



AUGUST 22, 2012

Via Electronic Mail (rule-comments@sec.gov)

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-NASDAQ-2012-090; Notice of Filing of Proposed Rule Change to Amend Nasdaq Rule 4626 – Limitation of Liability

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ appreciates the opportunity to comment on the above-referenced filing, which is a proposed rule change filed by the Nasdaq Stock Market (“Nasdaq”) with the Securities and Exchange Commission (“Commission”).² Nasdaq has proposed to modify its Rule 4626 in an effort to compensate its member firms for the effect of numerous systems and technical malfunctions that Nasdaq experienced during the May 18th, 2012, Initial Public Offering (“IPO”) of Facebook, Inc. (“Facebook”). However, Nasdaq’s proposal raises significant policy and procedural issues that the Commission should take into consideration when ruling on the proposal. Specifically:

- On a policy level, it is clear that Nasdaq is using the proposed rule change to establish grounds to claim regulatory immunity from lawsuits arising out of its actions during the Facebook IPO. SIFMA does not believe that Nasdaq is entitled to regulatory immunity in connection with the Facebook IPO, because Nasdaq was acting as a for-profit market participant, not in its capacity as a self-regulatory organization (“SRO”). Therefore, at a minimum, we believe the Commission should clearly state in any approval or disapproval of the proposed rule change that its action is limited to determining whether or not the proposed rule change is consistent with the requirements of the Securities Exchange Act of 1934 (“Exchange Act”) and the rules and regulations thereunder, and does not

¹ The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² Securities Exchange Act Release No, 67507 (July 26, 2012), 77 FR 45706 (August 1, 2012).

constitute a factual finding or a legal determination regarding Nasdaq's role in the Facebook IPO.

- Additionally, SIFMA requests that Nasdaq and the Commission address two procedural issues related to the compensation plan. First, Nasdaq should waive the one-year time limit in Sections 18 and 19 of its Services Agreement in connection with any claims, disputes, controversies, or other matters in question relating to the Facebook IPO. Second, Nasdaq should provide clarification that member firms participating in the compensation plan will not be required to release Nasdaq from liability until they have received a final payment amount under the plan.

The Proposed Rule Change Should Not Provide Nasdaq with Regulatory Immunity.

The proposed amendments to Nasdaq Rule 4626 would provide an exception from Nasdaq's rule-based limitation on liability, under which Nasdaq would compensate its member firms for some of the financial losses they incurred as a result of Nasdaq's systems issues during the Facebook IPO. SIFMA is not expressing a view on the sufficiency of Nasdaq's compensation to its member firms under the proposal. However, as described in more detail below, the proposal raises significant issues as to Nasdaq's roles and responsibilities in the market place.

As background, member firms interact with Nasdaq in two capacities, both in Nasdaq's capacity as an exchange and as an SRO:

- Nasdaq is registered with the Commission as a national securities exchange under Section 6 of the Exchange Act. In addition, Nasdaq is a for-profit corporation that is part of a global, publicly-traded corporation, The Nasdaq OMX Group, Inc. In its capacity as a for-profit national securities exchange, Nasdaq has a commercial objective to earn revenues through, among other things, the transaction fees and listings fees that it receives through the operation of a stock market.
- As a national securities exchange, Nasdaq also is an SRO pursuant to Section 3(a)(26) of the Exchange Act.³ In that capacity, Nasdaq is governed by Section 19 of the Exchange Act, which is titled, "Registration, Responsibilities, and Oversight of Self-Regulatory Organizations." In particular, Section 19(g)(1) of the Exchange Act provides that every SRO shall comply with the Exchange Act, the rules and regulations thereunder, and its own rules. Section 19(g)(1) also provides directives to specific types of SROs, as well as those that are specific to national securities exchanges. For instance, Section 19(g)(1)(A) provides that exchanges must enforce its members' compliance with the Exchange Act, the rules and regulations thereunder, and the exchange's own rules.

³ Under Section 3(a)(26), SROs include not only national securities exchanges, but also registered national securities associations (e.g., FINRA), registered clearing agencies, and the Municipal Securities Rulemaking Board.

Accordingly, the Exchange Act recognizes that national securities exchanges act in two distinct statutory roles: (1) as national securities exchanges, they act as market participants; and (2) as SROs, they act as market regulators. In SIFMA's view, Nasdaq's actions in connection with the Facebook IPO were solely in its role as a market participant, not as a market regulator, because Nasdaq's purpose in competing for the Facebook listing, serving as Facebook's primary exchange, and opening trading in the Facebook IPO was to further its business objectives as a for-profit corporation.

