

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69216; File No. SR-NASDAQ-2012-090)

March 22, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change to Amend Rule 4626—Limitation of Liability

I. Introduction

On July 23, 2012, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Exchange Rule 4626—Limitation of Liability (“accommodation proposal”). The proposed rule change was published for comment in the Federal Register on August 1, 2012.³ The Commission received 11 comment letters on the accommodation proposal⁴ and a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 67507 (July 26, 2012), 77 FR 45706 (August 1, 2012) (“Notice”).

⁴ See letters to Elizabeth M. Murphy, Secretary, Commission, from Sis DeMarco, Chief Compliance Officer, Triad Securities Corp., dated August 20, 2012 (“Triad Letter”); Eugene P. Torpey, Chief Compliance Officer, Vandham Securities Corp., dated August 21, 2012 (“Vandham Letter”); John C. Nagel, Managing Director and General Counsel, Citadel LLC, dated August 21, 2012 (“Citadel Letter”); Benjamin Bram, Watermill Institutional Trading LLC, dated August 22, 2012 (“Bram Letter”); Daniel Keegan, Managing Director, Citigroup Global Markets Inc., dated August 22, 2012 (“Citi Letter”); Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated August 22, 2012 (“SIFMA Letter I”); Mark Shelton, Group Managing Director and General Counsel, UBS Securities LLC, dated August 22, 2012 (“UBS Letter I”); Andrew J. Entwistle and Vincent R. Cappucci, Entwistle & Cappucci LLP, dated August 22, 2012 (“Entwistle Letter”); Douglas G. Thompson, Michael G. McLellan, and Robert O. Wilson, Finkelstein Thompson LLP, Christopher Lovell, Victor E. Stewart, and Fred T. Isquith, Lovell Stewart Halebian Jacobson LLP, Jacob H. Zamansky and Edward H. Glenn, Zamansky & Associates LLC, dated August 22, 2012 (“Thompson Letter I”); James J. Angel, Associate Professor of Finance, Georgetown University, McDonough School of

response letter from Nasdaq.⁵ On September 12, 2012, the Commission extended the time period for Commission action to October 30, 2012.⁶ On October 26, 2012, the Commission instituted proceedings to determine whether to approve or disapprove the accommodation proposal.⁷ The Commission then received six additional comment letters on the proposal⁸ and a second response letter from Nasdaq.⁹ On January 23, 2013, the Commission extended the time period for Commission action to March 29, 2013.¹⁰ This order approves the proposed rule change.

Business, dated August 23, 2012 (“Angel Letter”); and Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc., dated August 29, 2012 (“Knight Letter”).

⁵ See letter to Elizabeth M. Murphy, Secretary, Commission, from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated September 17, 2012 (“Nasdaq Letter I”).

⁶ See Securities Exchange Act Release No. 67842 (September 12, 2012), 77 FR 57171 (September 17, 2012).

⁷ See Securities Exchange Act Release No. 68115 (October 26, 2012), 77 FR 66197 (November 2, 2012).

⁸ See letters to Elizabeth M. Murphy, Secretary, Commission, from John Robinson, dated November 13, 2012 (“Robinson Letter”); Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated November 20, 2012 (“SIFMA Letter II”); Jeremy Abelson, MJA Capital, dated November 21, 2012 (“Abelson Letter”); Douglas G. Thompson, Michael G. McLellan, and Robert O. Wilson, Finkelstein Thompson LLP, Christopher Lovell, Victor E. Stewart, and Fred T. Isquith, Lovell Stewart Halebian Jacobson LLP, Jacob H. Zamansky and Edward H. Glenn, Zamansky & Associates LLC, dated November 23, 2012 (“Thompson Letter II”); Tim Mann, dated November 23, 2012 (“Mann Letter”); and Mark Shelton, Group Managing Director and General Counsel, UBS Securities LLC, dated November 23, 2012 (“UBS Letter II”).

⁹ See letter to Elizabeth M. Murphy, Secretary, Commission, from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated December 7, 2012 (“Nasdaq Letter II”).

¹⁰ See Securities Exchange Act Release No. 68707 (January 23, 2013), 78 FR 6154 (January 29, 2013).

