



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90987; File No. SR-BOX-2020-16]

Self-Regulatory Organizations; BOX Exchange LLC; Order Disapproving Proposed Rule Change, as Modified by Amendment No. 1, in Connection with the Proposed Establishment of the Boston Security Token Exchange LLC as a Facility of the Exchange

January 25, 2021.

I. Introduction

On May 12, 2020, BOX Exchange LLC (“Exchange” or “BOX”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change in connection with the proposed commencement of operations of the Boston Security Token Exchange LLC (“BSTX”) as a facility of the Exchange. The proposed rule change was published for comment in the Federal Register on June 1, 2020.³ On July 16, 2020, pursuant to Section 19(b)(2) of the Exchange Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ On August 3, 2020, the Exchange filed Amendment No. 1 to the proposed rule change (“Amendment No. 1”).⁶ On

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 88949 (May 26, 2020), 85 FR 33258 (June 1, 2020) (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 89329 (July 16, 2020), 85 FR 44333 (July 22, 2020). The Commission designated August 30, 2020, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

⁶ In Amendment No. 1 the Exchange revised the proposal to: (1) modify its description of the market that BSTX would operate, including what would be traded on that market; (2) clarify that it is proposing to establish BSTX as a facility of the Exchange, but that the

August 12, 2020, the Commission published notice of filing of Amendment No. 1, for notice and comment, and instituted proceedings to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.⁷ On November 24, 2020, pursuant to Section 19(b)(2) of the Exchange Act,⁸ the Commission designated a longer period within which to approve the proposed rule change, as modified by Amendment No. 1, disapprove the proposed rule change, as modified by Amendment No. 1, or institute proceedings to determine whether to disapprove the proposed rule change, as modified by Amendment No. 1.⁹

The proposed rule change is substantially similar to a proposed rule change previously filed with the Commission by the Exchange as SR-BOX-2019-37.¹⁰ SR-BOX-2019-37 was published for comment in the Federal Register on January 3, 2020.¹¹ The Commission received

Exchange would not commence operations of the “BSTX Market” (as defined below) absent trading rules approved by the Commission that are the subject of a separate filing, and that the Exchange’s regulatory oversight responsibilities with respect to BSTX would not be triggered unless SR-BOX-2020-16 is approved by the Commission; (3) update a citation to a proposed rule change filed by the Exchange to provide flexibility for the Exchange to regulate multiple facilities; and (4) include a citation to a separate proposed rule change filed by the Exchange to provide trading rules for the BSTX Market. Amendment No. 1 was filed as a partial amendment. See Form 19b-4 for Amendment No. 1 to SR-BOX-2020-16 (“Amendment No. 1 Form 19b-4”). When the Exchange filed Amendment No. 1 to SR-BOX-2020-16, it also submitted a redline, which the Exchange states reflects the text of the partial amendment compared to the original filing, as a comment letter to the filing, and which the Commission made publicly available at <https://www.sec.gov/comments/sr-box-2020-16/srbox202016-7525322-222100.pdf>.

⁷ See Securities Exchange Act Release No. 89537 (August 12, 2020), 85 FR 50850 (August 18, 2020) (Notice of Filing of Amendment No. 1 and Order Instituting Proceedings).

⁸ 15 U.S.C. 78s(b)(2).

⁹ See Securities Exchange Act Release No. 90513 (November 24, 2020), 85 FR 77334 (December 1, 2020). The Commission designated January 27, 2021, as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to disapprove, the proposed rule change.

¹⁰ See Securities Exchange Act Release No. 87868 (December 30, 2019), 85 FR 345 (January 3, 2020) (Notice of Filing of Proposed Rule Change).

¹¹ See id. See also Securities Exchange Act Release No. 88536 (April 1, 2020), 85 FR 19537 (April 7, 2020) (Order Instituting Proceedings) (instituting proceedings to determine whether to disapprove the proposed rule change). The only differences between SR-BOX-2019-37 and SR-BOX-2020-16 relate to: (1) reclassifying ownership interests in BSTX from a single class with voting rights into two classes—one with

comments on the substance of SR-BOX-2019-37.¹² BOX withdrew proposed rule change SR-BOX-2019-37 on May 12, 2020.¹³

This order disapproves the proposed rule change, as modified by Amendment No. 1 (“BSTX Governance Proposal”). The Exchange proposes to establish BSTX as a facility of the Exchange, as that term is defined in Section 3(a)(2) of the Exchange Act, that would operate a market for the trading of securities (“BSTX Market”) and be jointly owned and controlled by BOX Digital Markets LLC (“BOX Digital”), a Delaware limited liability company and a subsidiary of BOX Holdings Group LLC (“BOX Holdings,” which is also the parent company of the Exchange’s existing facility BOX Options Market LLC, “BOX Options”) and tZERO Group, Inc. (“tZERO”), a Delaware limited liability company and a subsidiary of Overstock.com Inc. (“Overstock”). According to the Exchange, it is proposing the Boston Security Token Exchange LLC, Second Amended and Restated Limited Liability Company Agreement, dated as of December 24, 2019 (“BSTX LLC Agreement”)¹⁴ as the source of governance and operating authority for BSTX. Among other things, the BSTX LLC Agreement includes provisions that are designed to prevent any owner of BSTX from exercising undue influence over the regulated