In its proposal, Nasdaq makes a number of arguments and assertions that it acted in an SRO capacity on May 18, 2012 with respect to the Facebook IPO and therefore is entitled to immunity from liability with respect to the damages caused by Nasdaq's commercial decisions on May 18th and the malfunctions of its systems and technology on that day. For instance:

- Nasdaq states that “[i]n the weeks since the Facebook IPO, Nasdaq has reviewed the events of May 18 with the goal of proposing a fair and equitable accommodation policy that is consistent with the Exchange Act and Nasdaq’s self-regulatory obligations.”⁴
- In discussing its decision to proceed with the IPO even after experiencing material systems issues, Nasdaq states that “[i]n an exercise of its regulatory authority, Nasdaq determined to proceed with the IPO at 11:30 a.m. rather than postpone it.”⁵ Nasdaq states further that “in Nasdaq’s regulatory judgment, the conditions after 11:30 a.m. did not warrant a halt of trading.”⁶ Moreover, Nasdaq states that “[u]pon concluding shortly before 11:30 a.m. that a system modification would resolve all system issues, Nasdaq, in an exercise of its market oversight obligations, determined to proceed with the IPO.”⁷
- Nasdaq expressly addresses regulatory immunity in its statutory basis for the proposal, stating that it “does not believe that the purposes of the [Exchange] Act related to the operation of the national market system would be well served...by effecting a wholesale modification to the risk and loss allocations underlying Rule 4626 and the similar rules of other exchanges that reflect the exchanges’ exercise of the regulatory authority and obligations delegated to exchanges by the Act. In this regard, it bears noting that in light of those regulatory duties, exchanges are also immune from civil liability for claims for damages caused by actions taken in connection with the discharge of their regulatory duties.”⁸

As the Commission is aware, there is a body of case law that provides SROs with immunity from lawsuits in limited situations involving the specific discharge of their

⁴ 77 FR at 45707.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* at 45709.

⁸ *Id.* at 45714.

responsibilities as SROs.⁹ However, the courts have extended this immunity to SROs only because they “stand in the shoes” of the Commission¹⁰ to perform a variety of regulatory functions that would otherwise be performed by the Commission.¹¹ As one court has noted, an SRO is entitled to immunity “when it engages in conduct consistent with the quasi-governmental powers delegated to it pursuant to the Exchange Act and the regulations and rules thereunder.”¹² In addition, courts considering these cases have stated that the extension of regulatory immunity is to be evaluated on a case-by-case basis, depending upon the nature of the governmental function being performed.¹³ One court in particular has stated that SROs “do not enjoy complete immunity from suits; it is only when they are acting under the aegis of the Exchange Act’s delegated authority that they so qualify. When conducting private business, they remain subject to liability.”¹⁴

SIFMA is of the strong belief that Nasdaq *did not* act in an SRO capacity in carrying out the Facebook IPO. Rather, we believe Nasdaq was operating solely in its role as a for-profit market participant. In this regard, we note that Nasdaq received the Facebook listing, and its attendant listing fees, after a hard-fought competition with the New York Stock Exchange to gain Facebook’s listings business.¹⁵ Nasdaq has provided no justification for its claim in the proposed rule change that it acted as a market regulator during the Facebook IPO.

In this regard, SIFMA is pleased that the Commission directly addressed Nasdaq’s statements on regulatory immunity and emphasized that it was not making any findings or expressing any opinion with respect to Nasdaq’s representations and interpretations contained in the proposal.¹⁶ We request therefore that any final disposition by Commission on the proposed rule change, whether approval or disapproval, should include similar language. Further, while we recognize that the Commission will be required to make a finding as to whether the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder, Nasdaq should not be permitted to leverage general conclusions or findings by the Commission on the proposal to support any claims of regulatory immunity.

⁹ See, e.g., *DL Capital Group, LLC v. Nasdaq Stock Mkt., Inc.*, 409 F.3d 93, 96 (2d Cir. 2005); see also *D’Alessio v. NYSE, Inc.*, 258 F.3d 93, 105 (2d Cir. 2001); *Sparta Surgical Corp. v. National Ass’n of Securities Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998); *Barbara v. NYSE*, 99 F.3d 49, 50 (2d Cir. 1996).

¹⁰ See *D’Alessio*.

¹¹ See *DL Capital Group*, 409 F.3d at 97.

¹² *Id.*

¹³ See, e.g., *D’Alessio*, 258 F.3d at 104-105.