II. Description of Proposal

Pursuant to existing Nasdaq Rule 4626(a), Nasdaq and its affiliates are not liable for any losses, damages, or other claims arising out of the Nasdaq Market Center or its use.¹¹ However, existing Nasdaq Rule 4626(b) allows Nasdaq to compensate users of the Nasdaq Market Center for losses directly resulting from the systems' actual failure to correctly process an order, Quote/Order, message, or other data, provided the Nasdaq Market Center has acknowledged receipt of the order, Quote/Order, message, or data. Nasdaq's payment for all claims made by all market participants related to the use of the Nasdaq Market Center during a single calendar month shall not exceed the larger of \$500,000 or the amount of the recovery obtained by Nasdaq under any applicable insurance policy.¹²

Nasdaq proposes to add subsection (3) to Nasdaq Rule 4626(b) to establish a voluntary accommodation program for certain claims arising from the initial public offering ("IPO") of

¹¹ According to Nasdaq Rule 4626(a), any 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 is 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.

¹² See Nasdaq Rule 4626(b)(1). Under Nasdaq Rule 4626(b)(2), with respect to the aggregate of all claims made by all market participants during a single calendar month related to a systems malfunction or error of the Nasdaq Market Center concerning locked/crossed market, trade through protection, market maker quoting, order protection, or firm quote compliance functions of the market participant, to the extent such functions are electronically enforced by the Nasdaq trading system and where Nasdaq determines in its sole discretion that such systems malfunction or error was caused exclusively by Nasdaq and no outside factors contributed to the systems malfunction or error, Nasdaq's payment during a single calendar month will not exceed the larger of \$3,000,000 or the amount of the recovery obtained by Nasdaq under any applicable insurance policy. See Nasdaq Rule 4626(b)(2). The Facebook initial public offering does not implicate the types of systems errors or malfunctions described in Nasdaq Rule 4626(b)(2).

Facebook, Inc. (“Facebook”) on May 18, 2012 (collectively “Facebook IPO”).¹³ Specifically, Nasdaq proposes to compensate market participants for certain claims related to system difficulties in the Nasdaq Halt and Imbalance Cross process (“Cross”)¹⁴ in connection with the Facebook IPO in an amount not to exceed \$62 million.¹⁵ Further, as proposed by Nasdaq, claims for compensation must arise solely from realized or unrealized direct trading losses from four specific categories of Cross orders: (i) sell Cross orders that were submitted between 11:11 a.m. ET and 11:30 a.m. ET on May 18, 2012, that were priced at \$42.00 or less, and that did not execute; (ii) sell Cross orders that were submitted between 11:11 a.m. ET and 11:30 a.m. ET on May 18, 2012, that were priced at \$42.00 or less, and that executed at a price below \$42.00; (iii) buy Cross orders priced at exactly \$42.00 and that were executed in the Cross, but not immediately confirmed; and (iv) buy Cross orders priced above \$42.00 and that were executed in the Cross, but not immediately confirmed, but only to the extent entered with respect to a customer¹⁶ that was permitted by the member to cancel its order prior to 1:50 p.m. and for which a request to cancel the order was submitted to Nasdaq by the member, also prior to 1:50 p.m.¹⁷

¹³ In addition to adding proposed subsection (b)(3) to Nasdaq Rule 4626, Nasdaq proposes to make certain technical amendments to existing subsections of that rule. See, e.g., proposed Nasdaq Rule 4626(b)(4) and (b)(6).

¹⁴ See Nasdaq Rule 4753. The Commission recently proposed Regulation Systems Compliance and Integrity (“Regulation SCI”) because of a highlighted “need to consider an updated and formalized regulatory framework for ensuring that the U.S. securities trading markets develop and maintain systems with adequate capacity, integrity, resiliency, availability, and security, and reinforce the requirement that [automated] systems operate in compliance with the [Act].” See Securities Exchange Act Release No. 69077 (March 8, 2013) (File No. S7-01-13) (proposing release for Regulation SCI).

¹⁵ See proposed Nasdaq Rule 4626(b)(3); Notice, supra note 3, at 47507.

¹⁶ As proposed, unless Nasdaq Rule 4626 states otherwise, the term “customer” includes any unaffiliated entity upon whose behalf an order is entered, including any unaffiliated broker or dealer. See proposed Nasdaq Rule 4626(b)(3)(A).