voting rights and one without voting rights, and related changes; (2) providing an updated Second Amended and Restated LLC Agreement, dated as of December 24, 2019; (3) removing the list of BSTX LLC Members and their initial capital contributions; and (4) modifying the Second Amended and Restated LLC Agreement to reflect that a “Membership Record” would be maintained by the Secretary of BSTX and updated from time to time as necessary and as provided in the Second Amended and Restated LLC Agreement, which shall include the name, address, and number of units of each class of ownership interests held by each BSTX LLC Member; (5) updating certain upstream ownership information; (6) updating references to other proposed rule changes of the Exchange; and (7) the modifications made by Amendment No. 1.

¹² Comments on SR-BOX-2019-37 can be found at: <https://www.sec.gov/comments/sr-box-2019-37/srbox201937.htm>. While the Commission considered the comments received on SR-BOX-2019-37, they are not germane to the basis for disapproval and are not discussed herein.

¹³ See Securities Exchange Act Release No. 89017 (June 4, 2020), 85 FR 35473 (June 10, 2020) (Notice of Withdrawal of a Proposed Rule Change).

¹⁴ The proposed BSTX LLC Agreement is attached as Exhibit 5A to the Form 19b-4 for SR-BOX-2020-16 (available on the Commission’s website at <https://www.sec.gov/rules/sro/box/2020/34-88949-ex5a.pdf>).

activities of BSTX. As is the case with BOX Options, the Exchange would not hold an ownership interest in BSTX, but would regulate BSTX as a facility of the Exchange pursuant to a separate agreement between the Exchange and BSTX (“Facility Agreement”). The Exchange currently regulates one facility, BOX Options, and recently amended the Exchange’s governing documents to provide for the flexibility to regulate additional facilities.¹⁵

The Exchange separately filed a proposed rule change containing proposed trading rules for BSTX that would have established the kinds of securities that would be listed and traded on BSTX, the manner of operations of the BSTX Market, and eligibility to participate on the BSTX Market (“BSTX Trading Rules Proposal”).¹⁶ The Commission disapproved the BSTX Trading Rules Proposal on December 18, 2020.¹⁷ As discussed in further detail below, this Order finds that, given that the trading rules for the BSTX facility were not approved, and BOX relied upon those rules in the BSTX Governance Proposal with respect to how BSTX would operate the BSTX market and the Exchange would provide regulatory oversight of BSTX, the Commission is unable to assess the scope of the Exchange’s regulatory operations, and therefore cannot find that the BSTX Governance Proposal is consistent with the Exchange Act. Specifically, the BSTX Governance Proposal does not provide sufficient detail about aspects of the proposed operation of the BSTX Market and regulation of BSTX that were addressed in the BSTX Trading Rules Proposal, including: (1) the rules that would establish which securities would be

¹⁵ See Securities Exchange Act Release Nos. 88236 (February 19, 2020), 85 FR 10765 (February 25, 2020) (Notice of Filing of Proposed Rule Change); 88934 (May 22, 2020), 85 FR 32085 (May 28, 2020) (Order Granting Approval of a Proposed Rule Change) (SR-BOX-2020-04) (“BOX-2020-04 Approval”).

¹⁶ See Securities Exchange Act Release Nos. 88946 (May 26, 2020), 85 FR 33454 (June 1, 2020) (Notice of Filing of Proposed Rule Change); 89536 (August 12, 2020), 85 FR 51250 (August 19, 2020) (Notice of Filing of Amendment No. 1 and Order Instituting Proceedings) (SR-BOX-2020-14).

¹⁷ See Securities Exchange Act Release No. 90735 (December 18, 2020), 85 FR 84403 (December 28, 2020) (SR-BOX-2020-14) (Order Disapproving Proposed Rule Change, as Modified by Amendment No. 1, to Adopt Rules Governing the Trading of Equity Securities on the Exchange Through a Facility of the Exchange Known as the Boston Security Token Exchange LLC) (“BSTX Trading Rules Disapproval”).

eligible for trading on BSTX, which the Exchange refers to as “BSTX Products;”¹⁸ (2) the rules that would govern an Exchange member’s eligibility to trade on BSTX as a “BSTX Participant”¹⁹ and their ongoing obligations; (3) the rules for trading on the BSTX Market; and (4) how the Exchange proposes to comply with its regulatory obligations with respect to the BSTX Market. The Commission cannot, therefore, find that the BSTX Governance Proposal is consistent with the Exchange Act, and in particular Section 6(b)(1) of the Exchange Act.²⁰

II. Description of the Proposed Rule Change and Exchange’s Representations

As described in the Notice, as modified by Amendment No. 1,²¹ the Exchange proposes to establish BSTX as a facility (as defined in Section 3(a)(2) of the Exchange Act) of the Exchange that will operate the BSTX Market and adopt the BSTX LLC Agreement for BSTX as a facility of the Exchange.²² Specifically, the Exchange states that with the BSTX Governance Proposal the Exchange proposes to establish BSTX as a facility of the Exchange that “operates a market for the trading of securities,” which market it refers to in the proposal as the BSTX Market.²³ The Exchange also states that it submitted a separate filing to establish rules relating to trading on BSTX, and that, subject to approval of those rules by the Commission, BSTX would operate the BSTX Market.²⁴ The Exchange states that without Commission approval of the BSTX Trading Rules Proposal, the Exchange would not permit BSTX to commence

¹⁸ See infra note 75 and accompanying text.

