FINKELSTEIN THOMPSON LLP

August 22, 2012

Reply to Washington, D.C. office

Writer's direct email: dthompson@finkelsteinthompson.com

VIA EMAIL

Ms. Elizabeth A. Murphy
Secretary
Securities and Exchange Commission
100 F Street NW
Washington, DC 20549-1090
rule-comments@sec.gov

Re: File Number SR–BX–2012–090

Dear Ms. Murphy:

NASDAQ has submitted a rulemaking proposal in the form of an amendment to NASDAQ Rule 4626, the stated purpose of which is to seek "the SEC's approval of a voluntary accommodation policy for claims arising from system difficulties that Nasdaq experienced during the initial public offering ("IPO") of Facebook, Inc. ("Facebook" or "FB") on May 18, 2012." Securities Exchange Act Release No. 67507 (July 26, 2012), 77 FR 45706, 45707 (Aug. 1, 2012) (SR-NASDAQ-2012-090) (hereinafter "NASDAQ Proposal").

These comments on the above NASDAQ Proposal are submitted on behalf of the plaintiffs and counsel in the following class action cases, which are currently pending before the United States District Court for the Southern District of New York:

- *Phillip Goldberg, David Kenton, Randy and Teresa Mielke, Nuhket Kahayan, George Michalitsianos, Crystal McMahon, Benjamin Levi, Steve Jarvis, Atish Gandhi, Dmitri Bougakov, Eric Hamrick, Colin Suzman, Katherine Loiacono, Meredith Bailey, Faisal Sami, Ryan Cefalu, Sanjeev Sharma, Dennis Kuhn, Lorrain Chin, Jacinto Rivera and Joe Johnson v. NASDAQ OMX Group, Inc. and The NASDAQ Stock Market LLC,* Case No. 12-cv-4054 ("Goldberg Action");

- *Jun Yan v. NASDAQ OMX Group, Inc. and The NASDAQ Stock Market LLC*, Case No. 12-cv-4200 ("Yan Action");

- *Elbita Alfonso, Vicky Jones, Steve Griffis, Phyllis Peterson, Edward Vernoff, and Jerry Rayburn v. The NASDAQ Stock Market LLC and NASDAQ OMX Group, Inc.*, Case No. 12-cv-4201 ("Alfonso Action");

- *Lidia Levy v. The NASDAQ Stock Market LLC and NASDAQ OMX Group, Inc.*, Case No. 12-cv-4315 ("Levy Action");

- *Khodayar Amin v. The NASDAQ Stock Market LLC and NASDAQ OMX Group, Inc.*, Case No. 12-cv-4403 ("Amin Action");

- *Barbara Steinman v. NASDAQ OMX Group, Inc. and The NASDAQ Stock Market LLC*, Case No. 12-cv-4600;

- *Chad Roderick v. NASDAQ OMX Group, Inc. and The NASDAQ Stock Market LLC*, Case No. 12-cv-4716; and

- *Eric McGinty v. NASDAQ OMX Group, Inc. and The NASDAQ Stock Market LLC*, Case No. 12-cv-5549.

Plaintiffs in the Goldberg Action are represented by Finkelstein Thompson LLP, Lovell Stewart Halebian Jacobson LLP, Zamansky & Associates LLC, Goldberg, Finnegan, & Mester, LLC, Miller Law LLC, and DiTommaso Lubin. Plaintiff in the Yan Action is represented by Murray Frank LLP. Plaintiffs in the Alfonso Action are represented by Gainey & McKenna and Rigrodsky & Long, P.A. Plaintiff in the Levy Action is represented by the Egleston Law Firm and the Law Offices of Scott D. Egleston. Plaintiff in the Amin Action is represented by the Law Offices of Thomas G. Amon, Robbins Umeda LLP, and The Wright Law Office, P.A. Plaintiff in the Steinman Action is represented by Stamell & Schager, LLP. Plaintiff in the Roderick Action is represented by Murray Frank LLP, Powers Taylor LLP, and The Briscoe Law Firm, PLLC. Plaintiff in the McGinty Action is represented by Kirby McInerney LLP.