¹⁷ See proposed Nasdaq Rule 4626(b)(3)(A); Notice, supra note 3, at 45710-11. In addition, proposed Nasdaq Rule 4626(b)(3)(C) states that alleged losses arising in any form or that

According to proposed Nasdaq Rule 4626(b)(3)(B), the measure of loss for the Cross orders described in (i), (iii), and (iv) above would be the lesser of: (a) the differential between the expected execution price of the orders in the Cross process that established an opening print of \$42.00 and the actual execution price received; or (b) the differential between the expected execution price of the orders in the Cross process that established an opening print of \$42.00 and a benchmark price of \$40.527.¹⁸ With respect to Cross orders described in (iv) above, the amount of loss would be reduced by 30 percent.¹⁹ Further, according to proposed Rule 4626(b)(3)(B), the measure of loss for the Cross orders described in (ii) above would be the differential between the expected execution price of the orders in the Cross process that established an opening print of \$42.00 and the actual execution price received.²⁰

With respect to the process for submitting claims pursuant to proposed Nasdaq Rule 4626(b)(3), all claims must be submitted in writing no later than seven days after this accommodation proposal is approved by the Commission.²¹ As proposed, the Financial Industry

in any way resulted from any other causes would not be considered losses eligible for the proposed accommodations. Proposed Nasdaq Rule 4626(b)(3)(C) sets forth a non-exhaustive list of examples of such losses.

¹⁸ \$40.527 constitutes the volume-weighted average price (“VWAP”) of Facebook stock on May 18, 2012, between 1:50 p.m. ET and 2:35 p.m. ET. See proposed Nasdaq Rule 4626(b)(3)(B). See also Notice, supra note 3, at 45710-11 (describing Nasdaq’s rationale for establishing the \$40.527 benchmark).

¹⁹ See proposed Nasdaq Rule 4626(b)(3)(B); see also Notice, supra note 3, at 45710 (describing Nasdaq’s rationale for lowering the amount of eligible losses for the fourth category of Cross orders).

²⁰ Each member’s direct trading losses calculated in accordance with proposed Nasdaq Rule 4626(b)(3)(A) and (B) are referred to as the “member’s share.” See proposed Nasdaq Rule 4626(b)(3)(B).

²¹ See proposed Nasdaq Rule 4626(b)(3)(D). According to Nasdaq, notice of approval would be publicly posted on the Nasdaq Trader website at www.nasdaqtrader.com and provided directly to all member firms via an Equity Trader Alert. See Notice, supra note 3, at 45712.

Regulatory Authority, Inc. (“FINRA”) would process and evaluate all the claims submitted, using the standards set forth in Nasdaq Rule 4626.²² FINRA would then provide to the Nasdaq Board of Directors and the Board of Directors of The NASDAQ OMX Group, Inc. an analysis of the total value of eligible claims submitted under proposed Nasdaq Rule 4626(b)(3), and Nasdaq would thereafter file with the Commission a proposed rule change setting forth the amount of eligible claims and the amount it proposes to pay to its members.²³ All payments would be made in cash and would not be made until the proposed rule change setting forth the amount of eligible claims becomes final and effective.²⁴

Furthermore, as proposed, in order to receive payment under Nasdaq Rule 4626(b)(3), not later than seven days after the effective date of the proposed rule change setting forth the amount of eligible claims, the member must submit to Nasdaq an attestation detailing the amount of customer compensation²⁵ and covered proprietary losses.²⁶ Failure to provide the required

²² See proposed Nasdaq Rule 4626(b)(3)(D). FINRA may request such supplemental information as it deems necessary to assist its evaluation of claims. See id. According to Nasdaq, FINRA’s role would be limited to measuring data against the benchmarks established under Nasdaq Rule 4626(b)(3) to ascertain the eligibility and value of each member’s claims. See Notice, supra note 3, at 45712. Further, Nasdaq represented that FINRA staff assessing the claims would not be involved in providing regulatory services to any Nasdaq market, and they would not have purchased Facebook stock during Nasdaq’s IPO opening process or currently own Facebook stock. See id.

