No. 07-__

IN THE

Supreme Court of the United States

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS)

Petitioner,

v.

NEW YORK STOCK EXCHANGE, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Is the New York Stock Exchange, a private entity that operates unhindered by constitutional limitations on governmental actors, entitled to claim absolute immunity against a suit by investors on the ground that it stands in the Securities and Exchange Commission's shoes even when it fails to enforce trading rules and regulations and acts instead to facilitate market manipulation and fraud?

PARTIES TO THE PROCEEDING

Petitioner California Public Employees' Retirement System (CalPERS) is a court-appointed Lead Plaintiff in this securities class action under the Securities Exchange Act of 1934 (the "Exchange Act" or "1934 Act"), acting on behalf of itself and all others who purchased securities listed on the New York Stock Exchange ("NYSE"), between October 17, 1998, and October 15, 2003 (the "Class Period").

The NYSE is a for-profit corporation that was nominally a non-profit during the Class Period but that was then preparing to reorganize as a for-profit venture, and that has since issued shares and is now a publicly traded for-profit company. The NYSE qualifies as a Self-Regulatory Organization or "SRO" under the Exchange Act which defines "self-regulatory organization" to include any "national securities exchange, registered securities association, or registered clearing agency," 15 U.S.C. §78c(a)(26), and which requires an SRO itself to comply with the Exchange Act, "the rules and regulations thereunder, and its own rules," and also to "enforce compliance . . . with such provisions by its members and persons associated with its members." 15 U.S.C. §78s(g).

The NYSE was the only defendant-appellee before the Second Circuit, as the underlying case proceeded – and continues to proceed – against its Specialist Firms in the district court. Additional defendants in those proceedings before the district court are the NYSE's Specialists, who were not parties to the Rule 54(b) appeal to the United States Court of Appeals

for the Second Circuit that produced the judgment review of which is hereby sought. They are:

LaBranche & Co., Inc.,

LaBranche & Co., LLC;

George M.L. LaBranche, IV;

Bear Wagner Specialists LLC;

Bear Stearns & Co., Inc.;

Spear, Leeds & Kellogg Specialists LLC;

Spear, Leads & Kellogg, LP;

The Goldman Sachs Group, Inc.;

Goldman Sachs & Co.;

Van der Moolen Specialists USA, LLC;

Van der Moolen Holding N.V.;

FleetBoston Financial Corporation;

Fleet Specialist, Inc.;

Bank of America Corporation;

Quick & Reilly, Inc.;

Performance Specialist Group, LLC;

Kellogg Group, LLC;

Susquehanna Specialists, Inc. (also known as SIG Specialists, Inc.);

Susquehanna International Group, LLP; and

Susquehanna Financial Group, LLP (collectively, the "Specialist Firms").

CORPORATE DISCLOSURE STATEMENT

Petitioner California Public Employees' Retirement System (CalPERS) is the largest public-employee retirement system in the United States, with nearly 1.5 million beneficiaries, and assets substantially exceeding $200 billion. CalPERS is administered by a 13-member Board of Administration, whose members are either elected by members of the retirement system, appointed, or designated by law to be on the Board. CalPERS has no parent corporation, and no publicly held corporation owns an interest in it.

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PETITION FOR A WRIT OF CERTIORARI

CITATIONS TO THE OPINIONS BELOW

The decision of the United States District Court for the Southern District of New York, dismissing with prejudice claims against the NYSE, was published as *In re NYSE Specialists Sec. Litig.*, 405 F. Supp. 2d 281 (S.D.N.Y. 2005), and is reprinted in the appendix hereto at Pet. App. 30a-135a.[1]

[1] Related decisions issued on the same date, sustaining claims against other defendants who engaged with the NYSE in the same scheme and course of conduct that operated as a fraud on investors, were reported as *In re LaBranche Sec. Litig.*, 405 F.

The Second Circuit's opinion affirming the dismissal in relevant part was published as *In re NYSE Specialists Litig. (California Public Employees' Retirement System v. The New York Stock Exchange)*, 503 F.3d 89 (2d Cir. 2007), and is reprinted in the appendix hereto at Pet. App. 1a-29a.

JURISDICTION

The district court exercised jurisdiction over this federal securities-fraud class action under 28 U.S.C. §1331 and 15 U.S.C. §78aa.

The district court certified its order dismissing claims against the NYSE for entry of a final appealable judgment pursuant to Federal Rule of Civil Procedure 54(b), upon a finding that there was no just reason for delay, thereby giving the United States Court of Appeals appellate jurisdiction under 28 U.S.C. §1291. Pet. App. 136a-139a.

The Second Circuit issued its judgment affirming in part and vacating in part on September 18, 2007. *See* Pet. App. 1a-29a. No petition for rehearing was filed.

On December 7, 2007, Justice Ruth Bader Ginsburg granted CalPERS' application for an extension of time within which to file a petition for a writ of certiorari, and extended the time to January 16, 2008. *See California Public Employees' Retirement System v. New York Stock Exchange, Inc.*, Application No. 07A483 (Dec. 7, 2007).

This Court has jurisdiction under 28 U.S.C. §1254 to review the judgment of the Second Circuit.

Supp. 2d 333 (S.D.N.Y. 2005), and as *In re Van der Moolen Holding N.V. Sec. Litig.*, 405 F. Supp. 2d 388 (S.D.N.Y. 2005).

STATUTORY PROVISIONS INVOLVED

Relevant statutory provisions are set out in the appendix hereto. *See* Pet. App. 149a-155a.

STATEMENT OF THE CASE

A. Nature of the Case and Jurisdiction Below

This is a securities class action prosecuted on behalf of investors who purchased and sold securities on the NYSE between October 17, 1998, and October 15, 2003, (the Class Period), while the NYSE and its seven Specialist Firms – on whom it has conferred an exclusive franchise to handle the trading in exchange-listed stocks – flouted securities laws and trading rules with a fraudulent course of business that produced enormous profits for themselves, at the expense of innocent public investors. The case arises under the Exchange Act §§6(b), 10(b) and 20(a), 15 U.S.C. §§78f, 78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission ("SEC") 17 C.F.R. §240.10b-5. The district court had jurisdiction under 28 U.S.C. §1331 and §28 of the Exchange Act, 15 U.S.C. §78aa.