I. INTRODUCTION

These cases ("NASDAQ Actions") are brought on behalf of a class of investors who made retail purchases of Facebook, Inc. ("Facebook") stock during the IPO on May 18, 2012, whose buy, sell, or cancel orders were not promptly and correctly processed, executed, and confirmed, and who suffered damages as a result. The NASDAQ Actions allege that NASDAQ OMX Group, Inc. and The NASDAQ Stock Market LLC (collectively "NASDAQ") were negligent in the preparation for and execution of the Facebook IPO. In the most common scenario, plaintiffs and class members placed orders that did not immediately execute, then timely cancelled the orders, only to find out hours, or even days later that the orders had been filled against their wishes, and at prices that had already resulted in large embedded market losses. The complaints allege that NASDAQ failed to adequately prepare for the huge expected volume of Facebook trades, and that its order processing software had major flaws that it was never able to satisfactorily resolve.

The recent financial crisis has sorely shaken the confidence of American investors. The Commission cannot afford to take action that will further erode investor confidence, which is already dangerously low. Approving NASDAQ's proposed amendment to Rule 4626 ("the Proposed Amendment") would do just that. NASDAQ offers to pay compensation only to its own member firms but offers no compensation plan directly tailored to the retail investors, or that would provide any degree of certainty that any of the member-firm compensation would flow through to ordinary retail investors. This would further perpetuate the narrative—already firmly fixed in the minds of many—that America's financial system is a rigged game in which insiders and big players receive bailouts and bonuses, while small investors bear the losses and pick up the bill.

The NASDAQ proposal is deficient and does not promote fair and equitable principles of trade or protect investors and the public interest in at least the following ways:

(1) The proposal purports to cover only a fraction, $62 million, of the hundreds of millions in losses that have been estimated in media reports;

(2) The proposal is merely a voluntary offer to the handful of large trading firms who are NASDAQ members;

(3) The proposal contains no provisions to reimburse ordinary retail investors for their losses, and it does not provide any degree of certainty that any amount of compensation will trickle down to the retail investor level;

(4) The proposal severely limits the kinds of transactions eligible for compensation as well as the measure of loss;

(5) The proposal is loaded with NASDAQ's own self-serving factual and legal assumptions – assumptions for which NASDAQ does not provide the underlying data and analysis, and assumptions that are contradicted by contemporaneous media reports.

While the NASDAQ Actions do not believe the proposal to be in the public interest, we recognize that the proposal at its core is a purely voluntary offer of compromise between NASDAQ and its own member firms. We do not wish these comments to be construed as an attempt to roadblock a purely private settlement offer that affects solely NASDAQ and its members, or prevent the NASDAQ member firms from individually accepting or rejecting the offer. Rather, the overriding concern of the NASDAQ Actions is that nothing stand in the way of the retail investors (whom NASDAQ does not propose to offer compensation) seeking full and fair compensation for their losses in a court of law. Accordingly, the NASDAQ Actions submit these comments primarily to urge the Commission, whether or not it approves

some form of the NASDAQ proposal, to do its utmost to ensure that nothing the Commission does or says would in any way jeopardize, hamper or limit the ability of retail investors to seek a full recovery of their losses in court. In particular, we urge the Commission to clarify, in whatever it finally adopts, that it makes no findings or rulings concerning, and expresses no approval of, such matters as NASDAQ's self-serving assumptions of the underlying facts, of the categories of transaction-types that should be eligible for compensation, of the appropriate measures of compensation, or of the scope of its claimed immunity from civil liability for its own negligence. NASDAQ's proposed rule change is for the limited purpose of making a one-time voluntary accommodation offer to its own members. Adoption of the proposed rule change does not require the Commission to make findings or rulings on the myriad of factual and legal assumptions that NASDAQ posits—assumptions that are self-serving, controversial, and untested in the crucible of an adversary proceeding—and the Commission should carefully avoid doing so.

Finally, we urge the Commission to state explicitly that any regulatory approval of the Proposed Amendment should not be construed to limit or affect the rights of retail investors to seek full redress against NASDAQ in court. Our detailed comments follow.

II. THE COMMISSION SHOULD PROCEED WITH CARE TO ASSURE THAT THIS MATTER REMAINS WITHIN THE PROPER AMBIT OF A RULEMAKING AND DOES NOT SPILL OVER INTO AN IMPROPER ADJUDICATION OF SPECIFIC DISPUTES

It is axiomatic that administrative agencies should use rulemaking to make policy and rules of general applicability, but must use adjudicatory proceedings for the resolution of specific, concrete disputes involving individual rights or duties. *See generally*, 1 Admin. L. & Prac. § 2:12 (3d ed.); Charles

Alan Wright & Charles H. Koch, Jr., 32 Fed. Prac. & Proc., Judicial Review of Administrative Action Sec. § 8122 (1st 3d.) ("Adjudication is a determination of individual rights or duties.")[1]

