NASDAQ OMX

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September 17, 2012

Ms. Elizabeth M. Murphy
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Response to Comments
File No. SR-NASDAQ-2012-090

Dear Ms. Murphy:

The NASDAQ Stock Market LLC ("Nasdaq" or "Exchange") welcomes the opportunity to respond to comments filed in connection with the above-captioned proposal to amend Nasdaq Rule 4626 to establish a one-time, voluntary accommodation pool of up to $62 million to compensate Nasdaq members for objectively measured losses directly arising from system difficulties Nasdaq experienced during the initial public offering of Facebook, Inc. ("Facebook") on May 18, 2012.[1] As noted in Nasdaq's filing, the technical problems that occurred on that date were highly unusual, and the proposed accommodation pool goes well beyond what is required under current Nasdaq rules and specifically prioritizes the compensation of investors.

To date, eleven comment letters have been filed in response to the Accommodation Proposal. The commenters generally fall into three categories: (1) Nasdaq members and representatives of members;[2] (2) retail investors who have filed class action lawsuits against

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[1] Securities Exchange Act Release No. 67507 (July 26, 2012), 77 FR 45706 (August 1, 2012) (SR-NASDAQ-2012-090) ("Accommodation Proposal" or "Proposal").

[2] Citadel LLC, Letter re: Notice of Filing of Proposed Rule Change to Amend Rule 4626; File No. SR-NASDAQ-2012-090 (August 21, 2012) ("Citadel Letter"); Citigroup Global Markets Inc. and Automated Trading Desk Financial Services, LLC, Letter re: File No. SR-NASDAQ-2012-090; Notice of Filing of Proposed Rule Change to Amend NASDAQ Rule 4626—Limitation of Liability (August 22, 2012) ("Citi Letter"); Knight Capital Group, Inc., Letter re: SEC Release No. 34-67507; File No. SR-NASDAQ-2012-090; Notice of Filing of Proposed Rule Change to Amend NASDAQ Rule 4626—Limitation of Liability (August 29, 2012) ("Knight Letter"); SIFMA, Letter re: File No. SR-NASDAQ-2012-90; Notice of Filing of Proposed Rule Change to Amend NASDAQ Rule 4626—Limitation of Liability (August 22, 2012) ("SIFMA Letter"); Triad Securities, Letter re: File No. SR-NASDAQ-

Nasdaq[3] and proprietary trading firms that have filed a class action lawsuit against Nasdaq;[4] and (3) one academic commentator.[5] For the reasons set forth below, the Exchange believes that none of the comments establishes a basis for the Commission to disapprove the proposed amendment to Nasdaq Rule 4626.

I. The Accommodation Proposal Is Fair and Equitable

As an initial matter, it must be noted that the vast majority of Nasdaq's approximately 560 members have raised no objection to Nasdaq's Accommodation Proposal, and that two of Nasdaq's largest members in terms of order volume in Facebook shares – Citadel LLC and Knight Capital Group, Inc. – actively urge the Commission to approve it. Similarly, even the retail investor and trading firm plaintiffs – acting through two different sets of counsel seeking to represent a class of such investors in class litigation – do not oppose the Proposal.

As with any proposed rule change filed under Section 19(b)(2)[6] of the Securities Exchange Act of 1934 (the "Exchange Act), the question before the Commission is whether the proposal is consistent with the requirements of the Exchange Act and the rules and regulations issued thereunder that are applicable to a national securities exchange. The few Nasdaq members that have filed comments critical of the Proposal do not assert that it discriminates unfairly among members or that it is otherwise inconsistent with the requirements of the Exchange Act. Rather, the commenters take issue primarily with the dollar amount of compensation that Nasdaq proposes to pay. Nasdaq notes, however, that objections based on the amount of compensation proposed are particularly unpersuasive here given that the Commission has already determined Rule 4626 and similar rules of other exchanges to be consistent with the Exchange Act. Thus, if the Proposal is disapproved, the applicable limit of liability under the approved rule will be $500,000, not the unprecedented amount of $62 million that Nasdaq is proposing to make available. As several commenters note, moreover, participation in the

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2012-90; Release No. 34-67507; Notice of Filing of Proposed Rule Change to Amend Rule 4626—Limitation of Liability (August 20, 2012) ("Triad Letter"); UBS, Letter re: File Number SR-NASDAQ-2012-090 (August 22, 2012) ("UBS Letter"); Vandham Securities Corp., Letter re: File No. SR-NASDAQ-2012-90; Release No. 34-67507; Notice of Filing of Proposed Rule Change to Amend Rule 4626—Limitation of Liability (August 21, 2012) ("Vandham Letter"); Watermill Inst'l Trading LLC, Letter re: File No. SR-NASDAQ-2012-090 (August 22, 2012) ("Watermill Letter").