After several related cases were consolidated, and Lead Plaintiffs appointed to prosecute the matter, claims against the NYSE's Specialist Firms that survived motions to dismiss are proceeding in the district court. *See* Pet. App. 107a; *see also LaBranche*, 405 F. Supp. 2d 333; *Van der Moolen Holding*, 405 F. Supp. 2d 388. Most claims against the NYSE itself, however, were dismissed with prejudice. *See* Pet. App. 67a-75a.

Following the December 13, 2005, dismissal with prejudice of plaintiffs' claims against the NYSE, Pet. App. 30a-135a, the NYSE joined in Lead Plaintiffs'

request for certification and entry of final judgment under Fed. R. Civ. P. 54(b). Finding no just reason for delay, the district court granted the Rule 54(b) certification, directing the clerk to enter final judgment, which the clerk did on February 17, 2006. Pet. App. 136a-144a. Plaintiffs timely filed a notice of appeal on March 3, 2006. The Second Circuit had jurisdiction under 28 U.S.C. §1291 to review a final judgment.

B. Statement of Facts

The Lead Plaintiffs' Consolidated Complaint alleges in detail how the NYSE and its Specialist Firms executed a fraudulent scheme and course of business designed to cheat public investors and enrich themselves. JA2:70-72 (¶¶2-3).[2] It sets forth how the NYSE falsified trading records, tipped off the Specialist Firms to pending investigations so that fraudulent practices could be concealed, and worked with its specialists to hide evidence of wrongdoing from the SEC. JA2:121-22 (¶116), 123-24 (¶¶121-126). Moreover, while the scheme was in full operation, NYSE officials falsely assured investors that they were in fact operating a fair and orderly market. JA2:82 (¶18(a)).

1. The NYSE's Operation and the Specialist Firms

During the Class Period, the NYSE had only seven Specialist Firms that together managed the trading for all of the NYSE's 2,800 listed companies. JA2:93 (¶32). These Specialist Firms owned many seats on the NYSE trading floor, from which they conducted

---

[2] The operative complaint appears in the Second Circuit Joint Appendix at tab 2, and is cited herein as "JA2:__-__ (¶¶__)."

auction markets in particular securities. JA2:82 (¶18(b)), 98 (¶47). The stock of each NYSE-listed company was assigned to one of the Specialist Firms, which then conducted the trading of that company's securities, receiving and processing trading orders on an electronic workstation "Display Book" containing all electronic orders entered into the NYSE's "SuperDot" order-processing system. JA2:96-97 (¶43).

The seven Specialist Firms performed four functions. First, they acted as auctioneers, by continually quoting the best-available prices on a particular stock throughout the trading day. JA2:98 (¶47). Specialist Firms also were required to act as agents, matching the orders of buyers and sellers to ensure timely execution at the best-available price. *Id.* When it was not possible to match buy and sell orders, Specialist Firms were to act as principals, by buying and selling their own holdings of a security in order to maintain liquidity and price continuity. *Id.* Finally, the Specialist Firms acted as catalysts by using their knowledge of interested parties and potential offers to bring buyers and sellers together. *Id.*

Each trading day, billions of shares were bought and sold through the Specialist Firms in NYSE's auction market. JA2:82 (¶18(a)). The NYSE received substantial fees from these trades, JA2:93-84 (¶18(d)), and its executives' continuing employment and compensation were directly tied to the operations of the Specialist Firms. JA2:181 (¶189).

2. The NYSE Abandons Its Regulatory Duties to Foster a Fraudulent Course of Business

Although the NYSE is charged with obeying the securities laws and its own rules, and also with en-

forcing compliance by its members with those provisions, *see* 15 U.S.C. §78s(g)(1), the NYSE effectively abandoned its regulatory function before and during the Class Period, in order to actively encourage and participate with its Specialist Firms in acts of manipulation, a scheme to defraud, and a course of business that operated as a fraud and deceit on public investors trading on the NYSE. JA2:93-85 (¶¶18(d)-(e)), 182 (¶¶191-192).

Rather than regulating them, the NYSE actively engaged with its Specialists in wide-ranging manipulative, self-dealing, deceptive and misleading conduct – thereby violating several sections of the Exchange Act, SEC rules, and NYSE rules. JA2:71-72 (¶3). The wrongs alleged included:

> "interpositioning" in which a Specialist "steps in the way" of matching orders of public sellers and buyers of stock in order to generate riskless profits for itself to the detriment of Class members;
>
> "trading ahead" or "front-running," in which Specialists trade for their own account before completing orders of public investors by taking advantage of their confidential knowledge of public investors' orders that will impact the price of the stock;
>
> "freezing the book," in which a Specialist freezes its Display Book on a stock so it can first engage in trades for its own account before executing public investors' orders; and
>
> manipulating the "tick" or the price of a stock to effect principal trades.

See id.; JA2:109-24 (¶¶75-126).

The NYSE and its Specialist Firms falsified trade records and reports to conceal these illegal and manipulative practices. JA2:71-72 (¶3), 120-24 (¶¶110-126). The Specialist Firms profited by hundreds of millions of dollars from this fraudulent scheme and course of business, and the NYSE paid its top executives exorbitant compensation packages. JA2:71 (¶3), 190 (¶217).

The NYSE thus effectively abandoned its delegated regulatory functions, and engaged instead in improper and illegal conduct far beyond – and utterly inconsistent with – the regulatory authority delegated to it under the Exchange Act. For example, NYSE officials routinely tipped off Specialists ahead of impending investigations, so that the Specialists could cover the tracks of their improper and illegal conduct. JA2:121-22 (¶116). Toni-Ann Turco, who had previously worked in the NYSE Division of Market Surveillance, during the Class Period worked as the head of one Specialist Firm's compliance department – where she was tipped off to investigations by the NYSE's Lucy Palmieri. *Id.* Turco often bragged that "'it pays to have friends at the Exchange.'" *Id.* (citation omitted).