Here, read broadly, the Proposed Amendment appears to call upon the Commission to make a one-time resolution of potential claims of specific individuals (the NASDAQ member firms) arising from a specific event (the Facebook IPO) involving specific disputed facts, and not to fashion a general rule of prospective, future applicability. The increase in the Rule 4626 liability limits that the NASDAQ requests is for this event only. Moreover, NASDAQ is asking the Commission to include in the amended rule specific and detailed provisions as to the overall dollar amount that NASDAQ proposes to pay as compensation, the specific types of cross orders that it proposes to recognize as eligible for compensation and those it proposes should not be eligible, the measures used to calculate the amount of eligible losses, to whom and under what conditions compensation will be offered, and scope of the release that must be executed. All of these subjects are specifically covered in the Proposed Amendment. *See* Proposed

[1] "[T]hree primary considerations [in distinguishing adjudication from rulemaking] are: (1) whether the government action applies to specific individuals or to unnamed and unspecified persons; (2) whether the promulgating agency considers general facts or adjudicates a particular set of disputed facts; and (3) whether the action determines policy issues or resolves specific disputes between particular parties." *Gallo v. U.S. Dist. Court for Dist. of Arizona*, 349 F.3d 1169, 1182 (9th Cir. 2003), *cert. denied*, 541 U.S. 1073.

"Two principle characteristics distinguish rulemaking from adjudication. First, adjudications resolve disputes among specific individuals in specific cases, whereas rulemaking affects the rights of broad classes of unspecified individuals. Second, because adjudication involves concrete disputes, they have an immediate effect on specific individuals (those involved in the dispute). Rulemaking, in contrast, is prospective, and has a definitive effect on individuals only after the rule subsequently is applied." *Yesler Terrace Community v. Cisneros*, 37 F.3d 442, 448 (9th Cir. 1994).

Amended Rule 4626, SR-NASDAQ-2012-090 Ex. 5, Sections (b)(3) and subsections (A) through (H).[2] And yet all of them are subject to legitimate dispute.

In essence NASDAQ is asking the Commission to put its imprimatur on a detailed offer of settlement and compromise to resolve on a one-time basis all potential claims of its members arising from a discrete series of events and involving a limited number of participants and claimants. As such, the Proposed Amendment has all the earmarks of the adjudication of a specific controversy and not the making of a rule of general applicability.[3]

The adjudicative nature of the proposal is underscored by NASDAQ's recitation of numerous, potentially disputed factual predicates. The factual predicates include, inter alia, the circumstances and causes of the system malfunctions that permeated the IPO process, the impact of the malfunctions upon various types of trade orders, the impact of the malfunctions at various times during the trading day, what the correct market opening and subsequent prices would have been in the absence of the system malfunctions, when the system returned to normal operations, how reasonable investors would have behaved in the face of a malfunctioning system that was producing either no timely information regarding prices and execution of trade orders, or misinformation, and what kinds of transactions should be considered eligible for compensation.

The Commission should not engage in even the appearance of resolving any of these potential fact issues in the guise of a rulemaking proceeding, and it is unnecessary for the Commission to do so. The

[2] Available at http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2012/SR-NASDAQ-2012-090.pdf.

[3] The 2011 increase in the Rule 4226 limit to $5 million was quite different in that it was a permanent increase applicable to future events and did not involve the kind of specific, detailed settlement offer proposed here. *Cf.* Securities Exchange Act Release Nos. 64365 (April 28, 2011), 76 FR 25384 (May 4, 2011) (SR-NASDAQ-2011-058), *and* 67507 (July 26, 2012), 77 FR 45706 (Aug. 1, 2012) (SR-NASDAQ-2012-090).

Commission could simply approve the requested increase in NASDAQ Rule 4626 liability limits to its member firms for the purpose of allowing NASDAQ to make a compromise offer of settlement to those members, all without resolving or even appearing to agree with any of NASDAQ's self-serving factual predicates. Whether to accept the offer, or pursue their legal remedies, would then be a decision solely left to the member firms, and there would be no Commission findings on disputed factual or legal issues that might taint or hamper the rights of retail investors to seek appropriate remedies in a court of law.