[3] Finkelstein Thompson LLP, Letter re: File Number SR-BX-2012-090 [sic] (August 22, 2012) ("Finkelstein Thompson Letter").

[4] Entwistle & Cappucci LLP, Letter re: File No. SR-NASDAQ-2012-90; Release No. 34-67507; Notice of Filing of Proposed Rule Change to Amend NASDAQ Rule 4626—Limitation of Liability (August 22, 2012) ("Entwistle & Cappucci Letter").

[5] James J. Angel, Letter re: Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend Rule 4626—Limitation of Liability (August 23, 2012) ("Angel Letter").

[6] 15 U.S.C. 78s(b)(2).

proposed accommodation program is voluntary. As such, members that disagree with the amount of compensation set forth in the Proposal remain free not to participate in the program. Nasdaq believes that the Accommodation Proposal establishes a fair, transparent, and equitable method of identifying the categories of members for whom Nasdaq's system issues caused objective, discernible loss, quantifying the amount of that loss, and making payments that consider the member's commitments to compensate their investor customers.[7]

As noted above, the objecting commenters' main complaint seems to be the amount of money in the proposed accommodation pool. In several cases, this complaint is couched in terms of an objection to the time period used by Nasdaq to determine a benchmark reference price to assess the amount payable on orders qualifying for accommodation. Certain market participants (Citi, Triad, Watermill, and Vandham) argue that the benchmark price used in calculating the accommodation amount should take into account trading beyond the 45 minutes after the dissemination of Cross transaction reports at 1:50 p.m. Given that the price of Facebook stock declined during the afternoon of May 18, this is another way of asserting that the amount of compensation Nasdaq proposes to pay them is inadequate.

Nasdaq proposes to use a 45-minute window because 45 minutes should have been ample time for a reasonably diligent member to identify any unexpected losses or unanticipated positions and take steps to mitigate or liquidate them. This is a reasonable and objective approach given that trading firms typically process and determine actions on trading messages within seconds or fractions of a second. At 1:50 p.m., Nasdaq advised all members of their executions in Facebook (both in the Cross and in the continuous market), the market was receiving accurate real-time trading data from Nasdaq regarding Facebook, Nasdaq's Facebook-related systems issues were fully resolved, and the market was operating normally with robust trading. More specifically:

(1) *All Trades Were Processed.* As of 1:50 p.m., all Facebook orders and cancellations of orders, including orders and cancellations entered between 11:11 a.m. and 11:30 a.m. for participation in the Cross, had been executed, cancelled, or released into the market,[8] and the market for Facebook was operating normally with robust trading.

(2) *All Trades Were Confirmed.* As of 1:50 p.m., confirmations of all trades and cancellations, including delayed Cross transaction confirmations, had been disseminated to members.

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[7] As evidenced by the submissions of members, Nasdaq's proposal has the distinct advantage of providing not only a reasonable, but an objective measurement across member firms of their proposed claims. The submissions of the few objecting members illustrate that these commenters would propose highly individualized, subjective measurements that would be tailored to the individual decisions and situations of a given member, rather than a measurement that is fair and equitable across members.

[8] Depending on the instructions associated with such orders, orders released into the market may have been executed, cancelled, routed, or posted to the Nasdaq book.

(3) *All Data Feeds Were Operating Normally.* As of 1:50 p.m., Nasdaq's issues with the Facebook bid and ask being reported to TotalView and the SIP were resolved, the locked or crossed Facebook quote reported as non-firm was removed, and Nasdaq began reporting a firm bid and ask to the tape.

(4) *Nasdaq Announced That Its Systems Issues Were Resolved.* At 1:57 p.m., Nasdaq issued a System Status message notifying members that all systems were operating normally.

Thus, between 1:50 p.m. and 2:35 p.m., reasonably diligent members could have obtained shares to mitigate any unexpected losses or liquidated any unanticipated positions attributable to the Nasdaq system issues. Nasdaq believes that forty-five minutes is more time than required by any reasonable principle of fairness or market reality.