The NYSE worked with the Specialist Firms to facilitate improper trading by helping to doctor the Specialist Firms' weekly trading reports to create records of fictitious trades and conceal the improper trading. JA2:123-24 (¶¶121-126). The NYSE did this by flagging the individual specialists' weekly transaction reports containing improper trading, alerting the Specialists to the problem, then giving the Specialists the rest of the week to "correct" the reports – allowing them to violate NYSE trading rules, cover up the violations, and escape without any penalty. *Id.*

The NYSE – through Richard Grasso himself – also strongly encouraged the Specialists to engage in "freezing the book" on a regular basis, while the NYSE's public-relations people simultaneously told public investors that "there was no such thing . . . as 'freezing the book.'" JA2:115-17 (¶¶91-98) (citation omitted).

3. The SEC Finds that the NYSE Abandoned Its Duties

In early 2003, the SEC finally conducted an investigation of the NYSE and its Specialists because the NYSE, a *self-regulatory organization*, had refused to conduct a genuine investigation into complaints regarding its own improper conduct. JA2:73 (¶7). *The Wall Street Journal* in a November 3, 2003, article, reported that the SEC found that investors were shortchanged by millions of dollars in trades involving more than two billion shares during the Class Period. JA2:74-77 (¶8), 199-200 (¶¶230-233),). *The Wall Street Journal* reported that the SEC had "'blasted the New York Stock Exchange,'" painting a picture of a floor-trading system "'riddled with abuses.'" JA2:74-77 (¶8) (citation omitted). The NYSE itself had fostered abuse – including blatant rule violations by its Specialists – creating and following unwritten policies about the amount of fraud it would allow, and granting "grace periods" during which its Specialists could with impunity violate NYSE rules and the federal securities laws. JA2:74-77 (¶8), 190-95 (¶¶218-220).[3] Abusive business practices and the fraudulent scheme flourished on the

[3] This was only the latest in a history of malfeasance and abuse at the NYSE. The SEC had in 1999 cited the NYSE for knowledge of illegal trading practices. JA2:191-195 (¶¶219-220).

NYSE floor, creating huge profits for the NYSE's Specialist Firms, at enormous cost to public investors.

On March 30, 2004, and on July 26, 2004, the SEC announced settlements with the NYSE's Specialist Firms, imposing over $245 million in disgorgement and penalties for trading unlawfully for the Specialist Firms' own profit at the expense of public investors. JA2:77-80 (¶¶10-12); *see* JA2:124-26 (¶127), 140-45 (¶131). The Specialist Firms had "'themselves engaged in fraud through that proprietary trading in violation of Exchange Act Section 10(b) and Rule 10b-5.'" JA2:79 (¶ 11) (citation omitted).

An internal SEC report implicated the NYSE itself, which the agency charged with fostering an environment where trading violations were rampant, while displaying "'a habit of ignoring repeat violations by specialist firms.'" JA2:199-200 (¶230) (citation omitted). In utter derogation of its self-regulatory responsibilities, the NYSE itself had tipped off Specialists to investigations, and had facilitated falsification of trading records – making it not a market regulator at all, but a primary participant in fraudulent and unlawful conduct. *See* JA2:121-22 (¶116), 123-24 (¶¶121-126). The NYSE, in effect, abandoned its regulatory duties – publicly assuring investors of the integrity and honesty of its market while simultaneously cheating them out of hundreds of millions (if not billions) of dollars on its rigged market. *See* JA2:71-72 (¶3), 82 (¶18(a)), 182 (¶192).

After the operative Complaint was on file, and while the case was pending before Judge Sweet, the SEC on April 12, 2005, announced the simultaneous filing and settlement of "an enforcement action against the New York Stock Exchange, Inc., finding that the

NYSE, over the course of nearly four years, failed to police specialists, who engaged in widespread and unlawful proprietary trading on the floor of the NYSE." Pet. App. 140a.[4]

The SEC emphasized that the NYSE had in effect abandoned its delegated regulatory function from 1999 through 2003 by failing to police its Specialist Firms: "The Commission found that the NYSE violated §19(g) of the Securities Exchange Act of 1934 by failing to enforce compliance with both the federal securities laws and NYSE rules which prohibit specialists from 'interpositioning' and 'trading ahead' of customer orders." *Id.* The release continued:

> Specifically, the Commission's Order finds that from 1999 through 2003, various NYSE specialists repeatedly engaged in unlawful proprietary trading, resulting in more than $158 million of customer harm. The improper trading took various forms, including "interpositioning" the firms' dealer accounts between customer orders and "trading ahead" for their dealer accounts in front of executable agency orders on the same side of the market. From 1999 through almost all of 2002, the NYSE failed to adequately monitor and police specialist trading activity, allowing the vast majority of this unlawful conduct to continue.

Id. at 2.[5]

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[4] The district court judicially noticed the SEC's April 12, 2005, action, referring to it in the Order appealed from, *see* Pet. App. 10a. The SEC's release (Pet. App. 140a-144a) is available on the Internet at http://www.sec.gov/news/press/2005-53.htm, while the NYSE's press release acknowledging the government's action (Pet. App. 145a-147a) is available on the Internet at http://www.nyse.com/content/articles/111330299300 5.html.

[5] *Id.*; *see id.* at 6 ("The Commission's Order finds that the NYSE violated Section 19(g) of the Exchange Act by failing to

C. Course of Proceedings

Following the initial disclosures of the SEC's investigation of the NYSE and its Specialist Firms, investors who during the Class Period had purchased or sold securities on the NYSE filed several securities-fraud actions in late 2003. The district court consolidated the actions, appointing statutory "lead plaintiffs." *See* 15 U.S.C. §78u-4(a)(3)(B)(iii). The country's largest public-employee retirement system, with nearly 1.4 million beneficiaries and assets exceeding $166 billion at the time, Lead Plaintiff CalPERS during the Class Period had bought or sold nearly three billion NYSE-listed shares in transactions executed by the NYSE's Specialist Firms.[6]

A Consolidated Complaint filed on September 16, 2004, charged the NYSE and its Specialist Firms with various securities violations over a Class Period running from October 17, 1998 to October 15, 2003, JA2, seeking relief under §§10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder. JA2:202-04 (¶¶234-244).