III. THE COMMISSION SHOULD MAKE NO FINDINGS, RULINGS OR COMMENTS REGARDING CLAIMS OF NASDAQ IMMUNITY OR LIMITATIONS ON NASDAQ'S LIABILITY

The NASDAQ Proposal goes further than necessary to implement a voluntary, one-time compensation offer to its members, and broadly posits that NASDAQ would otherwise be immune from liability for an activity that amounts to its private, for-profit business of increasing trading volume and profits by encouraging big, high-profile IPO's like Facebook to go forward on the NASDAQ stock exchange rather than competing stock exchanges. NASDAQ states that "exchanges are also immune from civil liability for claims for damages caused by actions taken in connection with the discharge of their regulatory duties," implying that handling an IPO is somehow a regulatory function delegated by the Commission and that such immunity would apply to the Facebook IPO. The Commission need not, and should not, make any findings, rulings or comments as to NASDAQ's self-serving claims of purported immunity in this rulemaking context, where all that is necessary is a narrow approval (or disapproval) to raise NASDAQ's member compensation limits on a one-time basis, in an amount sufficient to accommodate the proposal.

NASDAQ only enjoys absolute immunity from suits for civil damages when it performs "regulatory, adjudicatory, or prosecutorial duties in the stead of the SEC." *Weissman v. Nat'l Ass'n of*

Secs. Dealers, Inc., 500 F.3d 1293, 1298 (11th Cir. 2007). NASDAQ is not entitled to immunity for acts performed in the furtherance of its own business interests, or acts that would not be performed by the government in the absence of NASDAQ. *See id.* at 1299 (rejecting immunity claim for NASDAQ's promotion of WorldCom stock); *Opulent Funds, L.P. v. The NASDAQ Stock Market LLC*, No. C-07-03683 RMW, 2007 WL 3010573, at *5 (N.D. Cal Oct. 12, 2007) (rejecting immunity claim for NASDAQ's negligent failure to properly calculate and disseminate index price). As the Eleventh Circuit stated in *Weissman*, "because the law favors providing legal remedy to injured parties, grants of immunity must be narrowly construed; that is, courts must be careful not to extend the scope of the protection further than its purposes require." 500 F.3d at 1297 (internal quotation marks omitted).

Whether NASDAQ's alleged negligence in conducting the Facebook IPO falls outside the scope of the Exchange Act's delegated authority, and hence does not qualify for quasi-governmental immunity from civil suits by investors, will be a hotly contested issue in the investor litigation. Indeed, the Commission itself has recognized the important difference between the exercise of delegated regulatory authority and the business of running a stock exchange, and has voiced the well-founded concern that "[a]s competition among markets grows, the markets that SROs operate will continue to come under increased pressure to attract order flow. This business pressure can create a strong conflict between the SRO regulatory and market operation functions." Concept Release Concerning Self-Regulation, Release No. 34-50700 (Nov. 18, 2004), 69 FR 71256 (Dec. 8, 2004) (S7-40-04).

In ruling upon the NASDAQ Proposal, the Commission should take care not to do or say anything to jeopardize or compromise the ability of investors fully and fairly to litigate the immunity questions in a court of law, but should remain neutral so as not to tilt the playing field. A ruling by the Commission upon the scope of NASDAQ immunity is not necessary for this rulemaking, and the Commission should

expressly state it is making no such ruling. The Proposed Amendment is a wholly voluntary accommodation to be offered exclusively to exchange members, and only those members who voluntary agree to participate will be required to sign releases. All that is required of the Commission is to allow NASDAQ to raise its member compensation limits in NASDAQ Rule 4626 to fit the parameters of the voluntary offer.

By the same token, the Commission should refrain from ruling or comment upon the scope of NASDAQ Rule 4626 or its potential applicability to the negligence claims of retail investors. By virtue of its plain language and its context, Rule 4626 has no bearing on such investor claims. We note that Rule 4626 is a NASDAQ internal rule that purports to govern the relationships between NASDAQ and the firms who have applied for and been granted membership and who are authorized to use the facilities of the NASDAQ exchange. NASDAQ member firms are required to agree to Rule 4626 as a condition of membership and use of the exchange facilities.

The NASDAQ rules by their own explicit terms apply to members: "These Rules shall apply to all members and persons associated with a member. Persons associated with a member shall have the same duties and obligations as a member under these Rules." NASDAQ Rule 0115(a). A member is defined as, "any registered broker or dealer that has been admitted to membership in Nasdaq. A Nasdaq Member is not a member of Nasdaq within the meaning of the Delaware Limited Liability Company Act by reason of being admitted to membership in Nasdaq." NASDAQ Rule 0120(i).