Moreover, commenters that focus on their own individualized circumstances -- such as the system problems that they experienced, the timing of particular trades that they made, or conclusions that they made about the intent of Nasdaq or others -- make assumptions about the purpose of the Proposal that are unwarranted. The purpose of the Proposal is not to pay all claims of losses alleged with respect to the trading of Facebook stock, nor even all claims of losses alleged to have been incurred on May 18, 2012. The purpose of the Proposal is to modify an existing rule that limits Nasdaq's liability to $500,000 in order to make additional funds available to compensate members and their customers for the categories of loss defined in the Proposal, in accordance with the terms and conditions of the Proposal. Nasdaq believes that these categories of loss reflect a fair, objective, and reasonable method of allocating the $62 million that it has volunteered to make available. Thus, unless Nasdaq increases the compensation fund (which it is not prepared to do), modifying the proposal to add additional categories or to expand the VWAP period would merely result in a proration of the $62 million among claimants in accordance with different methods for allocation. Moreover, Nasdaq believes that none of the comments provides a basis for the Commission to determine that a modification to the methodology and criteria proposed is necessary to remedy any inconsistency with the Exchange Act. Finally, as discussed below, members that believe the proposal does not address their individual circumstances remain free to reject the voluntary program and pursue alternative means of pursuing their claims.

II. A Release of Claims Is an Appropriate and Essential Element of the Voluntary Accommodation Proposal

Two commenters (Knight and UBS) object to the requirement of a release.[9] As mentioned above, participation in the accommodation program is entirely voluntary, and the

[9] Two others (Citi and SIFMA) object only to the timing of the release, contending that it should only be effective upon payment under the Accommodation Proposal. The proposed rule, however, provides that the release requirement does not apply until a future Nasdaq rule proposal setting forth the amount of eligible claims and the amount to be proposed to members becomes effective. *See* Proposed Rule 4626(b)(3)(H). In any event, Nasdaq does not object to the release becoming effective upon payment, and intends to implement the Accommodation Proposal such that a member will be aware of the results of its claim prior to being required to execute a release.

required release is an essential, and non-severable, component of the program. As explained more fully in Nasdaq's Proposal,[10] the release requirement also furthers the objectives of Section 6(b)(5) of the Act insofar as it is aimed at avoiding unnecessary litigation and ensuring equal treatment of all members receiving funds under the Proposal.[11] Members that would prefer not to release Nasdaq and instead attempt to pursue claims against it, notwithstanding the otherwise applicable provisions of Rule 4626, the judicially recognized doctrine of self-regulatory organization ("SRO") immunity, the contractual limitations on such claims, and Nasdaq's defenses to the substance of such claims, are obviously free to do so. But if a member desires to take advantage of Nasdaq's voluntary accommodation, it is fair, reasonable, and necessary that the member waive any other claims it might otherwise attempt to assert against Nasdaq to recover losses sustained by the member in connection with the Facebook IPO.[12] Indeed, the use of a release is routine in the context of a payment in settlement of a disputed claim, including those brought against regulated entities. In short, while Nasdaq is willing to pay accommodation amounts to compensate members for Facebook losses directly related to its own system issues, it is not willing to subsidize the costs of future litigation against itself.

III. Rule 4626 Applies To Claims Arising From Nasdaq's System Difficulties in Connection with the Facebook IPO

With the exception of Citi,[13] no commenter has challenged the applicability of Rule 4626 to the Nasdaq system failures of May 18th. By its plain terms, Rule 4626 protects Nasdaq from liability from all "claims arising out of the NASDAQ Market Center or its use." There can be no serious question that Citi's complaints "arise" out of the NASDAQ Market Center and its use. Rule 4626(a) makes clear that

> [e]xcept as provided for in paragraph (b) below, NASDAQ and its affiliates shall not be liable for any losses, damages, or other claims arising out of the NASDAQ Market Center or its use. ***Any***

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[10] *See* Accommodation Proposal, 77 FR at 45713-45714.

[11] Two commenters have asked the Commission to amend the NASDAQ OMX U.S. Services Agreement by waiving the one-year time limit for claims in Sections 18 and 19. This request improperly asks the Commission to interfere with existing contractual relationships that have no bearing on whether Rule 4626 should be amended. Members voluntarily choosing to proceed with their purported claims, based on contract or otherwise, outside of the accommodation process, should do so under the terms and conditions they have agreed to, and not seek to use the Commission's notice and comment process to renegotiate their prior contractual commitments.