Both the Specialist Firms and the NYSE moved to dismiss the Complaint, on a variety of grounds, with the NYSE asserting that it was entitled to absolute immunity based on its status under the Exchange Act as a self-regulatory organization or "SRO." *See* 15 U.S.C. §78c(a)(26). The district court agreed with the NYSE, citing *D'Alessio v. NYSE*, 258 F.3d 93, 106 (2d

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enforce compliance with the federal securities laws and NYSE rules that prohibit unlawful proprietary trading by specialists – specifically, Section 11(b) of the Exchange Act, Rule 11b-1 thereunder, and NYSE Rules 92 and 104.10.").

[6] JA2:81 (¶17(a)). CalPERS' assets currently exceed $200 billion.

Cir. 2001), which held that "'the NYSE, when acting in its capacity as a[n] SRO, is entitled to immunity from suit when it engages in conduct consistent with the quasi-governmental powers delegated to it pursuant to the Exchange Act and the regulations and rules promulgated thereunder.'" Pet. App. 68a (quoting *D'Alessio*, 258 F.3d at 106).

The district court acknowledged the SEC's findings that NYSE had *failed to regulate* its Specialist Firms, but ruled the NYSE is absolutely immune to suit – reasoning that the NYSE's *failure to regulate*, and actual *participation in unlawful conduct*, somehow came within the legitimate scope of the regulatory authority delegated to it by the SEC. Pet. App. 68a-75a.

The Second Circuit affirmed. "Although the NYSE is not a government entity," the court explained, "we have recognized that in certain circumstances it is entitled to absolute immunity for actions it takes pursuant to its quasi-governmental role in the regulation of the securities market." Pet. App. 14a. Citing *Forrester v. White*, 484 U.S. 219, 229 (1988), which *denied immunity* to a state-court judge who had dismissed a subordinate court employee, the Second Circuit said that "as in other absolute immunity contexts, we focus on 'the nature of the function performed, not the identity of the actor who performed it.'" Pet. App. 14a. "Thus," the Second Circuit reasoned, "so long as the 'alleged misconduct falls within the scope of the quasi-governmental powers delegated to the NYSE,' absolute immunity attaches." Pet. App. 15a.

The court held, however, that the NYSE acts within the scope of its quasi-governmental delegated powers even when it actually *abandons* its role as a

regulator, to join its Specialist Firms in a fraudulent scheme:

> Because the allegations demonstrate that the NYSE failed to regulate and at times actually participated in fraud and misconduct, Lead Plaintiffs further contend, the doctrine does not bar their claims. We disagree.

Pet. App. 15a.

"The power to exercise regulatory authority necessarily includes the power to take no affirmative action," the Second Circuit explained, holding that the NYSE acts as a regulator even when it chooses *not* to regulate, and to perpetuate a fraud instead. Pet. App. 16a. The appeals court held that allegations that "'the NYSE deliberately failed to halt, expose or discipline the illegal trading practices [of member firms]'" in fact amounted to "a tacit concession that the NYSE's decisions to act (or not to act) . . . is 'consistent with' the powers delegated to it by the SEC." Pet. App. 21a.

The SEC had found "that the NYSE violated Section 19(g) of the Exchange Act by failing to enforce compliance with the federal securities laws and NYSE rules that prohibit unlawful proprietary trading by specialists." Pet. App. 140a, 142a-143a. The Second Circuit concluded that the NYSE's illegal conduct nonetheless qualified as conduct "'consistent with' the powers delegated to it by the SEC." Pet. App. 21a.

REASONS FOR GRANTING THE WRIT

This case presents important questions concerning the availability and scope of absolute immunity for private entities that are supposed to enforce compliance with legal rules and regulations. Specifically, it

presents the question of whether a nongovernmental "Self-Regulatory Organization" or "SRO" such as the NYSE enjoys absolute immunity when it steps out of its role as a regulator to instead foster illegal trading and fraud on investors. This Court's review is badly needed to bring order to a confused field.

The Second Circuit holds, on the one hand, that SROs are purely private, nongovernmental actors utterly beyond the reach of constitutional limitations on governmental power. *See infra* at 15-16. On the other hand, it holds that SROs enjoy absolute immunity when acting or failing to act pursuant to their self-regulatory powers, on the ground that they in fact stand in the shoes of the SEC – exercising delegated governmental powers. *See infra* at 15-16. Commentators have noted an inconsistency here that warrants this Court's review. *See infra* at 17.

With the decision below in this case, moreover, the Second Circuit holds that absolute immunity applies even where the SRO *fails* to regulate itself and in fact – abandoning its self-regulatory functions – actually joins its members in perpetrating a fraud upon investors.

This sweeping doctrine of absolute immunity is utterly at odds with this Court's holding in *Silver v. NYSE*, 373 U.S. 341 (1963), that the NYSE may be liable for unjustified and arbitrary self-regulatory actions, and with its holding in *Richardson v. McKnight*, 521 U.S. 399 (1997), that private companies and their employees are not entitled to the immunity that government actors receive merely because they are performing delegated governmental functions. *See infra* at 17-26. The Second Circuit's sweeping doctrine conflicts as well with this Court's decisions holding that absolute immunity must be

narrowly cabined and carefully limited "to those exceptional situations where it is demonstrated that absolute immunity is essential to the conduct of the public business." *Butz v. Economou*, 438 U.S. 478, 507 (1978). *See infra* at 26-30.

