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# High-Frequency Trading Leads to Lawsuit Against Exchanges

## Suit Seeks Class-Action Status; a Test of Exchanges' Legal Immunity

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By **SCOTT PATTERSON** [CONNECT](#)

Updated Sept. 8, 2014 2:54 p.m. ET



The complaint frequently cites Haim Bodek, a former trader who has told the SEC of alleged abuses. *Jesse Neider for The Wall Street Journal*

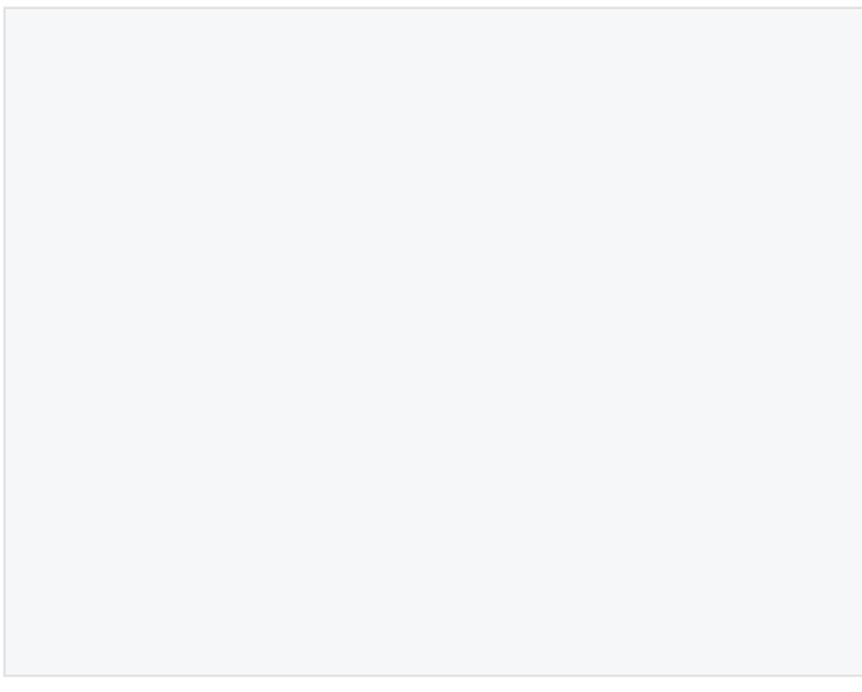
WASHINGTON—Three big law firms have joined forces to pursue legal action against major U.S. stock exchanges, claiming the exchanges handed unfair advantages to high-frequency traders to the detriment of regular investors.

The lawsuit, filed in the U.S. District Court of the Southern District of New York, could test a cornerstone of U.S. securities law: exchanges' immunity from lawsuits seeking damages.

The firms leading the case, Robbins Geller Rudman & Dowd LLP, Motley Rice and Labaton Sucharow LLP, are seeking class-action status for their suit. They allege in a 136-page complaint that the biggest stock exchanges gave preferential treatment to certain customers, costing regular investors, such as public pension funds, billions of dollars.

Plaintiffs include the City of Providence, Rhode Island, and the State-Boston Retirement System.

The complaint, filed Sept. 2, alleges stock exchanges provided high-frequency firms "enhanced trading information at faster speeds" than other investors received. The exchanges also crafted "complex order types" that gave sophisticated traders advantages, such as the ability to trade in front of other investors to get a better price.



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The judge overseeing the case hasn't ruled on whether to grant the lawsuit class-action status. Defendants named in the lawsuit include U.S. exchange operators BATS Global Markets Inc., the [Nasdaq Stock Market](#), NDAQ +0.76% the Chicago Stock Exchange and the New York Stock Exchange. The lawsuit also names [Barclays](#) BARC.LN +0.11% PLC, which isn't an exchange but operates a private trading venue called a dark pool that is the target of a civil lawsuit by the New York Attorney General's office.

The lawsuit could face stiff challenges in court, legal experts say. The plaintiffs need to demonstrate clear and specific damages, a hurdle that could prove to be extremely difficult, since the allegations often involve opaque and superfast shifts in market prices. "Explaining how to allocate the damages [in this case] could prove to be impossible," said John Coffee, a securities-law professor at Columbia University.