¹⁹ See infra notes 39 and 52 and accompanying text.

²⁰ 15 U.S.C. 78f(b)(1).

²¹ See Notice, supra note 3; Amendment No. 1 Form 19b-4, supra note 6.

²² See Notice, supra note 3, 85 FR at 33259; Amendment No. 1 Form 19b-4, supra note supra note 6.

²³ See Amendment No. 1 Form 19b-4, supra note 6, at 4.

²⁴ See id. (citing BSTX Trading Rules Proposal, supra note 16). The proposed trading rules for BSTX, titled the BSTX Rulebook (“BSTX Rules”), were attached as Exhibit 5A to the 19b-4 for SR-BOX-2020-14 (available on the Commission’s website at <https://www.sec.gov/rules/sro/box/2020/34-89536-ex5a.pdf>). Proposed amendments to the Exchange’s existing rules to facilitate trading on BSTX were attached as Exhibit 5B to the 19b-4 for SR-BOX-2020-14 (available on the Commission’s website <https://www.sec.gov/rules/sro/box/2020/34-89536-ex5b.pdf>).

operations of the BSTX Market.²⁵ Further, the Exchange states that it will not permit BSTX to commence operations of the BSTX Market, and the Exchange’s regulatory oversight responsibilities with respect to BSTX would not be triggered, unless the BSTX Governance Proposal is approved by the Commission.²⁶

Pursuant to the proposal, ownership interests in BSTX are represented by two classes of units (“Units”): Class A Units, which represent equal units of limited liability interest in BSTX, including an interest in the ownership and profits and losses of BSTX and the right to receive distributions from BSTX as set forth in the BSTX LLC Agreement (“Class A Units”); and Class B Units, which are generally identical to the Class A Units, except that they do not have the right to vote on any matter related to BSTX (“Class B Units”).²⁷ According to the Exchange, 50% of the voting Class A Units are owned by BOX Digital, which is 98% owned by BOX Holdings, and the other 50% of the voting Class A Units are owned by tZERO.²⁸ According to the Exchange, BOX Digital and tZERO each have over a 45% economic interest in BSTX, and the non-voting Class B Units are held by various employees and directors of BSTX, each of whom hold less than a 5% economic interest in BSTX.²⁹ Holders of Units are referred to as “Members” of BSTX (“BSTX LLC Members”).³⁰ The Exchange also states that BSTX is an affiliate of the Exchange and, if approved as a facility of the Exchange, will be subject to regulatory oversight by the Exchange.³¹

²⁵ See Amendment No. 1 Form 19b-4, supra note 6, at 4.

²⁶ See id.

²⁷ See Notice, supra note 3, 85 FR at 33259, nn.10-12 and accompanying text.

²⁸ See id. at 33260. The Exchange also provides additional information about the upstream ownership of BOX Digital and tZERO. See id.

²⁹ See id.

³⁰ See Notice, supra note 3, 85 FR at 33259-60. “Members” are defined by the Exchange as the duly admitted holders of BSTX Units and would include any person later admitted to BSTX as an additional or substitute LLC Member as provided by the BSTX LLC Agreement. See id.; BSTX LLC Agreement, supra note 14, Section 1.1.

³¹ See Amendment No. 1 Form 19b-4, supra note 6, at 4. The Exchange also states that tZERO and BSTX are affiliates of Overstock. See Notice, supra note 3, 85 FR at 33260.

The Exchange states that BOX Holdings wholly owns BOX Options, which is a facility of the Exchange³² and the only facility that the Exchange currently operates.³³ According to the Exchange, the BSTX LLC Agreement provisions are generally the same as provisions of the BOX Options LLC Agreement or the BOX Holdings LLC Agreement.³⁴ The Exchange states that it will enter into a Facility Agreement with BSTX pursuant to which the Exchange will exercise regulatory oversight over BSTX.³⁵ Furthermore, the Exchange has entered into an IP License and Services Agreement (“LSA”) with tZERO,³⁶ under which tZERO will provide BSTX and the Exchange with a license to use its intellectual property that comprises the BSTX trading system and services related to, among other things, implementing and maintain the trading system.³⁷

Pursuant to the BSTX LLC Agreement, a person that establishes an indirect ownership interest in BSTX that meets certain thresholds would be required to become a party to the BSTX LLC Agreement, by executing an amendment to the BSTX LLC Agreement, and abide by its provisions to the same extent as if they were a BSTX LLC Member.³⁸ The Exchange further

³² See Notice, supra note 3, 85 FR at 33259.

³³ See Amendment No. 1 Form 19b-4, supra note 6, at 5.