This Court's review is needed to determine the availability and scope of immunity when an SRO abandons its regulatory role and instead facilitates illegal manipulation and fraud. Even if the NYSE should be immune to suit by those it regulates, that should not mean that investors, who are not similarly regulated by the NYSE, cannot sue if the NYSE *abandons* its regulatory duties and steps outside the legitimate scope of its delegated powers to foster, not an honest market, but a scheme by its own Specialist Firms to defraud those who trade on the Exchange.

I. This Court's Review Is Needed to Resolve Inconsistencies in Lower Court Decisions

The Second Circuit and other courts have repeatedly held that an SRO, such as the NYSE, is a purely private, non-governmental private entity, not subject to constitutional limitations on governmental actors. Even when an SRO investigates or disciplines a member specialist or broker, the Second Circuit holds that it acts "in pursuance of its own interests and obligations, not as an agent of the SEC."[7] The Second Circuit has repeatedly held that an SRO "is

[7] *United States v. Solomon*, 509 F.2d 863, 869 (2d Cir. 1975) (holding that because NYSE does not act on behalf of the government, its investigations are not subject to Fifth Amendment right not to testify against oneself).

not a government functionary"[8] and "not a state actor."[9] The other Circuits are in accord.[10]

But when victims of *deliberate misconduct* by an SRO seek relief for tortious misconduct, the Second Circuit holds that the SRO suddenly "'stands in the shoes of the SEC'" after all and is therefore absolutely immune for its wrongs.[11]

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[8] *D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 161-62 (2d Cir. 2002) (no Fifth Amendment rights in NASD investigations because "the NASD itself is not a government functionary").

[9] *Desidario v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) (expanding upon *Solomon* to hold the NASD is not subject to constitutional restrictions on the exercise of governmental power: "[I]ndeed, we have already ruled that the New York Stock Exchange – a self-regulatory private organization like the NASD – is not a state actor").

[10] *See, e.g., First Jersey Sec., Inc. v. Bergen*, 605 F.2d 690, 699 (3d Cir. 1979) ("NASD is not a state agency; therefore, First Jersey is unable to state a claim under [42 U.S.C.] section 1983."); *Otto v. SEC*, 253 F.3d 960, 965 (7th Cir. 2001) ("we have previously expressed doubt about 'the proposition that the comprehensive regulation of securities exchanges by the federal government would turn those exchanges into government actors'") (citation omitted); *Marchiano v. NASD*, 134 F. Supp. 2d 90, 95 (D.D.C. 2001) ("The court is aware of no case . . . in which NASD Defendants were found to be state actors either because of their regulatory responsibilities or because of any alleged collusion with criminal prosecutors").

[11] Pet. App. 15a (quoting *D'Alessio*, 258 F.3d at 105 (2d Cir. 2001) ("The NYSE, as a SRO, stands in the shoes of the SEC in interpreting the securities laws for its members and in monitoring compliance with those laws."). "'Although the Exchange is a private, rather than a governmental entity,' the Second Circuit held below, "'immunity doctrines protect private actors when they perform important governmental functions.'" Pet. App. 14a (quoting *Barbara v. NYSE*, 99 F.3d 49, 58 (2d Cir. 1996)); *see also DL Capital Group v. NASDAQ Stock Mkt.*, 409 F.3d 93 (2d Cir. 2005); *Sparta Surgical Corp. v. NASD*, 159 F.3d

> 'This inconsistency has created a need for greater enlightenment from the Supreme Court on whether the SROs are indeed private organizations capable of compelling witnesses to waive their Fifth Amendment privilege against self-incrimination and disciplining their membership without due process, whether they are quasi-governmental entities which are absolutely immune from lawsuits when acting in their regulatory capacity under the Exchange Act, or whether they are both.'

William I. Friedman, *The Fourteenth Amendment's Public/Private Distinction Among Securities Regulators in the U.S. Marketplace – Revisited*, 23 Ann. Rev. Banking & Fin. L. 727, 767 (2004).

II. This Court's Review Is Needed to Clarify the Scope of Absolute Immunity for Nongovernmental Actors

More than an inconsistency in lower-court precedents is at stake here, for the opinion below directly conflicts with what this Court has held regarding the availability of immunity to the NYSE itself in *Silver*, 373 U.S. 341, with what it has said, more generally, about the availability of immunity to private actors performing public functions, *see Richardson*, 521 U.S. 399, and with its holdings that absolute immunity should be strictly limited to "those exceptional situations where it is demonstrated that absolute immunity is essential to the conduct of the public business." *Butz*, 438 U.S. at 507.

1209, 1213 (9th Cir. 1998); *Austin Mun. Sec., Inc. v. NASD, Inc.*, 757 F.2d 676, 689-90 (5th Cir. 1985).

A. Conflict with *Silver v. NYSE*

In *Silver*, 373 U.S. 341, this Court flatly rejected the NYSE's contention that it was impliedly immune to liability when sued under the antitrust laws by a nonmember broker-dealer who contended that the NYSE and its members had unlawfully acted in restraint of trade by terminating the broker-dealer's access to current quotations without "giving the nonmember notice, assigning him any reason for the action, or affording him an opportunity to be heard." *Id.* at 342-43.

The question presented was "the extent to which the character and objectives of the duty of exchange self-regulation contemplated by the Securities Exchange Act are incompatible with the maintenance of an antitrust action" by one denied any notice or opportunity to be heard before being ruled unfit to do business with the NYSE's members. *Id.* at 358. This Court held that the NYSE *could be liable* to the broker-dealer for exercising its self-regulatory powers in an arbitrary and unlawful fashion.