Spokesmen for BATS, Nasdaq, the Chicago Stock Exchange, NYSE and Barclays declined to comment. In response to the New York allegations, Barclays said the attorney general used certain facts and documents, such as emails, out of context.

The complaint frequently cites former high-frequency trader Haim Bodek, who made [allegations about order-type abuses](#) at exchanges to the Securities and Exchange Commission in 2011. Mr. Bodek, who declined to comment, was the subject of a September 2012 Wall Street Journal article that described how he came to believe stock exchanges were giving high-speed traders advantages with certain complex order types.

The Wall Street Journal reported in August that BATS is in [advanced talks](#) with regulators to settle allegations that its Direct Edge exchanges gave unfair advantages, including access to certain order types, to high-speed traders, citing people close to the negotiations.

The toughest challenge the lawsuit is likely to face is a special regulatory status exchanges enjoy that shields them from certain legal challenges.

Stock exchanges for years have been responsible for policing the trading they host, a system known as self-regulation. As self-regulators, exchanges are protected from liability for damages that clients might suffer as a result of the exchanges' actions. U.S. courts have found that exchanges, as self-regulators, should get the same immunity the SEC has as a government regulator.

But as competition among exchanges and other trading platforms has ramped up, critics say exchanges, focused on boosting their bottom lines, have fallen short of their regulatory responsibilities. SEC Chairman [Mary Jo White](#), in a speech in Washington last October, said exchanges' self-regulatory functions have "encountered challenges" and that the "current nature of exchange competition and the self-regulatory model should be fully evaluated in light of the evolving market structure."

The suit is an expanded version of a complaint filed earlier this year, which also named a number of banks and high-frequency traders. The updated lawsuit doesn't target any high-speed firms.

In the new complaint, the law firms argue that exchanges, as for-profit entities, shouldn't enjoy the same protections they did before becoming publicly traded.

Exchanges' "sale of advanced access to market data has nothing to do with their former roles as market regulators and everything to do with their private business interest," the complaint says.

Legal experts expect the exchanges to ask the judge in the case to dismiss the suit, citing their immunity, among other factors.

High-speed trading has come under scrutiny from federal and state regulators, who are looking into whether the firms operate in ways that take advantage of less-sophisticated investors or that can destabilize markets. Such trading has also come under attack in several other lawsuits.

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One suit filed in the U.S. Southern District led by law firms Richardson Patrick Westbrook & Brickman LLC and Keller Rohrback LLP against several exchanges alleges that the exchanges, in providing turbocharged data feeds to certain trading firms, violated contracts with other clients to provide market information "in a nondiscriminatory manner."

Another lawsuit against Chicago futures exchange [CME Group Inc.](#) CME +0.45% alleges that it "engaged in agreements with certain high-frequency trading firms to erode the integrity of the marketplace and manipulate prices." The exchange declined to comment.

The complaint, citing a May 2013 article by The Wall Street Journal, alleges that the CME gave high-speed traders the ability to [access and trade](#) on certain market data before other investors could see the data. The CME, which has said it is working to fix the trading issue, is expected to file a motion to dismiss the case on Friday.

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Jeremy Bethel



The problem with this case is the long standing precedent of immunity for the exchanges. Granted, the article makes a great point, can they be considered quasi-regulators/ public entities anymore? With the various options for listing and global market alternatives its no longer a one stop shop for these exchanges. These environments and the presence of shareholders introduce the incentive to monetize other facets of the exchanges i.e., showing favor to HFTs.

While I think something needs to be done to control HFT's (it is obviously an unfair advantage) I don't think the federal courts are the place to do it. Without precedent and in the face of Congressional delegation to the Executive its just not the Court's role, its the SEC's.

7 days ago



Brian Roberts



There is actually merit to this case. The "efficient markets" hooah is a bunch of baloney, yet all these trading firms pretend as though it's the case.

Hopefully these crooked firms get nailed to the wall. This isn't a case of suing just to sue, though we all know the motive for the law firms is pure profit and not some restoration of market integrity.

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