³⁴ See Notice, supra note 3, 85 FR at 33259, n.8 and accompanying text.

³⁵ See id. at 33259. The Exchange will also provide certain business services to BSTX pursuant to an administrative services agreement. See id.

³⁶ See id. at 33261.

³⁷ See id. at 33266. The Facility Agreement, administrative services agreement, and LSA were not provided as exhibits to the proposal.

³⁸ See Notice, supra note 3, 85 FR at 33260, 33267; BSTX LLC Agreement, supra note 14, Section 7.4(g). The Exchange specifically identifies certain upstream owners that would be required to execute such an amendment. See Notice, supra note 3, 85 FR at 33260.

proposes that any BSTX Participant³⁹ that directly or indirectly together with its Related Persons holds more than 20% of BSTX would have its voting power capped at 20%.⁴⁰

The Exchange states that the BSTX LLC Agreement includes provisions designed to prevent any owner of BSTX from having undue influence over regulatory actions and ensure that the Exchange has full regulatory control over BSTX and these provisions.⁴¹ These provisions, which according to the Exchange are the same provisions that are contained in the BOX Options LLC Agreement, include provisions that would require each of the BSTX LLC Members and the directors, officers, employees and agents of BSTX to give due regard to the preservation of the independence of the self-regulatory function of the Exchange and cooperate with the Exchange pursuant to its regulatory authority and with the Commission.⁴² The Exchange also states that

³⁹ BSTX LLC Agreement defines “BSTX Participant” as a firm or organization that is registered with the Exchange pursuant to Exchange rules for purposes of participating in trading on the BSTX Market as an order flow provider or market maker. See BSTX LLC Agreement, supra note 14, Section 1.1.

⁴⁰ See Notice, supra note 3, 85 FR at 33260; BSTX LLC Agreement, supra note 14, Section 7.4(h). According to the Exchange, this limitation is designed to prevent a market participant from exerting undue influence on an Exchange facility, and in particular is designed to minimize the ability of a BSTX Participant to improperly interfere with or restrict the ability of the Exchange to effectively carry out its regulatory oversight responsibilities under the Exchange Act. See Notice, supra note 3, 85 FR at 33260.

⁴¹ See e.g., Notice, supra note 3, 85 FR at 33261-62, 33268. Section 3.2(a)(i) of the proposed BSTX LLC Agreement, for example, which according to the Exchange is identical in substance to a provision in the BOX Options LLC Agreement, provides that the Exchange has authority to act as the “SRO for BSTX Market,” will “provide the regulatory framework for the BSTX Market” and will have “regulatory responsibility for the activities of the BSTX Market.” See Notice, supra note 3, 85 FR at 33262; BSTX LLC Agreement, supra note 14, Section 3.2(a)(i). It also provides that the Exchange will “provide regulatory services to BSTX pursuant to the Facility Agreement,” and that nothing in the LLC Agreement “shall be construed to prevent the Exchange from allowing BSTX to perform activities that support the regulatory framework for the BSTX Market, subject to oversight by the Exchange.” See Notice, supra note 3, 85 FR at 33262; BSTX LLC Agreement, supra note 14, Section 3.2(a)(i).

⁴² See Notice, supra note 3, 85 FR at 33261-62; BSTX LLC Agreement, supra note 14, Sections 4.12(a), (c). The BSTX LLC Agreement also includes provisions, which the Exchange states are substantively similar to provisions in the BOX Options LLC Agreement, that address the handling of confidential information, both pertaining to regulatory matters and otherwise (see Notice, supra note 3, 85 FR at 33268-69; BSTX LLC Agreement, supra note 14, Article 15); and provisions, which the Exchange states

the Exchange's powers and authority under the Facility Agreement ensure that the Exchange has full regulatory control over BSTX, which is designed to prevent any owner of BSTX from exercising undue influence over the regulated activities of BSTX.⁴³

The BSTX LLC Agreement provides that the Exchange shall receive notice of planned or proposed changes to BSTX, with the exception of certain changes not related to the operation of the market, or to the BSTX Market, and that such changes will require affirmative approval by the Exchange before implementation.⁴⁴ If the Exchange determines that planned or proposed changes could cause a "Regulatory Deficiency,"⁴⁵ the Exchange may direct BSTX, subject to Board approval, to modify the proposal as necessary.⁴⁶ Further, in the BSTX Governance Proposal the Exchange proposes how regulatory funds may be allocated and provisions regarding capital contributions and distributions.⁴⁷ The Exchange also states that it submitted a separate

are substantially similar to those of the BOX Options LLC Agreement, related to regulatory jurisdiction over BSTX LLC Members; the maintenance of books and records; and the independence of the self-regulatory function of the Exchange and compliance with federal securities laws. See Notice, supra note 3, 85 FR at 33269; BSTX LLC Agreement, supra note 14, Sections 4.12, 11.1, 18.6(a), and 18.6(c).

⁴³ See Notice, supra note 3, 85 FR at 33259.

⁴⁴ See Notice, supra note 3, 85 FR at 33264; BSTX LLC Agreement, supra note 14, Section 3.2(a)(ii).

