UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE: BARCLAYS LIQUIDITY CROSS AND HIGH FREQUENCY TRADING LITIGATION *This Document Relates to City of Providence, Rhode Island, et al. v. BATS Global Markets, Inc., et al.*, 1:14-cv-02811-JMF (S.D.N.Y.) (consolidated)	14-MD-2589 (JMF) ORAL ARGUMENT REQUESTED

REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF THE DEFENDANTS' RENEWED MOTION TO DISMISS THE SECOND CONSOLIDATED AMENDED COMPLAINT

TABLE OF CONTENTS

Page

PRELIMINARY STATEMENT 1
ARGUMENT 1
I. Plaintiffs Have Failed to Plead Article III or Statutory Standing 1
A. Plaintiffs lack Article III standing to assert their Section 10(b) claim 1
B. Plaintiffs lack statutory standing to assert their Section 10(b) claim 2
II. The SCAC Fails to State a Claim Upon Which Relief Could Be Granted 3
A. Plaintiffs have not adequately pleaded reliance 3
B. Plaintiffs fail to allege loss causation 5
C. Plaintiffs fail to plead scienter 6
III. Plaintiffs' Claim Is Precluded 7
CONCLUSION 10

GLOSSARY OF TERMS[*]

FINRA	Financial Industry Regulatory Association
Mem.	Memorandum of Law in Support of the Defendants' Renewed Motion to Dismiss the Second Consolidated Amended Complaint, ECF No. 83
Opp. or Plaintiffs' brief	Lead Plaintiffs' Memorandum of Law in Opposition to Defendants' Renewed Motion to Dismiss the Second Consolidated Amended Complaint, ECF No. 86
Plaintiffs' SEC Response	Plaintiffs-Appellants' Response to Brief of the Securities and Exchange Commission, Amicus Curiae, dated December 12, 2016, Second Circuit ECF No. 148

[*] Capitalized terms not defined here have the meanings set forth in the Memorandum of Law in Support of the Defendants' Renewed Motion to Dismiss the Second Consolidated Amended Complaint, ECF No. 83. Emphasis in quotations is in the original unless otherwise stated.

TABLE OF AUTHORITIES

Page(s)

CASES

Ashcroft v. Iqbal,
556 U.S. 662 (2009)....................8

ATSI Communications, Inc. v. Shaar Fund, Ltd.,
493 F.3d 87 (2d Cir. 2007)....................4, 5

Axcan Scandipharm Inc. v. Ethex Corp.,
585 F. Supp. 2d 1067 (D. Minn. 2007)....................8

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975)....................2, 3

City of Providence v. Bats Global Mkts., Inc.,
878 F.3d 36 (2d Cir. 2017)....................4, 5, 8, 9

Cohen v. UBS Fin. Servs., Inc.,
No. 12 Civ. 2147, 2012 WL 6041634 (S.D.N.Y. Dec. 4, 2012)....................8

Credit Suisse Securities (USA) LLC v. Billing,
551 U.S. 264 (2007)....................8, 9

Desai v. Deutsche Bank Sec. Ltd.,
573 F.3d 931 (9th Cir. 2009) 4

Elec. Trading Grp. LLC v. Banc of Am. Sec. LLC,
588 F.3d 128 (2d Cir. 2009)....................8, 9

Fezzani v. Bear, Stearns & Co.,
384 F. Supp. 2d 618 (S.D.N.Y. 2004)....................3, 5

Fezzani v. Bear, Stearns & Co.,
777 F.3d 566 (2d Cir. 2015)....................5

FrontPoint Asian Event Driven Fund, L.P. v. Citibank, N.A.,
No. 16 Civ. 5263 (AKH), 2017 WL 3600425 (S.D.N.Y. Aug. 18, 2017)....................2

Gelboim v. Bank of America Corp.,
823 F.3d 759 (2d Cir. 2016)....................2

