Comments of Michael Walsh
Re: NYSE Proposed Rule Change on Fine Income
File No. SR-NYSE-2016-37

The New York Stock Exchange ("NYSE" or "Exchange") has petitioned the Securities and Exchange Commission ("Commission" or "SEC") for permission to change its rules. Following the lapse of a delegation agreement, which temporarily separated the Exchange's regulatory functions from its market participant functions, the Exchange now wishes to streamline its rules. The Announcement of the proposed rule change was published for comment in the Federal Register on May 31, 2016. 81 F.R. 34393. I write to comment in opposition to the rule change, asserting both procedural and substantive objections.

1- Rule Text

The NYSE's proposed submission is deficient because it does not show what the rule change accomplishes. It is common in legal circles when drafting documents to "redline" them, to allow the reader to see and understand the actual changes being made. The NYSE submission contains no redlining. It does not even contain the legally operative text of the rules, either what was or what will be. Essentially the submission comments on what the rule does now and why the regulated entity would like to be free from the rule, but the submission asks that the reader simply trust the author that the text will do what it says.

The Submission, in an attempt to avoid this deficiency, incorporates by reference rules that are physically available at the SEC's Office and at the Exchange's office. Although I live outside of Boston, it would be impracticable and inconvenient to get to either Washington D.C. or New York, and if I find it hard, someone living in Chicago or L.A. must be impossibly shutout from participating in the process. As a saving grace the submission notes that the rules are available upon the NYSE website. As a sophisticated consumer of rule and law, in my capacity as a litigator, I could not find either the actual text of the "Fine Income Procedures" or Section 4.05. I made great search of both the SEC's various webpages and the complex maze of the NYSE website, to no avail.

I believe that this failure to make the text of the rules to be changed and the proposed changes to be highly problematic. Leaving aside hundreds of years of arguments about positivist legal norms, the definite and authoritative nature of rules approved through the Federal Register notice-and-comment process is that the rules are made in full view of the public. The NYSE submission does not quote or "redline" the relevant operative text, but has the gaul to argue that the unverifiable text is redundant. The entire process boils down to "trust us" which is not sufficient for an industry given special liberty to self-regulate.

2- Other SROs

One of the NYSE's arguments in favor of this rule change is that other Exchanges have similar protections to the scaled back model that the NYSE wishes to move to. Specifically, the NYSE cites to the Boston Stock Exchange, the Boston Options Market, and others. This is a great argument for anyone but the NYSE.

Although the argument is more developed that a five year-old's "but all my friends do it," the argument is of a type that the Courts have rejected time and again. It is why selective prosecution defenses are so rarely successful. It also is a logical fallacy known as *argumentum ad populum*, which expresses the incorrect belief that truth or validity emerge from group consensus or mainstream conduct.

There are also significant objective reasons to single the NYSE out for different treatment than all the rest of the Exchanges, even if the NYSE's factual assertions are true. The NYSE is a world leader. It is the biggest stock exchange in the world. If the NYSE's own claims are to be believed, it accounts for $25,000,000,000,000 (Twenty-five Trillion) of economic worth. Indeed, the physical location of the Exchange, Wall Street, is used as a short-hand for the entire economic and financial might of the American populace. The NYSE is also the first intercontinental exchange and far and away the biggest exchange, dwarfing all its competitors.

The fact that much smaller exchanges get away with less rules and less regulation only supports the fact that less is at stake. What the NYSE submission presents is an industry leader, held to a higher standard, seeking permission to sink to its industry's lowest common denominator. In contrast, the NYSE should be innovating and leading the way for exchanges world-wide, rather than claiming the right to dispense with protective regulations. If anything, the NYSE should be the model other look to, rather than it looking at other models.

This argument, coming from the NYSE, is offensive and, when phrased in the form of such an obvious logical fallacy, denotes sloppy lawyering.

3- Faulty Major Premise

The biggest guns in the asservational array assembled by the Exchange in support of the rules change is a breathtaking argument about the purpose of putting limits on the regulatory income. The NYSE asserts:

> Simply put, usage limitations on fine income do not provide oversight of regulatory performance. They just monitor how the resulting income is spent.