[12] Although UBS opposes the release requirement, its letter underscores precisely why such a release is appropriate when it notes that members that choose not to receive a voluntary accommodation may "pursue potentially cost- and resource-intensive alternative avenues of recovery." (UBS Letter at 3.) In the absence of a release, such members could easily opt to receive an accommodation and then attempt to pursue additional paths to recovery. Nasdaq submits that nothing in the Exchange Act may be fairly read to require it to use a voluntary accommodation plan as the means to fund litigation against it.

[13] *See* Citi Letter at 15–16.

> ***losses, damages, or other claims, related to a failure of the NASDAQ Market Center*** to deliver, display, transmit, execute, compare, submit for clearance and settlement, adjust, retain priority for, or otherwise correctly process an order, Quote/Order, message, or other data entered into, or created by, the NASDAQ Market Center ***shall be absorbed by the member, or the member sponsoring the customer, that entered the order,*** Quote/Order, message, or other data into the NASDAQ Market Center.[14]

This description clearly encompasses Citi's complaints. (*See* Citi Letter at 7-8.)

In light of comments concerning Nasdaq's potential liability, it bears emphasizing that the Accommodation Proposal is a modification of Rule 4626 – a pre-existing, SEC-approved rule[15] similar to rules approved for numerous other exchanges. As Nasdaq noted in its Proposal, the Commission has long recognized that it is consistent with the purposes of the Exchange Act for an SRO to limit its liability with respect to the use of its facilities by its members through rules such as Rule 4626.[16] Moreover, the applicability of Rule 4626 and its proposed amendment through the Accommodation Proposal are distinct from the common law doctrine of immunity for SROs.[17] Thus, comments concerning Nasdaq's common law immunity have no bearing on the question before the Commission – *i.e.*, whether the Accommodation Proposal is consistent with Section 6(b) of the Exchange Act in general and furthers the objectives of Section 6(b)(5) of the Exchange Act in particular.

IV. Immunity

Nasdaq agrees with several commenters to the extent that they assert that common law immunity is not at issue in connection with the Commission's review of Nasdaq's proposal to modify Rule 4626. Nasdaq referred to common law immunity in the Proposal to further an understanding of the context in which its unprecedented $62 million Proposal is being made. There is, however, no need for the Commission to discuss this judicially recognized doctrine in

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[14] NASDAQ Rule 4626 (emphasis added).

[15] *See* Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131).

[16] *See* Accommodation Proposal, 77 FR at 45714 n.33 (citing analogs of Rule 4626 in place at 15 other exchanges) and 77 FR at 45713-45714 (discussing the regulatory policy objectives underlying Rule 4626 and the reasons it is important to ensure that they are not compromised).

[17] To be sure, the commenters' constrained description of the applicable common law immunity is wrong and self-serving. Courts have consistently applied the immunity doctrine to SROs, and the Exchange Act expressly delegates authority to exchanges to "facilitate transactions in securities [and] to remove impediments to and perfect the mechanism of a free and open market." *See, e.g.*, *Standard Investment Chartered, Inc. v. NASD*, 637 F.3d 112 (2d Cir. 2011); *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49, 59 (2d Cir. 1996) ("[A]bsolute immunity is particularly appropriate in the unique context of the self-regulation of the national securities exchanges.").

analyzing the consistency of the Proposal with the Exchange Act. That being said, however, Nasdaq believes it important to correct at least some of the erroneous claims made by commenters about the doctrine and the case law governing it.

First, the Exchange Act expressly delegates authority to exchanges to "facilitate transactions in securities [and] to remove impediments to and perfect the mechanism of a free and open market." Consistent with that directive, an unbroken line of cases has recognized the applicability of immunity to exchanges from 1975 to the present.[18] *See, e.g., Standard Investment Chartered, Inc. v. NASD*, 637 F.3d 112 (2d Cir. 2011).