The Court acknowledged "that particular instances of exchange self-regulation which fall within the scope and purposes of the Securities Exchange Act may be regarded as justified in answer to the assertion of an antitrust claim." *Id.*, at 361. "The final question," however, was "whether the act of self-regulation in this case was so justified." *Id.* This Court held it was not, because the NYSE had exercised its self-regulatory authority arbitrarily: "Notwithstanding their prompt and repeated requests, petitioners were not informed of the charges underlying the decision to invoke the Exchange rules and were not afforded an appropriate opportunity to explain or refute the charges against them." *Id.*

This Court held that "no justification can be offered for self-regulation conducted without provision for some method of telling a protesting nonmember why a rule is being invoked so as to harm him and allowing him to reply in explanation of his position." *Id.*

> Indeed, the aims of the statutory scheme of self-policing – to protect investors and promote fair dealing – are defeated when an exchange exercises its tremendous economic power without explaining its basis for acting, for the absence of an obligation to give some form of notice and, if timely requested, a hearing creates a great danger of perpetration of injury that will damage public confidence in the exchanges.[12]

The NYSE objected that "disclosure of the reasons for its action and of the sources of its information will subject it and its informants to a risk of being sued for defamation." *Id.* n.14. This Court found any such risk was adequately met not by any sweeping doctrine of absolute immunity, but "by the flexibility inherent in the law of defamation in the concept of the conditional or qualified privilege." *Id.* (citing 1 Harper & James, *The Law of Torts* §§5.21, 5.25, 5.26 (1956)).

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[12] *Id.* The Court added:

> In addition to the general impetus to refrain from making unsupportable accusations that is present when it is required that the basis of charges be laid bare, the explanation or rebuttal offered by the nonmember will in many instances dissipate the force of the *ex parte* information upon which an exchange proposes to act. The duty to explain and afford an opportunity to answer will, therefore, be of extremely beneficial effect in keeping exchange action from straying into areas wholly foreign to the purposes of the Securities Exchange Act.

Id. at 362.

Summing up, this Court held that "Congress in effecting a scheme of self-regulation designed to insure fair dealing cannot be thought to have sanctioned and protected self-regulative activity when carried out in a fundamentally unfair manner." *Silver*, 373 U.S. at 364.

Thus, this Court has clearly held that the NYSE may be liable for misconduct in connection with the execution of its self-regulatory functions. Conflict between *Silver* and the lower court's creation of a sweeping doctrine of absolute immunity warrants this Court's review.

B. Conflict with *Richardson v. McKnight*

The Second Circuit has ruled that, as a nongovernmental private entity to which some quasi-governmental functions have been delegated, the NYSE must be entitled to the same broad governmental immunity that would be accorded a genuine government actor. Yet this Court rejected precisely that viewpoint, holding in *Richardson,* 521 U.S. 399, that even if prison officials ordinarily are entitled to qualified immunity as government actors, *see Procunier v. Navarette*, 434 U.S. 555 (1978), when the manifestly public function of operating prisons is delegated to private companies, the immunity vanishes. *Richardson*, 521 U.S. at 401. Lower courts have similarly held, in other contexts, that immunity does not attach to private companies merely because they are performing functions to which immunity attaches when performed by governmental agencies or their employees.[13]

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[13] *See, e.g., Ace Bev. Co. v. Lockheed Info. Mgmt. Servs.*, 144 F.3d 1218, 1219-20 (9th Cir. 1998) (no qualified immunity for

This Court was urged in *Richardson* to apply a "functional" approach to determine that a private entity performing delegated governmental functions should be entitled to the same immunity as governmental functionaries engaged in similar activities. That is exactly the approach embraced by the Second Circuit in this case, when it held that "we focus on 'the nature of the function performed, not the identity of the actor who performed it,' in order to determine whether an SRO, such as the Exchange, is entitled to immunity." Pet. App. 14a (quoting *Forrester*, 484 U.S. at 229, and following *D'Alessio*, 258 F.3d at 104-06).

But to embrace such an approach, this Court held in *Richardson*, is "to misread this Court's precedents." 521 U.S. at 408. "The Court has sometimes applied a functional approach in immunity cases, but only to decide which type of immunity – absolute or qualified – a public officer should receive." *Id.* at 408 (citing, *e.g.*, *Forrester*). That does not mean such a functional analysis applies where the party who claims immunity is *not* a public official. *Id.* "Indeed a purely functional approach bristles with difficulty, particularly since, in many areas, government and private industry may engage in fundamentally similar activities, ranging from electricity production, to waste disposal, to even mail delivery." *Id.* at 409.

This Court explained in *Richardson* that the need for governmental immunities is greatly reduced when

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Lockheed in connection with its enforcement of parking regulations); *Hepting v. AT&T Corp.*, 439 F.Supp 2d 974, 1006-10 (N.D. Cal. 2006) (Hon. Vaughn R. Walker, district judge) (no qualified immunity for AT&T in connection with its surveillance of customer communications on behalf of the government), *appeal pending* 9th Cir. Nos. 06-17132, 06-17137.

public functions are delegated to private companies competing in the marketplace, where they are "subject to the ordinary competitive pressures that normally help private firms adjust their behavior in response to the incentives that tort suits provide – pressures not necessarily present in government departments." *Richardson*, 521 U.S. at 409, 412. The NYSE is such an entity operating in the marketplace and subject to ordinary competitive pressures. Though nominally a non-profit corporation during the Class Period, it was planning to reorganize and operate as a for-profit company, and was in effect really operating as a private enterprise for the benefit of its members and officers.

It currently is a for-profit company competing with other organizations – such as the American Stock Exchange and NASDAQ – to provide a market for securities. The NYSE is, indeed, one of ten securities exchanges registered with the SEC as national securities exchanges.[14] Its major competitor, The Nasdaq Stock Market LLC is a publicly traded for-profit company whose stock trades under the ticker symbol NDAQ. Since 1998, moreover, the registered exchanges' competitors have included Alternative Trading Systems and Electronic Communications Networks, or ECNs, as defined in Rule 600(b)(23) of Regulation NMS, that operate as electronic trading systems automatically matching buy and sell

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[14] They are: American Stock Exchange; Boston Stock Exchange; Chicago Board Options Exchange; Chicago Stock Exchange, International Securities Exchange; National Stock Exchange (formerly the Cincinnati Stock Exchange), The Nasdaq Stock Market LLC; New York Stock Exchange; NYSE Arca (formerly the Pacific Exchange); and Philadelphia Stock Exchange. *See* http://www.sec.gov/ answers/exchanges.htm.

orders.[15] Examples include Instinet, a wholly owned subsidiary of Nomura Holdings, Inc. Competition is so stiff, according to the financial press, that the American Stock Exchange, which has been struggling to compete with upstart electronic exchanges, now is in merger negotiations with the NYSE Euronext (NYX), the NYSE's parent holding company.[16]

Thus, the very sort of competitive market forces cited in *Richardson* are present here and weigh against immunity of any kind – particularly given the Second Circuit's rationale of affording absolute immunity "so that SROs will not be excessively timid in their regulatory decisions." Pet. App. 17a. In *Richardson*, this Court held that this rationale overlooks "certain important differences that, from an immunity perspective, are critical." 521 U.S. at 409.