⁴⁵ The BSTX LLC Agreement defines "Regulatory Deficiency" as the operation of BSTX (in connection with matters that are not Non-Market Matters) or the BSTX Market (including, but not limited to, the BSTX System) in a manner that is not consistent with the Exchange rules and/or the Commission rules governing the BSTX Market or BSTX Participants, or that otherwise impedes the Exchange's ability to regulate the BSTX Market or BSTX Participants or to fulfill its obligations under the Exchange Act as an SRO. See BSTX LLC Agreement, supra note 14, Section 1.1. "Non-Market Matters" means changes related solely to one or more of the following: marketing, administrative matters, personal matters, social or team-building events, meetings of the BSTX LLC Members, communication with the BSTX LLC Members, finance, location and timing of the Board meetings, market research, real property, equipment, furnishings, personal property, intellectual property, insurance, contracts unrelated to the operation of the BSTX Market and de minimis items. See BSTX LLC Agreement, supra note 14, Section 3.2(a)(ii). See also infra note 51 (defining "BSTX System").

⁴⁶ See Notice, supra note 3, 85 FR at 33264; BSTX LLC Agreement, supra note 14, Section 3.2(a)(iii).

⁴⁷ See, e.g., Notice, supra note 3, 85 FR at 33264-66; BSTX LLC Agreement, supra note 14, Sections 6.1, 6.2, and 8.1, and 8.2.

filing to introduce structural changes to the Exchange to accommodate regulation of BSTX as well as BOX Options, which was approved by the Commission.⁴⁸ According to the Exchange, BSTX Participants will have the same representation, rights, and responsibilities as BOX Options Participants.⁴⁹

Additionally, as described above, the Exchange proposes that without Commission approval of the BSTX Trading Rules Proposal, it would not permit BSTX to commence operations of the BSTX Market.⁵⁰ Pursuant to the BSTX Trading Rules Proposal, the Exchange proposed to operate a fully automated, price/time priority execution system for the listing and trading of securities (“BSTX Securities”).⁵¹ BSTX Securities would be NMS stock, and members approved for trading on BSTX (i.e., BSTX Participants),⁵² and issuers of BSTX Securities, would be required to comply with a protocol to enable BSTX to record and publicly

⁴⁸ See Amendment No. 1 Form 19b-4, supra note 6, at 5 (citing the BOX-2020-04 Approval, see supra note 15).

⁴⁹ See Notice, supra note 3, 85 FR at 33259.

⁵⁰ See supra note 25 and accompanying text.

⁵¹ See BSTX Trading Rules Proposal, supra note 16, 85 FR 51251. The BSTX Rules would have defined the “Securities” that would be traded on BSTX as a facility of the Exchange as “NMS stock, as defined in Rule 600(b)(47) of the Exchange Act, trading on the BSTX System and for which ancillary Ethereum blockchain records are maintained under [the BSTX Rules]”; and the BSTX System as the “the automated trading system used by BSTX for the trading of Securities.” See BSTX Rules, supra note 24, Rules 17000(a)(30) and (14), respectively. Exchange Act Rule 600(b)(47) defines “NMS security” as “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.” 17 CFR 242.600(b)(47). Exchange Act Rule 600(b)(48) then defines “NMS stock” as “any NMS security other than an option.” 17 CFR 242.600(b)(48). The BSTX LLC Agreement defines “System” as “the technology, know-how, software, equipment, communication lines or services, services and other deliverables or materials of any kind as may be necessary or desirable for the operation of the BSTX Market.” See BSTX LLC Agreement, supra note 14, Section 1.1.

⁵² The BSTX LLC Agreement defines “BSTX Participant” as “a firm or organization that is registered with the Exchange pursuant to Exchange Rules for purposes of participating in Trading on the BSTX Market.” See BSTX LLC Agreement, supra note 14, Section 1.1. The proposed trading rules would have defined “BSTX Participant” as “a Participant or Options Participant (as defined in [Exchange] Rule 100 Series) that is authorized to trade Securities on the Exchange.” See BSTX Rules, supra note 24, Rule 17000(a)(11).

disseminate digital representations of end-of-day ownership balances to the Ethereum blockchain.⁵³ Specifically, in the BSTX Trading Rules Proposal, which the Commission disapproved,⁵⁴ the Exchange proposed:

- rules for which securities could be listed and traded on the BSTX Market,⁵⁵ including:
 - rules governing listing on BSTX, such as initial listing standards;⁵⁶
 - rules governing suspension and delisting;⁵⁷ and
 - forms to be used by issuers applying to list on BSTX;⁵⁸
- rules governing the process for and eligibility to become a BSTX Participant, as well as ongoing obligations, including:
 - rules defining BSTX Participant;⁵⁹
 - rules setting forth requirements to participation on BSTX;⁶⁰
 - agreements and forms required to become a BSTX Participant,⁶¹ and

⁵³ See BSTX Trading Rules Proposal, supra note 16, 85 FR at 51256, 51258-62.

⁵⁴ See BSTX Trading Rules Disapproval, supra note 17.

⁵⁵ See BSTX Rules, supra note 24, Rule 26000 Series and 27000 Series; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51277-81.