This argument is true, as far as it goes, but it misses the point. The stock exchange is an oddity in the entire patchwork of different American regulatory regimes. Subject to the general supervision of the SEC, stock exchanges are industry participants who self-regulate to avoid the imposition of burdensome, sluggish, and policy-based interference by the government with the market workings. Self-regulating Organizations ("SRO") are a concept that must be explained in detail to thousands of law students across the nation who struggle to understand the initially counter-intuitive concept of businesses acting against their own economic interest to punish and police themselves. In other classes, such as administrative law and constitutional law, these same law students learn about the requirements of impartial decision-makers and hearing officers, who must be disinterested and have no stake in their own decision. In classes like Trust and Estates and Corporate Taxation those same law students learn about the presumptions against self-dealing and the requirements of legitimate arms-length transactions. Students have no trouble with those concepts because of a societal wide consensus that people act in their own interest, and that a fair decision cannot be made when the arbiter has a stake in the proceedings. So law professors must explain about the demands of the market for agility and resistance to government interventions. The law professors explain a compromise that the SROs could police the market under SEC supervision, but they also explain the menace that keeps SROs honest—that someday the government will step in to regulate when the SROs lose public confidence. This legislative compromise, reached in the aftermath of the Great Depression of the 1930's, forces the SROs in a hybrid role.

The NYSE submission shows a shocking ignorance of their perilous position. An increasing number of Americans no longer trust that unfettered capitalism works properly, or in their interest.

- An August 2015 poll question by the Pew Research Center asked respondents which statement was more true—"Wall Street helps the American economy more than it hurts. OR. Wall Street hurts the American economy more than it helps" 45% said Wall Street helps, 42% said Wall Street hurts, and 13% weren't sure or didn't answer.
- A series of Government polls ("primary elections") have generated significant support for a self-admitted socialist presidential candidate. The socialist candidate has amassed 9,957,889 votes as of Noon on June 7, 2016, according to Real Clear Politics. This candidate's entire position is aimed at attacking the economic engine that Wall Street represents, from promising to break up the banks to attacking the disproportionate influence that economic interests have in political decisions.
- A study of popular discontentment with the recent economic crash was conducted, through a fundraising entertainment ("The Big Short") and Americans voted with their wallet giving the fundraiser $133,346,506. The industry experts also awarded the fundraising entertainment a recognition of its excellent manufacture, in the form of a Academy Award.

These represent only a small portion of significant evidence mounting of popular discontentment with business interests. Part of the problem is that the regulation of the economy lacks traditional and trusted guarantees of fairness. After all, how can you trust a business to make uneconomic decisions against its own self-interest in that name of some abstract governmental principle, particularly when there is no consequence for making the wrong decisions, as the business polices itself?

Consider a conceptually related campaign against civil forfeiture by the police. Libertarian and civil rights groups have been, for at least a year and half, waging a public campaign against the ability of the police to civilly seize assets. The media has been rife with stories about various police agencies abusing the seizure powers given to them in the name of the public good. The parallels to Wall Street self-regulation are uncanny. Not that he's any great scholarly authority, but consider Mr. John Oliver's review of the forfeiture issue. He notes that if the seizure power is abused, you cannot effectively report it, because the abuser is the enforcement authority. He notes the conflict of interest inherent in the situation. Mr. Oliver highlighted one police chief who admitted that there were no limitations on their power to seize and that they did so according to their need, not according to the guilt of the parties being seized from. He summarizes arguments against forfeiture generally, noting claims that forfeiture is merely "legalized robbery." He notes the inequality of behavior that is illegal when done by one party but not another. Most persuasively, Mr. Oliver highlights some flagrant abuses of the forfeiture power, such as police agencies buying margarita machines and Zamboni machines.

The rule at issue in the NYSE submission is the equivalent anti-zamboni rule. While it is true that "usage limitations on fine income do not provide oversight of regulatory performance" that is irrelevant. The rules on Fine Income are about legitimacy of the Exchange as a self-regulator. Though it technically is a logical fallacy, Mr. Oliver's point about margarita machines is simply the assertion that the process is not merely susceptible to abuse but is illegitimate because it lacks credibility.

The Fine Income rules are important because they provide an objectively justifiable arms-length limitation to separate business from regulation. The rules also take away any economic incentive for the regulators, making them much more in line with trusted norms about decision-makers and hearing officers without a stake in the proceedings. To the extent that support of Senator Sanders think the economy is rigged against them, the Fine Income Rules provide a tangible separation between the enforcement authorities and those who play the game.

Blithely rolling up rules in place to ensure credibility, rules put in place after the market crash put the regulators credibility in question, is both ironic and idiotic. How easy would it be for some discontented individual to run up and down the halls of government complaining that Wall Street has a tame set of regulators who operate under tough rules when the scrutiny is on, but once the market is recovered and the money is flowing again the tough rules vanish into the night?