> First, the most important special government immunity-producing concern – unwarranted timidity – is less likely present, or at least is not special, when a private company subject to competitive market pressures operates a prison. Competitive pressures mean not only that a firm whose guards are too aggressive will face damages that raise costs, thereby threatening its replacement, but also that a firm whose guards are too timid will face threats of replacement by other firms with records that demonstrate their ability to do both a safer and more effective job.

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[15] *See* http://www.see.gov.divisions/marketreg/mrcen.shtml; Exchange Act Rel. No. 37619A, http://www.sec.gov/rules/final/37619a.txt; Exchange Act Rel. No. 51808, http://www.sec.gov/rules/final/34-51808.pdf.

[16] *See* Steven M. Sears, *What Amex Brings to NYSE*, Barron's January 14, 2008, http://online.barrons.com/article/SB120009540845484983.html.

Richardson, 521 U.S. at 409. "In other words, marketplace pressures provide the private firm with strong incentives to avoid overly timid, insufficiently vigorous, unduly fearful, or 'nonarduous' employee job performance." *Id.* at 410.

Addressing the availability of either qualified or absolute immunity, moreover, this Court first has "generally looked for a historical or common-law basis for the immunity in question." *Mitchell v. Forsyth*, 472 U.S. 511, 521 (1985). "History," it found in *Richardson*, "does *not* reveal a 'firmly rooted' tradition of immunity applicable to privately employed prison guards." 521 U.S. at 404 (Court's emphasis). For reported nineteenth century precedents included suits against privately operated prisons, with "no evidence that the law gave purely private companies or their employees any special immunity from such suits." *Id.* at 406.

Much the same may be said of securities or commodities exchanges, which often were subjects of a suit in connection with the operation of their markets and the regulation of members. Even those whom the exchanges regulated could file suit and recover damages for arbitrary or improper self-regulatory actions.[17] When suits against commodities exchanges or stock exchanges were dismissed, it was on their merits, not because the exchange enjoyed any immu

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[17] *See, e.g.*, *Fisher v. Board of Trade*, 80 Ill. 85, 86-87 (1875) (denying equitable relief to trader expelled by Board of Trade but upholding an award of damages "assessed, under the proofs heard on that question, at five hundred dollars"; "We perceive no error in assessing damages. The proof sustains the amount found as damages.").

nity from suit, whether qualified or absolute.[18] Many decisions denied equitable relief, to be sure, but typically on the ground that adequate relief was available at law.[19]

The conflict of the rationales offered below for the Second Circuit's doctrine of absolute immunity with the contrary analysis of *Richardson*, warrants this Court's review.

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[18] *See, e.g., Ulery v. Chicago Live Stock Exchange*, 54 Ill. App. 233, 238-39 (1894) (suit by livestock broker against Live Stock Exchange that directed its members not to transact business with him dismissed because no libel was shown). In *Cohen v. Thomas,* 209 N.Y. 407, 103 N.E. 708 (N.Y. 1913), a broker filed suit seeking reinstatement as a member of the NYSE after being expelled for making a material misstatement when applying for membership. New York's highest court held that the lower court properly entertained and resolved the suit in the NYSE's favor, explaining that an Exchange's disciplinary ruling shall be upheld "unless it is made to appear that the proceedings were contrary to natural justice, or that the decision was not come to in good faith." 209 N.Y. at 410. "Associations, such as the New York Stock Exchange, which exist by virtue of the compact of its members and not by any force of statutory incorporation, will be left for their internal governance to the regulations agreed upon and those will be allowed effect, so far as they do not violate any rules of law, or of natural justice." 209 N.Y. at 411. "That the proceedings were in accordance with the constitution and that the Committee acted in good faith, without prejudice, or ill will, the court has, expressly, found." *Id.*

[19] *Baxter v. Board of Trade*, 83 Ill. 146, 148 (1876) (following *Fisher*: "If appellant has any remedy in the courts for his supposed illegal expulsion from the board of trade, his remedy is at law and not in equity by injunction."); *Sturges v. Board of Trade*, 86 Ill. 441, 442 (1877) (holding that under *Baxter*, 83 Ill. 146, "even if a member may resort to the courts for a remedy in such cases, he must go to a court of law").

C. Conflict with *Butz v. Economou* and Its Progeny

Under this Court's precedents the availability of *absolute* immunity is even more narrowly constrained than is the mere *qualified immunity* with which *Richardson* dealt. This Court has denied absolute immunity even to top Presidential aides and cabinet members. *Harlow v. Fitzgerald*, 457 U.S. 800, 807 (1982). It holds that the Attorney General of the United States is not "absolutely immune from suit for actions undertaken in the interest of national security." *Mitchell*, 472 U.S. at 513.

For absolute immunity, this Court has repeatedly emphasized, must be limited "to those exceptional situations where it is demonstrated that absolute immunity is essential for the conduct of the public business." *Butz*, 438 U.S. at 507; *see, e.g.*, *Cleavinger v. Saxner*, 474 U.S. 193, 201 (1985) (quoting *Butz*). It is doubtful, however, that immunity for an SRO that abandons its regulatory functions and joins in a scheme to defraud investors, is "essential for the conduct of the public business." *Butz*, 438 U.S. at 507.