¹⁴ *Sparta*, *supra* note 9

¹⁵ See, e.g., <http://dealbook.nytimes.com/2012/04/05/facebook-picks-nasdaq-for-i-p-o/>

¹⁶ Specifically, the Commission stated that it “emphasizes that this notice was solely prepared by Nasdaq. As with all self-regulatory organization rule filings, the representations, views, and opinions contained in the notice are those of Nasdaq. The Commission is publishing the notice pursuant to the Exchange Act and the rules thereunder. The Commission neither makes any findings nor expresses any opinion with respect to Nasdaq’s representations and interpretations contained in this notice.” 77 FR at 45707, n.3.

Nasdaq Should Waive the One-Year Time Limitation in its Services Agreement for Bringing Claims Against Nasdaq

All Nasdaq member firms are required to execute the “Nasdaq OMX U.S. Services Agreement” in order to gain access to Nasdaq’s exchange facilities.¹⁷ Section 18(H) of that agreement provides that any claim, dispute, controversy, or other matter in question arising out of the agreement must be made no later than one year after it has arisen. Section 19 of the agreement provides that any claim, dispute, controversy, or other matter in question arising out of the agreement is expressly waived if it is not brought within that period. The application of that time limitation is unrealistic given that the process that Nasdaq has set out in the proposed rule change is such that member firms are unlikely to have certainty on payments under the plan until after May 18, 2013 – the one-year anniversary of the Facebook IPO.

Specifically, Nasdaq’s proposed rule change sets out a process that, even if it is approved by the Commission, will not be fully effectuated until after the approval of the current proposed rule change and then approval of a subsequent proposed rule change. The public comment and Commission approval process for those two proposed rule changes could easily extend past May 18, 2013. Unless Nasdaq waives the application of Section 18(H) and Section 19 of the Nasdaq OMX U.S. Services Agreement, Nasdaq’s member firms could lose their ability to pursue their own claims in this matter if they ultimately determine that they are not satisfied with Nasdaq’s compensation, or if the Commission does not approve Nasdaq’s proposal. Accordingly, SIFMA believes that Nasdaq should waive the application of Sections 18(H) and 19 of its Services Agreement in connection with any claims, disputes, controversies, or other matters in question relating to the Facebook IPO.

Nasdaq Member Firms Should Not be Required to Release Nasdaq from Liability Before they Receive a Final Payment Amount Under the Plan.

Under the proposed rule change, Nasdaq would require its member firms to execute a release of claims against Nasdaq as a condition of receiving payments under the compensation plan for losses associated with the Facebook IPO related to Nasdaq’s conduct on May 18, 2012. Ultimately, the Commission will have to determine whether the requirement of such a release in this context is consistent with the requirements of the Exchange Act and the rules and regulations thereunder. However, if the Commission agrees to approve Nasdaq’s release requirement, SIFMA believes Nasdaq should clarify that its member firms participating in the Facebook IPO compensation plan would not be required to execute a release of claims against Nasdaq until the firms have been informed of the specific amounts they will receive under the compensation plan. As noted above, Nasdaq’s compensation plan involves two separate and consecutive proposed rule changes: the current proposal seeking Commission approval to put the plan in place, and a second proposal that, assuming the Commission approves the current proposal, would provide for the actual payment process.

¹⁷ See http://www.nasdaqtrader.com/content/AdministrationSupport/AgreementsTrading/nasdaq_access_agreement.pdf

Nasdaq states in the current proposal that member firms would be required to submit to Nasdaq, not later than *seven* days after the effective date of the second proposed rule change, an attestation detailing the amount of its claim. However, the amounts of the compensation payments would not be finalized at that time because Nasdaq has stated that it may have to prorate (and therefore reduce) claims after they are submitted, depending on the total amount of claims. As stated above, Nasdaq would require any final payment to a member firm under the compensation plan be conditioned on the execution by the member firm of a formal release of claims against Nasdaq for losses associated with the Facebook IPO related to Nasdaq's conduct on May 18, 2012. It should be noted that the release would have to be submitted not later than within *14 days* after the effective date of the second proposal – just seven days after the deadline for submitting attestations of claims. There are no assurances in the proposal that Nasdaq member firms would know the final amounts to be received under the compensation by the time of that 14-day deadline. Accordingly, Nasdaq should clarify that the deadline for filing a release of claims will be set *after* member firms are notified of the final amount that Nasdaq is willing to pay under the compensation plan.

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SIFMA appreciates the opportunity to comment on the proposed modifications to Nasdaq Rule 4626. We look forward to discussing the matter further with the Commission and its staff. If you have any comments or questions, please do not hesitate to contact me at 202-962-7383 or tlazo@sifma.org.

Sincerely,



Theodore R. Lazo
Managing Director and
Associate General Counsel

cc: Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Daniel J. Gallagher, Commissioner
Robert W. Cook, Director, Division of Trading and Markets