⁵⁶ See BSTX Rules, supra note 24, Rule 26000 Series; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51277-80.

⁵⁷ See BSTX Rules, supra note 24, Rule 27000 Series; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51280.

⁵⁸ See BSTX Trading Rules Proposal, supra note 16, 85 FR at 51283-85. The proposed forms for issuers to list on BSTX were attached as Exhibits 3G through 3M to the 19b-4 for SR-BOX-2020-14 (available on the Commission's website at <https://www.sec.gov/rules/sro/box.htm#SR-BOX-2020-14>).

⁵⁹ See supra note 52.

⁶⁰ See BSTX Rules, supra note 24, Rule 18000 Series; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51264-65.

⁶¹ See BSTX Trading Rules Proposal, supra note 16, 85 FR at 51283. The proposed forms for issuers to list on BSTX were attached as Exhibits 3A through 3F to the 19b-4 for SR-BOX-2020-14 (available on the Commission's website at <https://www.sec.gov/rules/sro/box.htm#SR-BOX-2020-14>).

- rules governing business conduct, trading practice, financial responsibility for BSTX Participants;⁶²
- rules for trading on the BSTX Market and access to the BSTX System;⁶³
- rules for BSTX Participants and the Exchange requiring reporting of end-of-day balance information of BSTX Participants in BSTX Securities to the Exchange for recording to the Ethereum blockchain;⁶⁴ and
- rules for how the Exchange would satisfy its regulatory obligations (including by extending its existing Regulatory Services Agreement (“RSA”) with the Financial Industry Regulatory Authority (“FINRA”) to cover BSTX Participants).⁶⁵

III. Discussion and Commission Finding

A. Applicable Standard of Review

Under Section 19(b)(2)(C) of the Exchange Act, the Commission must approve the proposed rule change of a self-regulatory organization (“SRO”) if the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the applicable rules and regulations thereunder; if it does not make such a finding, the Commission must disapprove the proposed rule change.⁶⁶ Additionally, under Rule 700(b)(3) of the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization that proposed the rule change.”⁶⁷ The description of a proposed rule change, its

⁶² See BSTX Rules, supra note 24, Rule 19000 Series, 20000 Series, and 23000 Series; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51265-68.

⁶³ See BSTX Rules, supra note 24, Rule 25000 Series; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51268-75.

⁶⁴ See BSTX Rules, supra note 24, Rule 17020; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51258-62.

⁶⁵ See BSTX Rules, supra note 24, Rule 22040; BSTX Trading Rules Proposal, supra note 16, 85 FR at 51267, 51286-87.

⁶⁶ See 15 U.S.C. 78s(b)(2)(C)(i).

⁶⁷ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must be sufficiently detailed and specific to support an affirmative Commission finding.⁶⁸ Any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations issued thereunder that are applicable to the SRO.⁶⁹ Moreover, “unquestioning reliance” on an SRO’s representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.⁷⁰

As discussed throughout, the rules for operation of the BSTX Market proposed in the BSTX Trading Rules Proposal undergird the operation and governance of BSTX as a facility of the Exchange. Those listing and trading rules, which are cited and relied upon by the Exchange in the BSTX Governance Proposal, were disapproved by the Commission and, as a result, the BSTX Governance Proposal, standing alone, does not reflect the proposed operations of the BSTX facility. Given that the rules for the BSTX facility were not approved, and BOX relied on those rules in the BSTX Governance Proposal with respect to how BSTX would operate the BSTX market and the Exchange would provide regulatory oversight of BSTX, the Commission is unable to assess the scope of the Exchange’s regulatory operations, and therefore cannot find that the BSTX Governance Proposal is consistent with the Exchange Act, and in particular Section 6(b)(1). For these reasons, the Commission is unable to find that the Exchange has met its burden to show that the proposed rule change is consistent with the Exchange Act and the

⁶⁸ See id.

⁶⁹ See id.

⁷⁰ Susquehanna Int’l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 447 (D.C. Cir. 2017).

applicable rules and regulations thereunder, and in particular Exchange Act Section 6(b)(1), and is therefore unable to find that the proposal is consistent with the Exchange Act.⁷¹

B. Whether the Record Supports a Finding that the Proposal is Consistent with Section 6(b)(1) of the Exchange Act

With the BSTX Governance Proposal, the Exchange proposes to establish BSTX as a facility of the Exchange and proposes the BSTX LLC Agreement as the source of operating and governance authority for BSTX. The Exchange rules that would have governed operation of the BSTX Market, and established many of the Exchange's obligations as an SRO with respect to BSTX as a facility of the Exchange, were the subject of a separate proposed rule change – the BSTX Trading Rules Proposal – that the Commission disapproved.⁷² In the BSTX Governance Proposal, the Exchange cites the BSTX Trading Rules Proposal and states that it would not commence operations of the BSTX Market until the BSTX Trading Rules Proposal is approved by the Commission.⁷³ Many aspects of the BSTX Governance Proposal and many provisions of the BSTX LLC Agreement, however, are substantively relevant only in the context of the existence and operation of the BSTX Market, and in the absence of the BSTX Trading Rules Proposal, the Commission is unable to assess these provisions and determine that the Exchange would be organized and have the capacity to carry out the purposes of the Exchange Act, consistent with Section 6(b)(1) of the Exchange Act.