Gill v. Whitford,
No. 16-1161 (U.S. June 18, 2018) 2

Harry v. Total Gas & Power North American, Inc.,
889 F.3d 104 (2d Cir. 2018)..2

In re Barclays Liquidity Cross & High Frequency Trading Litig.,
126 F. Supp. 3d 342 (S.D.N.Y. 2015)...3, 4, 5

In re: Initial Pub. Offering Sec. Litig.,
241 F. Supp. 2d 281 (S.D.N.Y. 2003)...6

In re: Initial Pub. Offering Sec. Litig.,
297 F. Supp. 2d 668 (S.D.N.Y. 2003)...6

In re Interest Rate Swaps Antitrust Litig.,
261 F. Supp. 3d 430 (S.D.N.Y. 2017)...8

In re NYSE Specialists Sec. Litig.,
405 F. Supp. 2d 281 (S.D.N.Y. 2005)...5

Joseph v. Wiles,
223 F.3d 1155 (10th Cir. 2000) 4

Lanier v. BATS Exch., Inc.,
838 F.3d 139 (2d Cir. 2016)..8

Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit,
547 U.S. 71 (2006)..3

Patel v. Contemporary Classics of Beverly Hills,
259 F.3d 123 (2d Cir. 2001)..7

POM Wonderful LLC v. Coca-Cola Co.,
134 S. Ct. 2228 (2014)..9

Ross v. Bank of America, N.A. (USA),
524 F.3d 217 (2d Cir. 2008)..2

Rothstein v. UBS AG,
708 F.3d 82 (2d Cir. 2013)..2

S. Cherry St., LLC v. Hennessee Grp. LLC,
573 F.3d 98 (2d Cir. 2009)..6

Sharette v. Credit Suisse Int'l,
127 F. Supp. 3d 60 (S.D.N.Y. 2015)...6, 8, 9

Sierra Club v. Morton,
405 U.S. 727 (1972)..2

Spokeo v. Robins,
136 S. Ct. 1540 (2016) 1

Stoneridge Inv. Partners, LLC v. Scientific-Atlanta,
552 U.S. 148 (2008) 10

United States ex rel. Kolchinsky v. Moody's Corp.,
238 F. Supp. 3d 550 (S.D.N.Y. 2017) 7

United States v. Cotton,
535 U.S. 625 (2002) 1

CONSTITUTIONAL PROVISIONS AND RULES

U.S. Const. art. III 1, 2

Fed. R. Civ. P. 12 .... 1, 7, 10

PRELIMINARY STATEMENT

The Second Circuit gave specific instructions for this Court to consider grounds for dismissal that neither this Court nor the Second Circuit had addressed. Yet Plaintiffs' brief reads those instructions out of existence by, among other things, incorrectly claiming that the Second Circuit already decided everything relevant to whether their claim can proceed. Plaintiffs are wrong: The SCAC suffers from multiple fatal flaws that require dismissal.

ARGUMENT

I. Plaintiffs Have Failed to Plead Article III or Statutory Standing

A. Plaintiffs lack Article III standing to assert their Section 10(b) claim

Plaintiffs argue that Article III standing "should not be raised now." Opp. 17. But questions about Article III standing are not waivable and can be raised at any time. *See* Fed. R. Civ. P. 12(h)(3); *United States v. Cotton*, 535 U.S. 625, 630 (2002).

Plaintiffs fail even the "low threshold" for standing under Article III, which requires, among other elements, a concrete, particularized injury. An injury is "particularized" if it "affect[s] the plaintiff in a personal and individual way" and is "concrete" if it "actually exist[s]." *Spokeo v. Robins*, 136 S. Ct. 1540, 1548 (2016). Merely alleging that a statute was somehow violated by someone is not enough to plead either of these aspects of Article III standing. *See id.* at 1549.