4- Faulty Minor Premise

One of the other arguments that the NYSE advances in favor of the rules change is that the disciplinary process provides a sufficient safeguard. The NYSE in particular relies on the appellate opportunities that the disciplinary process provides. I leave to one side whether this is the same discipline process that was in place before the 2008 market crash, in which case it is plainly insufficient.

The disciplinary process is an adversarial system in which a business who the NYSE regulators have decided to fine, may choose to appeal to a hearing officer. This is a familiar assumption as one underlying the Court system, under which each party must bring all their best arguments and through the crucible of adversarial testing, truth will emerge.

This argument is improvident for several reasons. In the first place the fundamental assumptions underlying self-regulation contradict any confidence that can be placed on an adversarial system. It is also unfair to place the risk of regulator misbehavior upon the parties, leaving the rule change nothing more than an economic powergrab by the NYSE.

This argument also fails to understand the importance of the rule. The fine income limitation rule regulates the behavior of the regulators. It answers the question "who watches the watchers?" It is practically impossible to guarantee good regulator behavior because inherent in the regulation function is discretion that can be abused. However, through checks and balances it is possible to create institutional and systemic rules that minimize the possibility of regulator misbehavior. That is what the fine income procedure does. It is counter-productive to rely on the regulated to police regulator misbehavior, because it is against the economic interest of the regulated party who does not want to earn the animus of the regulator. This kind of phenomenon is almost guaranteed to create regulatory capture, and lead to a cozy relationship between regulator and regulated, the likes of which undermine the entire foundation of the self-regulation scheme.

The argument that regulator misbehavior can be challenged in the regulated party's own hearing invites retaliation by regulators against any who would challenge them or try and keep them honest. It not merely makes the regulators impervious to review, it grants them the power to control review of themselves. If carried to its logical extension it would create a class of super-business, who would reign supreme vested with governmental-backed regulatory powers to ensure their own business triumph over their competitors. The possibility is made all the more sinister for the NYSE's vague and ominous declaration that all burdens being placed on competitors is "necessary or appropriate." Then as if to complete a bad joke the NYSE goes on to assert that the rules change relate only to the internal operation of the exchange. That argument has no force whatsoever in a self-regulatory scheme.

All of these concerns are of course high-level abstractions which say nothing of the difficulties that the regulated entities would have discovering regulator misconduct or enforcing rules against the regulators.

5- The Specific Over the General

Another of the arguments that the Exchange floats in support of its rule change is the idea that Section 4.05 is a broader mandate that will perform all the same functions. The idea that Section 4.05 renders the Fine Income Procedures redundant or superfluous is one that I have been unable to verify for myself (see part 1). Nonetheless, I will presently assume a certain redundancy.

It is a fundamental rule of statutory construction that the specific provision prevails over the general. There are hundreds of court cases that have found reasons to carve out implied or inferred exceptions to general grants of power or general prohibitions. Imagine the future circumstance wherein Section 4.05 is asserted to cover conduct now prohibited by the Fine Income Procedures. The defense will argue that the more vague reach of Section 4.05 does not cover the conduct, because at the time of enactment the Fine Income Procedures would have regulated it. The drafters of Section 4.05 would have known that. Therefore when the Fine Income Procedure was the exclusive regulation on the topic and its repeal authorized the conduct.

Or less far-fetched, the simple application of statutory construction principles show that the specific prevails over the general, making the Fine Income Procedures superior to Section 4.05, within their bailiwick. It is not like having two overlapping provisions will cost the NYSE barrels and barrels of ink to print and reprint in the modern world, but the reverse is that questions of what is now prohibited and what isn't may arise if the Fine Income Procedures are repealed.

6- Change in Circumstances

The NYSE also notes that a change in circumstances has occurred that should prevent the reoccurrence of the situation leading to the original enactment of the Fine Income Procedures. The cynical observer would note that the only important change that has occurred is in the oriented direction of the market (up rather than down). Although I understand, clearly, the explanation that the arms-length subsidiary exercised regulatory power for a period of time, the argument does not explain what circumstances occurred that will not occur again. Nor does it explain what the guarantees of lack of reoccurrence are.

Summary

I find the NYSE's draft to be ill considered. I find their lawyering sloppy. I find their lack of redlining to be suspicious. I also believe that that spend an awful lot of time and ink to explain something that they argue to be both inconsequential and trivial. In sum, I urge the Securities and Exchange Commission to disapprove of the rule change in its current form.

Sincerely,

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