN shortly after any Commission approval of the Form 1 Applications and the Exchange Subsidiaries' commencement of operations as national securities exchanges.²⁸ Accordingly, ISE expects that DECN would operate as a facility of ISE for a relatively brief period of time.²⁹

The Commission believes that it is appropriate to issue a temporary exemption, subject to the conditions described below, to allow DECN to operate as a facility of ISE without being subject to the rule filing requirements of Section 19(b) of the Exchange Act for a temporary period.³⁰ Accordingly, the Commission has determined to grant ISE's request for a temporary exemption, subject to certain conditions, for a period not to exceed 180 days from the date of the Closing. The Commission finds that the temporary conditional exemption from the provisions of Section 19(b) of the Exchange Act is appropriate in the public interest and is consistent with the protection of investors. In particular, the Commission believes that the temporary exemption

²⁶ See Exemption Request at 1.

²⁷ See Exemption Request at 1 – 2.

²⁸ See Exemption Request at 2.

²⁹ Id.

³⁰ In granting this relief, the Commission makes no finding regarding whether ISE's operation of DECN as a facility would be consistent with the Exchange Act.

should help promote efficiency and competition in the market by allowing DECN to continue to operate as an ECN for a limited period of time while DE Holdings prepares the Form 1 Applications. In this regard, the Commission notes ISE's belief that it would be unduly burdensome and inefficient to require DECN's operating rules to be separately subjected to the Section 19(b) rule filing and approval process because DECN would operate only temporarily as a facility of ISE while the Commission considers the Form 1 Applications.³¹ To provide the Commission with the opportunity to review and act upon any proposal to change DECN's fees or to make material changes to DECN's operations as an ECN during the period covered by the temporary exemption, as well as to ensure that the Commission's ability to monitor ISE and DECN is not diminished by the temporary exemption, the Commission is imposing the following conditions while the temporary exemption is in effect.³² The Commission believes such conditions are necessary and appropriate in the public interest for the protection of investors. Therefore, the Commission is granting to ISE a temporary exemption, pursuant to Section 36 of the Exchange Act, from the rule filing requirements imposed by Section 19(b) of the Exchange Act as set forth above, provided that ISE and DECN comply with the following conditions:

- (1) DECN remains a registered broker-dealer under Section 15 of the Exchange Act³³ and continues to operate as an ECN;
- (2) DECN operates in compliance with the obligations set forth under Regulation ATS;
- (3) DECN and ISE continue to operate as separate legal entities;

³¹ In addition, the Commission notes that the rules governing the operation of the Exchange Subsidiaries will be subjected to public comment and Commission review and approval as part of the exchange registration process.

³² See Exemption Request at 3.

³³ 15 U.S.C. 78o.

- (4) ISE files a proposed rule change under Section 19 of the Exchange Act³⁴ if any material changes are sought to be made to DECN's operations. A material change would include any changes to a stated policy, practice, or interpretation regarding the operation of DECN or any other event or action relating to DECN that would require the filing of a proposed rule change by an SRO or an SRO facility;³⁵
- (5) ISE files a proposed rule change under Section 19 of the Exchange Act if DECN's fee schedule is sought to be modified; and
- (6) ISE treats DECN the same as other ECNs that participate in the Facility, and, in particular, ISE does not accord DECN preferential treatment in how DECN submits orders to the Facility or in the way its orders are displayed or executed.³⁶

In addition, the Commission notes that the Financial Industry Regulatory Authority is currently the Designated Examining Authority for DECN.

³⁴ 15 U.S.C. 78s.

³⁵ See Section 19(b) of the Exchange Act and Rule 19b-4 thereunder. The Commission notes that a material change would include, among other things, changes to DECN's operating platform; the types of securities traded on DECN; DECN's types of subscribers; or the reporting venue for trading that takes place on DECN. The Commission also notes that any rule filings must set forth the operation of the DECN facility sufficiently so that the Commission and the public are able to evaluate the proposed changes.

³⁶ See Exemption Request at 3.

For the reasons discussed above, the Commission finds that the temporary conditional exemptive relief requested by ISE is appropriate in the public interest and is consistent with the protection of investors.

IT IS ORDERED, pursuant to Section 36 of the Exchange Act,³⁷ that the application for a temporary conditional exemption is granted for a period of 180 days following the Closing, as defined above.

By the Commission.

Florence E. Harmon
Acting Secretary

³⁷ 15 U.S.C. 78mm.