NASDAQ itself states that Rule 4626 applies only to use of the exchange facilities by members: "Accordingly, the Commission has recognized that it is consistent with the purposes of the act for a self-regulatory organization to limit its liability *with respect to the use of such facilities by its members*

through rules such as Rule 4626." NASDAQ Proposal, 77 FR at 45714 (emphasis added).[4]

Because any limitations on liability of NASDAQ contained in Rule 4626 apply only to NASDAQ members or other sponsored or registered participants on the NASDAQ exchange, and because the Proposed Amendment is only for the purpose of permitting a voluntary accommodation offer to be made to those same NASDAQ members, the Commission need not and should not purport to address the scope and applicability, if any, of that rule to retail investors who are not NASDAQ members and not subject to NASDAQ's internal member rules.

IV. THE COMMISSION SHOULD REFRAIN FROM RULING ON NASDAQ'S ASSUMPTIONS CONCERNING TRANSACTIONS ELIGIBLE FOR COMPENSATION AND MEASURES OF DAMAGES

NASDAQ proposes a compensation plan that is (1) voluntary; and (2) applies only to members of the NASDAQ Market Center. It provides no compensation to retail investors, voluntary or otherwise. Although NASDAQ proposes to give certain priorities in compensation to the extent that members in turn have agreed to compensate their own customers, it bears noting that the members' customers are typically broker-dealer firms and not retail investors. In addition, the NASDAQ proposal severely limits the types of transactions that would be considered eligible for compensation in the first instance. Thus, whether retail investors ultimately will receive any benefit from the proposal is uncertain and hinges on the extent and nature of voluntary accommodations by the members and their customers.

Nevertheless, NASDAQ purports to define standards for, and place limits on, what types of transactions should be compensated and by how much. NASDAQ, however, should not be permitted to speak for what is a fair means of compensating the investing public for the damages caused by NASDAQ's negligence on the opening day of Facebook trading on May 18, 2012. NASDAQ addresses

[4] The terms of Rule 4626 are replete with references to "members," "market participants," and "use of the market center." *See, e.g.*, Rule 4626 (a), (b), and (b)(1) through (b)(4).

its voluntary accommodation proposal exclusively to its own membership, and throughout its analysis, it is clear that the standard employed for establishing the boundaries for compensation is based upon the superior market position and knowledge of a NASDAQ member and not that of a typical retail purchaser of Facebook shares.

NASDAQ proposes to make "accommodation payments" to its members under certain limited circumstances which are in no way conceived to address the myriad of ways in which the investing public, trusting in the efficacy and competence of the NASDAQ system, suffered material losses by transacting on the NASDAQ market in shares of Facebook on the first day of trading. As described in the Introduction, the far more typical scenario for a retail investor in Facebook involved placing a pre-market buy order, and then after seeing delays in the actual opening of the shares, placing a timely cancellation of that buy order. When the market finally did open for trading, the typical investor did not promptly receive a purchase confirmation and therefore reasonably assumed that the order had been cancelled. Only much later on that Friday afternoon, or in some cases as late as the next Monday, the investor received a confirmation of a purchase at the opening price of $42.00 per share, at a time when the market for Facebook shares had already fallen several dollars lower, or, by the following Monday, even below the offering price of $38.00. In this scenario, the typical investor was unaware that he or she owned Facebook shares or at what price, and by the time confirmations had been sent out, had been denied any opportunity to avoid or mitigate any losses through promptly selling such shares in the marketplace.

However, by directing its remedial concerns solely to member issues, NASDAQ makes clear in its description of "accommodation standards" that within the context of the "unexpected and unprecedented difficulties" experienced with the Cross on the first day of trading, the defining concept would be "the expectation that members would exercise reasonable diligence to respond and mitigate losses once made

aware that their Cross orders had not executed, or had executed at unexpected prices." *See* NASDAQ Proposal, 77 FR at 45708-710. Thus, the very governing premise for any form of compensation makes no allowance for the much different motivations and concerns, and the much different level of information available to, retail investors in Facebook shares during the opening day of trading. It is also abundantly clear that whatever "reasonable diligence" that a member might be able to exercise would in no way comport with the options open to a typical retail client, and that the notice involved here, "to respond and mitigate losses once made aware that their Cross orders had not executed," would not have been the kind of notice available to the average retail investor. *See id* at 45710. Many investors were not notified about the status of their Facebook orders until long after the 1:50 p.m. time on Friday, May 18th when NASDAQ alleges complete information regarding the Cross was disseminated to members, and in some cases not for several days. Even if investors had somehow managed to be informed of the status of their Facebook orders on a roughly contemporaneous basis as were their respective broker-dealers, investors were in no way similarly equipped to obtain necessary market-maker information and execute orders on a similarly advanced transactional level as member firms.