For example, in the BSTX LLC Agreement the Exchange defines the BSTX Market as “the market operated by BSTX pursuant to Section 3.1 [of the BSTX LLC Agreement],”⁷⁴ and Section 3.1 of the BSTX LLC Agreement states that the purpose of BSTX is to “develop the

⁷¹ Other than as discussed below, this Order makes no findings with respect to whether other aspects of the proposed rule change are consistent with the Exchange Act.

⁷² See supra note 17 and accompanying text.

⁷³ See supra notes 24-25 and accompanying text.

⁷⁴ See BSTX LLC Agreement, supra note 14, Section 1.1.

System, to own and operate the BSTX Market for the Trading of BSTX Products,⁷⁵ and to engage in all related activities arising therefrom or relating thereto or necessary, desirable, advisable, convenient, or appropriate in connection therewith as the [BSTX] LLC Members may determine.”⁷⁶ And while the BSTX LLC Agreement generally defines the terms System,⁷⁷ BSTX Market,⁷⁸ Trading,⁷⁹ and BSTX Products,⁸⁰ the BSTX Governance Proposal and the BSTX LLC Agreement do not describe the proposed operation of the BSTX Market, how trading would occur on the BSTX Market, or the products proposed to be traded on the BSTX Market. Instead, the proposed rules for, and the description of, these aspects of the proposed facility were the subject of the BSTX Trading Rules Proposal.⁸¹

In particular, the securities that are proposed to be traded on BSTX are described in the BSTX Governance Proposal only as “securities,” but are defined in the BSTX LLC Agreement as “BSTX Products,” which are “security tokens” authorized for trading on the BSTX Market. And the Exchange does not further explain BSTX Products. The BSTX Trading Rules Proposal, however, proposed rules governing what securities could be listed and traded on BSTX,⁸² and explained how securities listed and traded on BSTX would be represented on the Ethereum blockchain as “tokenized assets,” a characteristic which would distinguish them from other NMS stocks.⁸³ In the absence of the BSTX Trading Rules Proposal, the BSTX Governance Proposal

⁷⁵ The BSTX LLC Agreement defines “BSTX Products” as “security tokens (emphasis added) authorized for trading on the BSTX Market.” See id. at Section 1.1.

⁷⁶ See BSTX LLC Agreement, supra note 14, Section 3.

⁷⁷ See supra note 51 and accompanying text.

⁷⁸ See supra note 74 and accompanying text.

⁷⁹ The proposed BSTX LLC Agreement defines “Trading” as “availability of the System to authorized users for entering, modifying and canceling orders in BSTX Products.” See BSTX LLC Agreement, supra note 14, Section 1.1.

⁸⁰ See supra note 75 and accompanying text.

⁸¹ See supra notes 55-65 and accompanying text.

⁸² See supra note 55 and accompanying text.

⁸³ See e.g., BSTX Trading Rules Proposal, supra note 16, 85 FR at 51257; BSTX Rules, supra note 24, proposed BSTX Rule 17020(d).

does not sufficiently explain what kinds of securities would be listed and traded on BSTX, including what the Exchange intends by the term “security tokens.” Furthermore, the Exchange states in the BSTX Governance Proposal that BSTX will be a “facility of the Exchange that operates a market for the trading of securities”⁸⁴ and the BSTX LLC Agreement defines the products to be traded on the facility as “authorized for Trading on the BSTX Market.”⁸⁵ As noted above, the Commission disapproved the rules that would have established this authority.

Similarly, the BSTX Governance Proposal does not sufficiently explain who would be a member of the Exchange that is eligible to trade on BSTX and qualify as a BSTX Participant. The BSTX LLC Agreement defines BSTX Participant as “a firm or organization that is registered with the Exchange pursuant to Exchange Rules for purposes of participating in Trading on the BSTX Market,”⁸⁶ and “Exchange Rules” as “the rules of the Exchange that constitute the ‘rules of an exchange’ within the meaning of Section 3 of the Exchange Act, and that pertain to the BSTX Market.”⁸⁷ However, the BSTX Governance Proposal does not provide the rules for and eligibility to become a BSTX Participant, as well as ongoing obligations. Those were proposed in the BSTX Trading Rules Proposal.⁸⁸ The BSTX Governance Proposal does not sufficiently establish what the “Exchange Rules” referred to in that proposal are, the extent of their application, and what they would require of BSTX members.

In addition, the BSTX LLC Agreement states that the Exchange will have regulatory responsibility for the activities of the BSTX Market. But the Exchange also states that it will only commence operations of the BSTX Market if the BSTX Trading Rules Proposal is approved. Additionally, as described above, the BSTX Governance Proposal does not provide information about the proposed operations of BSTX as a facility. As a result, it is not clear what

⁸⁴ See supra note 23 and accompanying text.

⁸⁵ See supra note 75.

⁸⁶ See BSTX LLC Agreement, supra note 14, Section 1.1.

⁸⁷ See id.