Plaintiffs have neither pleaded facts about any of their specific trades or securities nor described how any particular trades or securities were affected by an HFT firm's use of the products and services they challenge. Indeed, Plaintiffs concede that the scheme they allege "*could* conceivably be applicable" to all securities bought or sold in the United States (Opp. 15-

17 & n.9, emphasis added).[1] Yet the SCAC contains no factual allegations sufficient to show anything about the impact (positive, negative, or nonexistent) of the products and services at issue on Plaintiffs' securities trades (none of which is specified), meaning it is not discernable from the SCAC whether Plaintiffs were harmed at all or how the relief they seek would remedy any legal injury. That is particularly problematic because Plaintiffs seek not just monetary damages, but also broad injunctions that would fundamentally change how markets operate. Mem. 4. At a bare minimum, Plaintiffs should be able to (i) point to *some* trade of theirs that they think was *somehow* negatively influenced and (ii) explain how the relief they seek would fix that alleged problem. Because the SCAC is entirely silent on those issues, Plaintiffs have not pleaded Article III standing.[2] *See Sierra Club v. Morton*, 405 U.S. 727, 734-35 (1972).

B. Plaintiffs lack statutory standing to assert their Section 10(b) claim

Plaintiffs do not satisfy the purchaser-seller standing requirement adopted in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), or the requirements of the PSLRA. Plaintiffs effectively concede this by ignoring the dispositive arguments made and binding authorities cited

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1 There is no question that the Supreme Court requires plaintiffs to plead injury specific to themselves. *See Gill v. Whitford*, No. 16-1161, slip op. at 13-14 (U.S. June 18, 2018) (noting that federal courts are not fora for "'generalized grievances,' and the requirement of such a personal stake 'ensures that courts exercise power that is judicial in nature'").

2 Plaintiffs' citations are not to the contrary. *Harry v. Total Gas & Power North American, Inc.*, 889 F.3d 104 (2d Cir. 2018), addressed manipulation by a specific entity with respect to particular contracts on specific markets. In *Ross v. Bank of America, N.A. (USA)*, 524 F.3d 217, 223 (2d Cir. 2008), the plaintiffs alleged that suppressed competition injured them in a specific way. In *Gelboim v. Bank of America Corp*., 823 F.3d 759, 770 (2d Cir. 2016), the plaintiffs pleaded that they were all harmed by the same alleged manipulation of LIBOR. *Rothstein v. UBS AG*, 708 F.3d 82, 91-92 (2d Cir. 2013), held only that traceability is a lower standard than proximate cause, not that it has no boundaries at all. Finally, in *FrontPoint Asian Event Driven Fund, L.P. v. Citibank, N.A*., No. 16 Civ. 5263 (AKH), 2017 WL 3600425, at *9 (S.D.N.Y. Aug. 18, 2017), the alleged manipulation might have both helped and hurt plaintiffs' trades, but here it is just as plausible from the SCAC that Plaintiffs were helped or not affected by the alleged misconduct as that they were harmed, which is not enough to clear even a low bar for Article III standing.

by the Exchanges and instead asserting only that the Exchanges urge a narrow reading of the "in connection with" clause in Rule 10b-5. Opp. 4-6. That *non sequitur* fails because the Supreme Court made clear—*in the case Plaintiffs rely on*, Opp. 5—that the "in connection with" requirement is completely separate from the *Blue Chip Stamps* standing rule. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 84 (2006) ("The *Blue Chip Stamps* Court … define[d] the scope of a private right of action under Rule 10b-5—not … the words 'in connection with' … ." (citation omitted)). Plaintiffs' citations are irrelevant because they address only the "in connection with" requirement. Although Plaintiffs cite the district court's decision in *Fezzani v. Bear, Stearns & Co.*, 384 F. Supp. 2d 618 (S.D.N.Y. 2004) (Opp. 5-6), the plaintiffs there specifically listed the purchases and sales at issue on a "security-by-security, trade-by-trade basis." Am. Compl. ¶¶ 4, 37 & Ex. A, *Fezzani*, No. 99-cv-0793 (S.D.N.Y. filed Apr. 7, 2005), 2005 WL 6251885. Plaintiffs' reliance on *Fezzani* thus *highlights* the SCAC's standing deficiencies.