The foundation of NASDAQ's analysis is the manner in which a typical IPO cross process works. Such a process is a fundamental market procedure employed by NASDAQ in basically the same format for many years and well known to any broker-dealer participating in IPO aftermarkets, either as a principal or agent. At the heart of the Facebook Cross analysis is the pinpointing of exactly when the Cross did not operate as expected, and when trading finally resumed in what could be termed as a normal manner for the opening day of trading. Thus, as between member firms, NASDAQ concludes in its analysis that the Cross was functioning normally up until 11:11:00 a.m., with all new order, cancel and

replace messages received before that time duly acknowledged and incorporated into the Cross order book at that time, and that therefore no compensable errors occurred for any orders placed up until then.

The analysis that NASDAQ provides of what could have transpired with various types of orders is predicated on the fact that transaction confirmation messages were not delivered until 1:50 p.m., yet NASDAQ never provides a cogent explanation as to why it took two hours and twenty minutes after the initial print of the Cross to confirm to member participants whether orders had been filled or cancelled, and if filled, at what prices. Instead, NASDAQ provides a detailed examination of what a broker-dealer should have expected based upon the type and time of order placed. None of these scenarios, however, have anything to do with what a retail investor would have known at the time of making an investment decision or while waiting for updated information as the trading day progressed. In fact, of the four categories of transactions for which NASDAQ proposes to make accommodation payments to members, only one posits a scenario in which the member might have lost money in connection with a retail order: the retail customer would have had to have placed a buy order before 11:11 a.m. at a price above $42.00 per share, and then sought a cancellation of the buy order, which the member allowed, prior to 1:50 p.m. Beside this one narrow category of possible events regarding retail orders, all other forms of direct member interactions with retail customers resulting in retail losses that members might have considered covering are excluded from the accommodation scheme.

NASDAQ provides eleven examples of how its proposed accommodation standards would apply, and again only one of the examples, example nine, involves member interaction with a customer, under the fourth category of transactions eligible for accommodation as described above. In that example, NASDAQ agrees to a limited accommodation to the member of 70% of its losses in making the customer whole, up to a maximum loss amount per share based upon 70% of an assumed average price per share

differential at which a member could have covered any position errors once transactions were reported, calculated by NASDAQ to be $42.00 - $40.527 = $1.473. Once again, it is important to note two assumptions by NASDAQ: (1) the average loss differential is premised upon what a diligent member could have achieved in mitigating its losses trading as a broker-dealer for its own account (i.e. a blended transaction price of $40.527 per share), and not what an average retail investor could achieve, placing a retail order in the open market; and (2) NASDAQ is willing to acknowledge, and then only partially make whole, only one of many forms of customer losses directly caused by NASDAQ's negligence, thereby severely dis-incentivizing its members from making any additional accommodations of their own with their customers who were deprived of sufficient knowledge and the ability to mitigate or avoid their own losses in transacting in the Facebook aftermarket.

It is clear from an examination of the NASDAQ accommodation scheme that it is not in the best interests of the investing public, as the emphasis is entirely upon the interaction between NASDAQ and its members, with no real consideration, except in one very limited instance, being given to the many ways in which retail investors in Facebook shares were directly and materially damaged by the negligent acts of NASDAQ in the events leading up to and immediately after the Facebook IPO. Even then, the compensation is only partial and flows only to the member. NASDAQ makes no proposals to compensate non-member investors directly.

Furthermore, beyond the more obvious forms of damages to investors that have been discussed, there is the question of responsibility for other collateral damage that is causally linked to events precipitated by NASDAQ's negligence. The UBS case is instructive as one further example of the kind of injury suffered, where due to a lack of timely transaction confirmations, UBS accumulated a massive position in Facebook shares equal to four times its desired position limit, which it then proceeded to

liquidate in subsequent trading days, putting material downward pressure on the price of Facebook shares. (It should also be noted that UBS was a highly-sophisticated NASDAQ member firm, but even it was not able to detect that its unconfirmed buy orders were in fact being executed and was not able to mitigate its losses, contrary to NASDAQ's assumptions about "reasonable" investor behavior.) As the transaction record becomes clearer over the coming months, there will no doubt be many further examples of excessive buying on the first day of the Facebook aftermarket, caused by the uncertainty of order confirmation status, followed by the inevitable readjustments to reach desired portfolio exposure once the transaction confirmations were fully reported. These types of market distortions, directly leading to large investor losses, would not have occurred but for the negligence of NASDAQ in the handling of the Facebook IPO, and any remedial scheme proposed by NASDAQ, which would purport to compensate all those proximately harmed by NASDAQ's actions, must include a far wider group than its own membership.