⁸⁸ See supra notes 59-62 and accompanying text.

the activities of the BSTX Market would be, over which the Exchange would exercise regulatory responsibility. For example, Section 3.2 of the BSTX LLC Agreement provides that the Exchange will (a) act as the Commission approved SRO for the BSTX Market, (b) have regulatory responsibility for the activities of the BSTX Market, and (c) provide regulatory services to BSTX pursuant to the Facility Agreement.⁸⁹ The BSTX LLC Agreement also states that the Exchange will become a party to the BSTX LLC Agreement and the Commission and the Exchange shall have “appropriate regulatory oversight responsibilities with respect to BSTX” upon the Commission’s approval of the Exchange’s proposal to operate the BSTX Market as a facility of the Exchange.⁹⁰ Because the BSTX Governance Proposal does not explain how the BSTX Market would operate, the Commission is unable to assess what the Exchange’s regulatory responsibilities would be and thus whether the Exchange would be organized and have the capacity to carry out the purposes of the Exchange Act with respect to BSTX as a facility of the Exchange.

Furthermore, the BSTX Trading Rules Proposal included discussion about how the Exchange planned to comply with its regulatory obligations with respect to the BSTX Market that is not included in the BSTX Governance Proposal. For example, the BSTX Governance Proposal does not explain whether the Exchange would enter into any agreements with other parties to provide regulatory services. However, the BSTX Trading Rules Proposal explained that in connection with the operation of BSTX, the Exchange planned to leverage many of the structures it previously established to operate a national securities exchange in compliance with Section 6 of the Exchange Act. The Exchange stated, among other things, its intent to extend its RSA with FINRA to cover BSTX Participants and trading on the BSTX System; that the RSA would govern many aspects of the regulation and discipline of BSTX Participants; and that the Exchange would perform Security listing regulation, authorize BSTX Participants to trade on the

⁸⁹ See BSTX LLC Agreement, supra note 14, Section 3.2(a)(i); supra note 41.

⁹⁰ See BSTX LLC Agreement, supra note 14, Section 18.8.

BSTX System, and conduct surveillance of Security trading on the BSTX System.⁹¹ The BSTX Trading Rules Proposal was disapproved, and this information, which is supportive of how the Exchange would be organized and have the capacity to carry out the purposes of the Exchange Act, is not part of the BSTX Governance Proposal. Because the BSTX Governance Proposal, standing alone, does not reflect these aspects of the operation of the BSTX facility or how the Exchange would provide regulatory oversight of BSTX, the Commission is unable to assess whether the BSTX Governance Proposal is consistent with Section 6(b)(1) of the Exchange Act.

In other regards, the BSTX LLC Agreement also refers to the Exchange's regulatory authority with respect to BSTX.⁹² For example, the BSTX LLC Agreement gives the Exchange the authority and discretion to take actions to limit or prevent a "Regulatory Deficiency," which the BSTX LLC Agreement defines as the operation of BSTX or the BSTX Market in a manner that is not consistent with Exchange Rules or the Exchange Act, or rules and regulations thereunder, governing the BSTX Market or BSTX Participants, or that otherwise impedes the Exchange's ability to regulate the BSTX Market or BSTX Participants or to fulfill its obligations under the Exchange Act as an SRO.⁹³ The Exchange states that such provisions ensure the Exchange maintains full regulatory control and authority over BSTX while it operates as a facility of the Exchange and help guarantee the Exchange's ability to fulfill its regulatory responsibilities and operate in a manner consistent with the Exchange Act, and in particular with Section 6(b)(1).⁹⁴ However, the BSTX Governance Proposal does not provide sufficient detail

⁹¹ See BSTX Trading Rules Proposal, supra note 16, 85 FR at 51286. See also supra note 65 and accompanying text. The Exchange also proposed that it would perform automated surveillance of trading on BSTX for the purpose of maintaining a fair and orderly market at all times and monitor BSTX to identify unusual trading patterns and determine whether particular trading activity requires further regulatory investigation by FINRA. See BSTX Trading Rules Proposal, supra note 16, 85 FR at 51286-87.

⁹² See, e.g., supra notes 41 and 43 and accompanying text.

⁹³ See BSTX LLC Agreement, supra note 14, Section 1.1. See also supra notes 45-46 and accompanying text.

⁹⁴ See Notice, supra note 3, 85 FR at 33264.

about how the BSTX Market would operate, and the Commission concludes that the information in the BSTX Governance Proposal on its own cannot support a finding that the Exchange will be organized and have the capacity to comply with the purposes of the Exchange Act, consistent with Section 6(b)(1) of the Exchange Act.

IV. Conclusion

For the reasons set forth above, the Commission does not find, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(1) of the Exchange Act.⁹⁵

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,⁹⁶ that the proposed rule change (SR-BOX-2020-16), as modified by Amendment No. 1, be, and hereby is, disapproved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁹⁷

J. Matthew DeLesDernier,

Assistant Secretary.

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⁹⁵ 15 U.S.C. 78f(b)(1).

⁹⁶ 15 U.S.C. 78s(b)(2).

⁹⁷ 17 CFR 200.30-3(a)(57).