II. The SCAC Fails to State a Claim Upon Which Relief Could Be Granted[3]

A. Plaintiffs have not adequately pleaded reliance

Plaintiffs admit that their only two arguments for reliance are that "(i) the *Affiliated Ute* presumption of reliance applies here" and "(ii) the Complaint adequately pleads reliance on the integrity of the public securities markets." Opp. 11. That admission is fatal because the Court *rejected* those arguments when Plaintiffs made them against Barclays. *See* Original Decision, 126 F. Supp. 3d at 365-66. Plaintiffs did not appeal that ruling, and it is now law of the case.

Plaintiffs attempt to distinguish the Barclays ruling in a footnote, Opp. 13 n.7, but they fail. Plaintiffs first claim that the Court did not apply *Affiliated Ute* against Barclays because Plaintiffs had not adequately pleaded that Barclays committed manipulative acts. *Id.* But the

[3] Because Plaintiffs affirmatively waived any claims based on misstatements (Opp. 8 n.5, 13 n.7), Plaintiffs have conceded Point II(D) of the Exchanges' opening brief.

Court clearly explained that the failure to plead manipulative acts and the failure to plead reliance were "independent reasons" for its decision. Original Decision, 126 F. Supp. 3d at 364.

Plaintiffs then cite this Court's statement that "omissions play[ed] only a minor role" in the claim against Barclays. *Id*. at 365. But Plaintiffs' claim against the Exchanges is no different. It is focused primarily on the Exchanges' alleged conduct in "provid[ing] HFT firms with a complex web of products and services … that the HFT firms used in combination to systematically manipulate the public securities markets." Opp. 1. Alleged omissions enter the picture only because Plaintiffs claim the Exchanges did not predict to the world how HFT firms supposedly might use those products and services to manipulate the markets.[4] *See City of Providence v. Bats Global Mkts., Inc.*, 878 F.3d 36, 52 (2d Cir. 2017). That cannot be enough to trigger the *Affiliated Ute* presumption because, as the Court held, if a manipulation claim could be reframed as an omission claim merely by alleging that a defendant "did nothing to dispel" its own manipulation, then the limitation of *Affiliated Ute* to omissions alone would be meaningless. Original Decision, 126 F. Supp. 3d at 366; *see also Desai v. Deutsche Bank Sec. Ltd.*, 573 F.3d 931, 940-41 (9th Cir. 2009) (declining to apply *Affiliated Ute* presumption to manipulation claim); *Joseph v. Wiles*, 223 F.3d 1155, 1163 (10th Cir. 2000) (same), *abrogated on other grounds by California Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.*, 137 S. Ct. 2042 (2017).

Plaintiffs do not even pretend that their "reliance on the integrity of the public securities markets" argument can be reconciled with this Court's ruling. Nor could they, because the Court *explicitly* "decline[d] [Plaintiffs'] invitation" "to apply a novel presumption of reliance based on the fairness and integrity of the market." Original Decision, 126 F. Supp. 3d at 366. Instead, Plaintiffs cite *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 100-01 (2d Cir.

[4] Plaintiffs do not allege that any of those products and services are in any way illegal or that their mere existence harms anyone.

2007)—which did not address reliance in the market-manipulation context—and *Fezzani v. Bear, Stearns & Co. Inc.*, 777 F.3d 566, 571-73 (2d Cir. 2015)—which held that the plaintiffs had *failed* adequately to plead reliance in a market-manipulation case. As this Court has already held, neither case supports Plaintiffs' brazen attempt to "all but eliminate the reliance requirement for a market manipulation claim against any entity involved in the operation of a market for securities." Original Decision, 126 F. Supp. 3d at 366.