V. THE COMMISSION SHOULD NOT MAKE ANY FINDINGS OR RULINGS BASED ON NASDAQ'S NUMEROUS FACTUAL ASSUMPTIONS

NASDAQ states that it "reviewed the events of May 18," and purports to describe the problems that occurred. However, NASDAQ does not provide the underlying basis for any of its factual assumptions, many of which appear to be controversial in light of contemporary media reports and analyses. For example, NASDAQ does not mention or acknowledge reports that it experienced a 17-second system outage or "blackout" which occurred from 11:29:52 to 11:30:09, according to *Nanex LLC*,[5] a firm providing real-time streaming data feeds for all quotes and trades transmitted by the exchanges. NASDAQ also fails to mention that it lacked an eligible national best bid/offer ("NBBO") quotation for

[5] *Nanex Research* has issued several white papers on the Facebook IPO including May 18, 2012 *Facebook IPO* and the *Facebook Fallout* and on June 7, 2012 *Total View and the Facebook IPO*. See http://www.nanex.net/FlashCrash/OngoingResearch.html.

Facebook stock until 13:50 p.m., or that it had stuck quotes during this period. *Nanex* confirmed these disruptions in its June 7, 2012, white paper entitled *Total View and the Facebook IPO*, which analyzed market data on May 18 obtained from NASDAQ's *TotalView*.

The most that NASDAQ has acknowledged publicly was that there was a design flaw in the program that ran the opening cross. On June 6, 2012, in a live television interview with CNBC reporter Maria Bartiromo, Chief Executive Officer of the Nasdaq OMX Group, Inc., Robert Greifeld admitted it was "an additional capability in our IPO cross" which caused problems with the opening cross, and he stated that NASDAQ had to "revert back to a simpler code base." However, despite numerous public interviews, neither Greifeld nor NASDAQ has given any details about the exact nature and origins of the system problems occurring that day. Without such details it is not possible to assess the credibility of NASDAQ's assumptions about the impact of the system breakdown on the functioning of the market for the Facebook IPO and on the investors who placed orders for Facebook stock

First, NASDAQ does not mention apparent disruptions experienced on May 18 and reported in the media. According to *Nanex*'s analysis of NASDAQ's *TotalView* market data, from 11:29:52 to 11:30:09, there was a 17-second outage or "blackout" which occurred in Facebook stock, and all NASDAQ stocks. In the public explanations it has given, including here, NASDAQ fails to address whether orders by investors placed during these 17 seconds were entered or lost. NASDAQ has claimed that it conducted the Opening Cross at 11:30:09 a.m., using all orders received before 11:11:00 a.m. Any orders received which were entered between 11:11:00 a.m. and 11:30:09 a.m., NASDAQ claims were entered into the market at 11:30:09 a.m., and the remainder were canceled or released into the market at 1:50 p.m. And yet NASDAQ makes no provision for those orders that may have been lost during the 17 seconds of outage.

Second, NASDAQ has failed to acknowledge that it lacked an eligible NBBO quotation until 1:50 p.m., or that it had stuck quotes during this period. In addition to *Nanex*, these problems were also reported on May 28, 2012, by Reuters in *Minute By Minute, Nasdaq Chaos Engulfed Facebook IPO*. From 11:30:34 a.m., and for the next two hours and 20 minutes until 1:50 p.m., NASDAQ failed to have an eligible NBBO quote published for Facebook. The NBBO represents the best price available on any market at the time that an order is placed, and customers expect to receive the NBBO when they place a buy or sell order in a security. During this time when NASDAQ had no published NBBO quotation, 272 million shares of Facebook traded. There is no way to ensure that these orders received the best price available.

According to *Nanex*, during the same period without an NBBO, NASDAQ's bid was stuck at $42.99, and failed to update. NASDAQ's ask was non-firm, and got stuck at $38.01 and did not update from 11:54:17 a.m. through 1:50 p.m. These quotes were reported by NASDAQ to the Securities Information Processor (known as "SIPS"), and created a crossed book. The crossed and stuck quotes on the SIPS remained visible to the retail investing public, which lacked direct market feeds.