Second, commenters' arguments that NASDAQ's actions on May 18th do not qualify for common law immunity misstate governing law. For example, Citi incorrectly purports to quote the *Weissman* decision as standing for the proposition that an SRO is not entitled to immunity for "its efforts to avoid a failed IPO."[19] The *Weissman* court said no such thing, and neither has any other court. Thus, Citi's principal legal authority is manufactured out of whole cloth. Nor has any court ever held that immunity no longer applies because exchanges are for-profit companies or because "[t]he era of market self-regulation has passed."[20]

Finally, one commenter argues that immunity is contrary to public policy.[21] That is not the conclusion the courts have reached. On the contrary, courts consistently have recognized the strong policy grounds for applying immunity, holding that "absolute immunity is particularly appropriate in the unique context of the self-regulation of the national securities exchanges." *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49, 59 (2d Cir. 1996). One important policy

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[18] The contention of one commenter that national securities exchanges act as market participants, not SROs, is illogical and inconsistent with the plain language of the Exchange Act (and of the commenter's own letter). *See* SIFMA letter at 2 ("As a national securities exchange, NASDAQ also is an SRO pursuant to Section 3(a)(26) of the Exchange Act."); Section 19(a)(1), 15 U.S.C. § 78s(a)(1) (section entitled "Registration, Responsibilities and Oversight of Self-Regulatory Organizations" refers to, *inter alia*, "a national securities exchange"). The Supreme Court has made clear that SROs include national securities exchanges. *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 233 (1987). Exchanges have always been among the entities to which immunity applies. *See, e.g., DL Capital Group, LLC v. NASDAQ Stock Market, Inc.*, 409 F.3d 93, 98 (2d Cir. 2005); *D'Alessio v. New York Stock Exchange, Inc.*, 258 F.3d 93, 106 (2d Cir. 2001); *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49, 105 (2d Cir. 1996). No court has ever held that an exchange is merely a "market participant."

[19] Citi Letter at 13 (inaccurately purporting to quote *Weissman v. NASD*, 500 F.3d 1293, 1297 (11th Cir. 2007). The Citi Letter also contains a number of erroneous statements of fact. Among these is the assertion (on page 3) that Nasdaq's rulebook is not posted on its website. In fact, two Nasdaq websites -- www.nasdaqomx.com and www.nasdaqtrader.com – post links to the Nasdaq rulebook (available at http://nasdaqomx.cchwallstreet.com/) on their homepages. In addition, searching "Nasdaq rules" on Google easily retrieves the Nasdaq rules. Similarly, Citi's claims to the contrary notwithstanding, the Commission is well aware that Nasdaq continues to have an active program to enforce the numerous market conduct rules in its rulebook through its own MarketWatch Department and its active partnership with FINRA.

[20] Citi Letter at 3.

[21] Citi Letter at 11.

justification for immunity is demonstrated by the sheer magnitude of the claims now being threatened. Immunity is necessary to prevent NASDAQ and other SROs from being "unduly hampered" in carrying out their regulatory functions by "disruptive and recriminatory lawsuits." *DL Capital Group, LLC v. NASDAQ Stock Market, Inc.*, 409 F.3d 93, 99 (2d Cir. 2005).

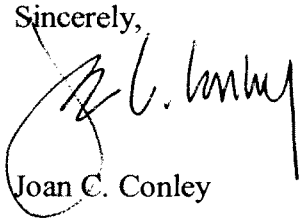
V. The Accommodation Proposal Will Benefit Retail Investors and Protect the Public Interest

Although Nasdaq has no direct relationship with retail investors, the Accommodation Proposal benefits them and protects the public interest. The Proposal provides that "[t]o the extent that a member receiving accommodation hereunder had customers that incurred losses, Nasdaq believes that *accommodation payments received by members from Nasdaq should be used for the benefit of such customers.*"[22] To ensure compliance with that principle, the Proposal requires each member to submit an attestation detailing "the amount of compensation . . . provided or to be provided by the member *to its customers.*"[23] If a member does not submit the attestation, it cannot receive accommodation with respect to claims based on customer orders.[24] Moreover, the Proposal provides for accommodation payments to be made in tranches that prioritize payments based on the extent to which the claimant has compensated its customers.[25] Nasdaq notes that no commenters criticized this aspect of the Proposal, and Nasdaq believes that it will ensure that accommodations are used for the benefit of the investing public.

Conclusion

For all of the foregoing reasons, and as further explained in its Rule 19b-4 filing, Nasdaq submits that its Accommodation Proposal is consistent with the Exchange Act and requests approval of the Proposal by the Commission.

Sincerely,



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[22] Accommodation Proposal, 77 FR at 45712 (emphasis added).

[23] *Id.* (emphasis added).

[24] *Id.* at 45712-45713.

[25] *Id.*