B. Plaintiffs fail to allege loss causation

Plaintiffs attempt to reduce their loss-causation burden to a triviality. Under their view of the law, loss causation can be pleaded by alleging some type of manipulative scheme, claiming it somehow influenced prices of some unidentified securities, and then asserting—without identifying even a single instance of buying or selling any particular security—that unnamed "innocent investors" were harmed as a result. *See* Opp. 15. And they do so while conceding that their allegations could "conceivably be applicable to all of the securities" traded on any of the Exchanges. Opp. 16 n.9. That is not the law. Under any reasonable understanding of loss causation, Plaintiffs have to offer more than the "general allegations" they present here, as their own citations confirm.[5] Plaintiffs' allegations that some type of manipulation occurred on some exchange and that it somehow negatively affected their trades in unidentified stocks does not meet that standard, especially given their concession that the alleged manipulation was carried out by unnamed HFT firms. *See City of Providence*, 878 F.3d at 52 ("if the HFT firms had not used these

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[5] *See Fezzani*, 384 F. Supp. 2d at 642-43 (dismissing manipulation claim because plaintiffs' "general" allegations failed to specify "which securities were manipulated in what way, how such manipulation affected the market for the *specific* security, and in what way [the] Plaintiffs were harmed"); *ATSI*, 493 F.3d at 102 ("[g]eneral allegations … are insufficient," and a plaintiff must plead "what effect the scheme had on the market *for the securities at issue*" (emphasis added)); *In re NYSE Specialists Sec. Litig.*, 405 F. Supp. 2d 281, 315 (S.D.N.Y. 2005) (noting that the plaintiffs annexed to the complaint "records of stock trades" in specific stocks).

products and services, the plaintiffs could not have suffered their alleged harm").[6]

C. Plaintiffs fail to plead scienter

Plaintiffs argue that they have satisfied the rigorous standards for pleading scienter based merely on the allegations that the Exchanges created products and services that certain customers (HFT firms) wanted and made a profit in doing so. *See* Opp. 6-11. Leaping from those allegations to the inference that the Exchanges intended to defraud potentially every public investor in the past nine years is not even plausible, let alone consistent with the PSLRA's "strong inference" scienter requirement. The Second Circuit has made abundantly clear that general allegations of motives possessed by all corporations, such as increasing corporate profitability, are insufficient to plead scienter. *See, e.g.*, *S. Cherry St., LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 109 (2d Cir. 2009). Plaintiffs' chief authority does not suggest otherwise, because here "Plaintiffs have … alleged merely that the purported scheme allowed the [Exchanges] to make a profit from the transaction[s] at issue, or to keep receiving fees" from the HFT firms. *Sharette v. Credit Suisse Int'l*, 127 F. Supp. 3d 60, 96 (S.D.N.Y. 2015).

Nor do Plaintiffs' "active concealment" allegations move the needle. Opp. 10-11. As required by the Exchange Act, the Exchanges publicly disclosed the existence of these products

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[6] Plaintiffs' reliance on the "laddering" cases actually *hurts* them. In *In re: Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 305-06, 309, 385 (S.D.N.Y. 2003), the court held that allegations of acts the SEC had long held "*clearly*" violative of federal securities laws sufficed to plead manipulation. But here the acts Plaintiffs plead were approved by the SEC as consistent with the Exchange Act. And although *In re: Initial Pub. Offering Sec. Litig.*, 297 F. Supp. 2d 668, 674 n.31 (S.D.N.Y. 2003), held that in *some* manipulation cases it *may* be difficult to precisely allege loss causation "[i]f the mechanism of the fraud is a mystery," that is not this case because Plaintiffs claim to know exactly how the alleged manipulation worked (and that court also stated that "market manipulation is a discrete act that influences stock price," *id*. at 674, which Plaintiffs curiously omit). And the plaintiffs in the laddering cases specifically identified all the securities they claimed were manipulated and complied with the PSLRA's certification requirements, unlike Plaintiffs here. *See* 241 F. Supp. 2d at 416-32.

and services. Even Plaintiffs claim only a limited concealment regarding "complex order types and how these order types were used [by HFT firms] in conjunction with co-location services and proprietary data feeds to disadvantage the investing public." Opp. 10. But nothing about the Exchanges' alleged failures to publicly speculate about how third parties might use their products and services suggests fraudulent intent, particularly when Plaintiffs identify no duty to make such disclosures and the SEC authorized the products or services *without* requiring any such disclosures.