NASDAQ's compensation plan is also premised on the unverified assertion that a Cross price of $42 per share is correct and accurate. NASDAQ submits that it ran its Cross at 11:30:09 based on all orders received by 11:11:00[6], and that this resulted in the $42 per share price. No explanation has been given why NASDAQ ran the Cross so late, or why it failed to include the additional order modifications that had been received. NASDAQ has also stated that it subsequently reran the Cross and that "[h]ad all

[6] NASDAQ also claims that the initial scheduled release time was extended to 11:05 a.m. and that there were no further extensions. However, at 11:05 a.m., NASDAQ notified investors that trading was postponed to 11:10 a.m., and it was at 11:10 a.m. that it notified investors that trading would begin at 11:30 a.m.

cross-eligible orders, including those entered between 11:11:00 a.m. and 11:20:09 a.m. . . . the Cross still would have taken place at $42.00." *See* NASDAQ Proposal, 77 FR at 45709 n. 20, 22.

Without more specific information on the results of NASDAQ's Cross (and subsequent analysis), including details about the systems that failed and the order data it used, there is no way to evaluate the accuracy of NASDAQ's claim that $42 per share is the correct and accurate price. It is further uncertain, without reviewing the order data, whether NASDAQ's Cross (and subsequent analysis) included all orders placed before 11:30:09, including those during the 17-second outage, or whether orders were omitted or lost.

NASDAQ's assumption of a $42 opening price has been questioned in the media. For example, on June 8, 2012, *Seeking Alpha* published an article which questioned the $42 per share opening price. According to *Seeking Alpha*, there were more than enough Facebook shares that were available at the $38 per share IPO price to satisfy the demand. On June 11, 2012, the *Wall Street Journal* reported that some long-time traders to whom it spoke were skeptical about the accuracy of the $42 per share opening price. Thus, if *Seeking Alpha* or the *Wall Street Journal*'s sources are correct, the Cross price is inaccurate and investors overpaid by $4 per share. Without more specific details from NASDAQ on the scope of its systems problems, the order data used for the Cross and its subsequent analysis, the accuracy of the $42 per share Cross price for the FB IPO cannot properly be evaluated.

NASDAQ also assumes that the Facebook IPO market functioned normally after the cross, but, as noted, the assumption of a normal market is contradicted by the media reports that, from 11:30:09 to 13:50:00 p.m., there was no published NBBO and NASDAQ's book was crossed.

In sum, NASDAQ's proposal is heavily laced with self-serving factual assumptions that directly impact the causes of the system malfunctions and the fairness of NASDAQ's proposed limited categories

and formulas for compensation. NASDAQ has not provided the underlying data that would be necessary to test the accuracy of these assumptions, and many of them are contradicted by media reports. Accordingly, the Commission should not make any findings or rulings that would in any manner suggest its agreement with any of NASDAQ's assumptions. Moreover, findings or rulings based on the NASDAQ assumptions are unnecessary here, where the sole purpose of the rulemaking is to allow an increase in NASDAQ's Rule 4626 limits of liability to its members, solely to facilitate a voluntary offer of compromise to those same members.

VI. CONCLUSION

In the face of widespread media reports of Facebook IPO losses in the several hundreds of millions of dollars, NASDAQ has proposed a mere $62 million compensation package to be offered exclusively to its own member firms, for them to take or leave on a purely voluntary basis, but bereft of any direct or certain plan to compensate for the losses incurred by retail investors. The Proposed Amendment has all the appearance of a self-serving effort by NASDAQ to limit its exposure to an amount that is far less than the losses sustained in the marketplace. Use of NASDAQ funds to offer compensation for only a fraction of the losses, and even then only to the handful of large trading firms who are its members, would, we submit, be contrary to the duties required in the Exchange Act to promote just and equitable principles of trade, to protect investors and the public interest, and not to permit unfair discrimination among customers. Exchange Act, sec. 6(b)(5). If, however, the Commission is inclined to approve an amendment to rule 4626 solely for the purpose of allowing NASDAQ to make a voluntary, member-only offer of settlement, then we urge the Commission not to do or say anything in the course of this rulemaking that would in any way hinder or prejudice the rights of retail investors to seek full compensation in the courts.

Respectfully submitted,

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