The fact that the NYSE is supposed to exercise extensive enforcement responsibilities does not mean that it must be absolutely immune for actions in derogation of those responsibilities – even if it sometimes plays a quasi-prosecutorial or adjudicative role.

With the principle of "judicial immunity firmly established, the Court has extended absolute immunity to certain others who perform functions closely associated with the judicial process." *Cleavinger*, 474 U.S. at 200. Thus, the Court accorded absolute immunity to a federal hearing examiner and administrative law judge in *Butz*, 438 U.S. 478, choosing absolute over qualified immunity for these public officials, because

"the role of the modern federal hearing examiner or administrative law judge . . . is 'functionally comparable' to that of a judge." *Id.* at 513. But this has never meant that all public officials performing some prosecutorial or adjudicatory role are entitled to absolute immunity, let alone that private entities must be.

This Court has, indeed, repeatedly rejected contentions that even public officials performing quasi-prosecutorial or adjudicatory functions are necessarily entitled to absolute immunity. In *Wood v. Strickland*, 420 U.S. 308 (1975), for example, school-board members functioned as "adjudicators in the school disciplinary process," and were to "judge whether there have been violations of school regulations and, if so, the appropriate sanctions for the violations." *Id.*, at 319. This adjudicative function did not entitle board members to absolute immunity. *See id.*

Similarly, in *Cleavinger*, 474 U.S. 193, this Court held that members of a federal prison's Institution Discipline Committee were not entitled to absolute immunity for their actions in proceedings disciplining prison inmates for alleged infractions of prison rules and regulations. Members of the Disciplinary Committee urged "that the Court's cases teach that absolute immunity shields an official if (a) the official performs an adjudicatory function comparable to that of a judge, (b) the function is of sufficient public importance, and (c) the proper performance of that function would be subverted if the officials were subject to individual suit for damages." *Id.* at 202-03. This Court acknowledged that "[t]he committee members, in a sense, do perform an adjudicatory function in that they determine whether the accused inmate is

guilty or innocent of the charge leveled against him; in that they hear testimony and receive documentary evidence; in that they evaluate credibility and weigh evidence; and in that they render a decision." *Id.* at 203. Yet they were not therefore entitled to absolute immunity.

In the past, even the Second Circuit specified that the NYSE may assert absolute immunity *only* for actions undertaken "*when acting in its capacity as a SRO*," and *only* to the extent that it "*engages in conduct consistent with the quasi-governmental powers delegated to it* pursuant to the Exchange Act and the regulations and rules promulgated thereunder." *D'Alessio*, 258 F.3d at 106 (emphasis added). Yet, the Second Circuit in this case ruled that the NYSE is absolutely immune from suit even when it effectively *abandons* its regulatory functions in order to facilitate fraud.

The fact that the SEC had to intervene to enforce the law – upbraiding the NYSE for *failure to act as a regulator* – suggests that the NYSE was *not* in fact "acting in its capacity as a SRO," *D'Alessio*, 258 F.3d at 106, but was instead abandoning its legitimate functions. Indeed, the SEC cited the NYSE for ignoring its Exchange Act responsibilities by systematically "failing to enforce compliance with the federal securities laws and NYSE rules." Pet. App. 140a, 142a-143a. Fostering a dishonest market in this fashion is by no means conduct consistent with the NYSE's delegated powers, *D'Alessio*, 258 F.3d at 106, let alone "essential for the conduct of the public business." *Butz*, 438 U.S. at 507.

Other decisions recognizing *absolute immunity* for an SRO generally accord its protection only to those who are *actually performing an adjudicative or prose-*

cutorial function, or acting in a law-making (or rule-making) quasi-legislative capacity.[20] Those cases involved assertions *by regulated parties* that the NYSE was liable to them for how it had conducted itself as a prosecutor or judge. In *DL Capital*, moreover, the Second Circuit ruled that *investors* may not sue the NASDAQ *for an exercise of regulatory authority* on the theory that it should have announced the cancellation of trades with greater speed.

If absolute immunity applies to protect the *exercise of prosecutorial, adjudicative and legislative functions*, its rationale ought not reach situations where, as here, the SRO has effectively *abandoned* its regulatory function – requiring the SEC to step in and discipline Specialist Firms who had been given free rein by the Exchange to cheat investors.

Engaging in fraud, obstructing justice, and facilitating deception and violation of our nation's securities laws, rules and regulations, is conduct by no means "consistent with the quasi-governmental powers delegated" by law to the NYSE. *Id.* It is conduct directly *contrary* to and entirely beyond the quasi-governmental power delegated to the NYSE, and

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[20] *See DL Capital*, 409 F.3d 93 (immunity for applying its rules and regulations); *D'Alessio*, 258 F.2d at 97-98 (SRO faced no liability to disciplined stockbroker because it had "acted in its adjudicatory capacity when it determined that D'Alessio was guilty of violating [Exchange Act] section 11(a) and various rules of the NYSE and suspended him from further trading on the NYSE floor"); *Barbara,* 99 F.3d 49, (action by disciplined stockbroker barred); *Austin*, 757 F.2d at 688 (noting that absolute immunity is limited to "judges, . . . prosecutors, . . . legislators, . . . and legislative aides acting in their legislative capacity"); *see also Butz*, 438 U.S. at 511-17 (affording absolute immunity to administrative-law judges and prosecutors).

protecting it is contrary to the Exchange Act's fundamental purpose – of ensuring that investors may trade in an honest market. *See, e.g.*, *Basic Inc. v. Levinson*, 485 U.S. 224, 230, 245-47 (1988).

The Second Circuit's radical expansion of absolute immunity in this case warrants this Court's attention, where the NYSE was clearly not discharging its duties under the Exchange Act by engaging in fraud, obstructing justice, and facilitating deception and violation of our nation's securities laws, rules, and regulations.

CONCLUSION

For all the foregoing reasons, a writ should issue to review the decision below.

Respectfully submitted,

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