III. Plaintiffs' Claim Is Precluded

The Exchanges' preclusion argument is neither a "recast" (Opp. 18) of a prior argument nor waived (Opp. 19-20).[7] Although some aspects of this argument—such as how and to what extent the SEC regulates SROs pursuant to the Exchange Act—overlap with arguments the Exchanges have made before, that does not make the arguments the same. Nor did the Second Circuit hold that preclusion cannot be decided without further factual development (Opp. 22); all it did was decline to decide the issue on the record before it. That declination is precisely what Plaintiffs asked the Second Circuit to do, and they did not assert that preclusion could not be addressed on remand. *See* Plaintiffs' SEC Response at 6 ("Given that the … issues are unbriefed and untested, Plaintiffs suggest that *this Court* not reach them *now*.") (emphasis added). Having asked the Second Circuit not to address the issue and achieved that goal, Plaintiffs cannot claim that the court of appeals really *did* decide preclusion.

Contrary to Plaintiffs' assertions (Opp. 19), preclusion also is not a way to reargue SRO immunity. Although the Second Circuit did not find the conduct at issue here to be "regulatory,"

[7] Plaintiffs' waiver argument fails because Rule 12 bars successive motions premised on the differing *defenses* listed in Rule 12(b)(2)-(5), not differing *arguments* raised on a Rule 12(b)(6) motion. *See United States ex rel. Kolchinsky v. Moody's Corp.*, 238 F. Supp. 3d 550, 555 (S.D.N.Y. 2017), *modified in part on other grounds*, 2017 WL 3841866 (S.D.N.Y. Sept. 1, 2017). And failure to state a claim is not a waivable defense. *See Patel v. Contemporary Classics of Beverly Hills*, 259 F.3d 123, 126 (2d Cir. 2001).

it *did* find that the conduct was "regulated." *See City of Providence*, 878 F.3d at 48. Claims such as these, based on "regulated" conduct of SROs, are precisely what preclusion is intended to address. *See* Mem. Point III.

Plaintiffs' primary protest against preclusion is that the legal test set forth in *Credit Suisse Securities (USA) LLC v. Billing*, 551 U.S. 264 (2007), supposedly applies only to antitrust cases, and Plaintiffs assert that the Exchanges offer no authority that the *Credit Suisse* analysis applies in this context. Opp. 20-22. Although *Credit Suisse* involved preclusion of antitrust claims by the Exchange Act, it set forth a general test for determining when the Exchange Act precludes a claim brought under federal law. Plaintiffs cite no cases holding that *Credit Suisse* applies only to antitrust claims and propose no alternative test. Opp. 21.[8] In fact, the *Credit Suisse* test makes even more sense when the question is how one part of the Exchange Act interacts with another part of the Exchange Act than when the conflict involves an entirely separate statute. Although Plaintiffs dismiss several state-law preemption cases out of hand, *see* Opp. 21 n.12, those authorities explain that the Exchange Act should be viewed holistically and that claims should be foreclosed where they would interfere with the comprehensive structure Congress created for SEC regulation of SROs. *See Lanier v. BATS Exch., Inc.*, 838 F.3d 139, 155 (2d Cir. 2016). That is precisely the case here, where Plaintiffs' Section 10(b) claim would create conflicts with

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[8] Plaintiffs' citations are inapposite. *Elec. Trading Grp. LLC v. Banc of Am. Sec. LLC*, 588 F.3d 128 (2d Cir. 2009), and *In re Interest Rate Swaps Antitrust Litig*., 261 F. Supp. 3d 430 (S.D.N.Y. 2017), were antitrust cases and had no reason to discuss preclusion in other contexts. *Cohen v. UBS Fin. Servs., Inc*., No. 12 Civ. 2147, 2012 WL 6041634 (S.D.N.Y. Dec. 4, 2012), addressed whether arbitration agreements were precluded by FINRA rules, not whether one part of the Exchange Act precluded claims under another part of the Act. And *Axcan Scandipharm Inc. v. Ethex Corp*., 585 F. Supp. 2d 1067 (D. Minn. 2007), held that *Credit Suisse* does not apply when there is no conflict between statutes, not that it only applies in the antitrust context. Plaintiffs' argument thus echoes a long history of failed attempts to limit legal rules that first arise in antitrust cases. *See, e.g.*, *Ashcroft v. Iqbal*, 556 U.S. 662, 684 (2009) (rejecting argument that "*Twombly* should be limited to pleadings made in the context of an antitrust dispute").

the SEC's regulatory authority over the products and services that form the basis for Plaintiffs' allegations. *See POM Wonderful LLC v. Coca-Cola Co.*, 134 S. Ct. 2228, 2236 (2014) (preemption principles are "instructive" to a preclusion analysis).

The Exchanges explained in detail why each of the *Credit Suisse* factors are satisfied here (Mem. Point III), and Plaintiffs' responses are uniformly unavailing. For example, Plaintiffs assert that there are disputes over whether the SEC has exercised its regulatory authority over the products and services at issue, Opp. 23, but the relevant question is whether the SEC has "exercised its legal authority to regulate conduct *of the general kind now at issue*." 551 U.S. at 277 (emphasis added). On that question, there is no dispute: The Commission both "has approved" the three challenged products and services and has "instituted enforcement proceedings against exchanges" in relation to them. *City of Providence*, 878 F.3d at 42-43. And although Plaintiffs argue that there is no "actual conflict" between their claim and the SEC's regulatory authority, Opp. 24, preclusion exists when there is a "*potential* conflict ... based on the possibility that the SEC will act upon its authority." *Elec. Trading Grp.*, 588 F.3d at 138 (emphasis added). Even if there were a dispute over whether the SEC had approved a particular aspect of the challenged products and services, there can be no dispute that it is *possible* that Plaintiffs' claim would conflict with the SEC's authority. Accordingly, further factual development is not necessary before dismissing Plaintiffs' claim on preclusion grounds.[9]

That no post-*Credit Suisse* case has yet to address this precise issue reflects the illogical nature of Plaintiffs' claims that products and services subject to specific regulation by the SEC,

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[9] *Credit Suisse* held a claim to be precluded at the motion-to-dismiss stage, 551 U.S. at 270, and Plaintiffs admit that courts routinely address preemption on motions to dismiss. Opp. 21 n.12. Preclusion is no different because both inquiries "assess the interaction of laws that bear on the same subject." *POM Wonderful LLC*, 134 S. Ct. at 2236. And although it remanded on preclusion, the Second Circuit identified no factual dispute preventing resolution on a motion to dismiss. 878 F.3d at 50 n.5.

despite being approved by the SEC pursuant to the requirements of the Exchange Act, can be the basis for market manipulation claims. Plaintiffs fall back on the argument that private rights of action are "essential" to securities markets (Opp. 21-22), but that argument fails here. *First*, it ignores the fact that any decision to extend the Section 10(b) cause of action is for Congress, not the courts; and the cause of action "should not be extended beyond its present boundaries." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 165 (2008). *Second*, it ignores the legislative fact—relied on by the SEC in raising this issue in its amicus brief (Mem. 25) and not disputed by Plaintiffs—that Congress has created a specific system for the SEC to regulate the products and services here and that system includes no role for district courts.

That leaves Plaintiffs' argument that the SEC's views do not support preclusion and, if they do, the Court should accord them no deference. Opp. 22 n.13. The SEC's views on preclusion were clearly stated and supported by the same analysis as its other views (Mem. 25), and before the Second Circuit Plaintiffs argued that "**The Views Expressed in the SEC's *Amicus Curiae* Brief Warrant Deference By This Court**" (Plaintiffs' SEC Response 2-6). Whatever standard of deference applies, the SEC's articulation of the preclusion standard, analyzed against the Exchange Act's comprehensive regulatory structure, supports dismissal.

CONCLUSION

For the reasons stated above and in their opening brief, the Exchanges request that this Court dismiss the SCAC.

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Respectfully submitted,

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