²³ See proposed Nasdaq Rule 4626(b)(3)(E). According to Nasdaq, the report that FINRA prepares for Nasdaq on its analysis of the eligibility of claims also would be provided to the public members of FINRA’s Audit Committee. See Notice, supra note 3, at 45712.

²⁴ See proposed Nasdaq Rule 4626(b)(3)(E).

²⁵ According to proposed Nasdaq Rule 4626(b)(3)(F)(i), “customer compensation” means the amount of compensation, accommodation, or other economic benefit provided or to be provided by the member to its customers (other than customers that were brokers or dealers trading for their own account) in respect of trading in Facebook on May 18, 2012.

²⁶ According to proposed Nasdaq Rule 4626(b)(3)(F)(ii), “covered proprietary losses” means the extent to which the losses reflected in the member’s share were incurred by the member trading for its own account or for the account of a customer that was a broker or dealer trading for its own account.

attestation within the specified time period would void the member's eligibility to receive compensation under proposed Nasdaq Rule 4626(b)(3).²⁷ In addition, under proposed Nasdaq Rule 4626(b)(3)(H), all payments to members under the accommodation proposal would be contingent upon the execution and delivery to Nasdaq of a release by the member of all claims by it or its affiliates against Nasdaq or its affiliates for losses that arise out of, are associated with, or relate in any way to the Facebook IPO Cross or any actions or omissions related in any way to that Cross.²⁸ The failure to provide this release within 14 days after the effective date of the proposed rule change setting forth the amount of eligible claims would void the member's eligibility to receive compensation pursuant to proposed Nasdaq Rule 4626(b)(3).²⁹

With respect to the priority of payment under proposed Nasdaq Rule 4626(b)(3), payments would be made in two tranches.³⁰ First, if the member has provided customer compensation, the member would receive an amount equal to the lesser of the member's share³¹ or the amount of customer compensation.³² Second, the member would receive an amount with respect to covered proprietary losses, however, the sum of payments to a member would not exceed the member's share.³³ According to proposed Nasdaq Rule 4626(b)(3)(G), if the amount calculated under the first tranche (i.e., customer compensation) exceeds \$62 million,

²⁷ See proposed Nasdaq Rule 4626(b)(3)(F). In addition, each member must maintain books and records that detail the nature and amount of customer compensation and covered proprietary losses. See id. According to Nasdaq, it, through FINRA, would expect to examine the accuracy of a member's attestation at a later date. See Notice, supra note 3, at 45712.

²⁸ See proposed Nasdaq Rule 4626(b)(3)(H); Notice, supra note 3, at 45713 (explaining the purpose of the release requirement).

²⁹ See proposed Nasdaq Rule 4626(b)(3)(H).

³⁰ See proposed Nasdaq Rule 4626(b)(3)(G).

³¹ See supra note 20.

³² See proposed Nasdaq Rule 4626(b)(3)(G).

³³ See id.

accommodation would be prorated among members eligible to receive accommodation under the first tranche. If the first tranche is paid in full and the amount calculated under the second tranche exceeds the funds remaining from the \$62 million accommodation pool, such funds would be prorated among members eligible to receive accommodation under the second tranche.³⁴ Further, if a member's eligibility to receive funds is voided under proposed Nasdaq Rule 4626(b)(3), and the funds payable to other members must be prorated, the funds available to pay other members would be increased accordingly.³⁵

III. Summary of Comments and Nasdaq's Responses

As previously noted, the Commission received a total of seventeen comment letters on the accommodation proposal and two response letters from Nasdaq.³⁶ Fourteen commenters raised concerns with respect to the accommodation proposal,³⁷ two commenters expressed their support for the accommodation proposal,³⁸ and one commenter addressed the issue of exchange liability more broadly.³⁹

Commenters raised concerns in the following areas, each of which is discussed in greater detail below: (1) the requirement that market participants release all other potentially valid claims as a condition to participation in the accommodation program; (2) Nasdaq's calculation

³⁴ See id.

³⁵ See id.

³⁶ See supra notes 4-5, and 8-9.

³⁷ See Triad Letter; Vandham Letter; Bram Letter; Citi Letter; SIFMA Letter I; UBS Letter I; Entwistle Letter; and Thompson Letter I, supra note 4. See also, Robinson Letter; SIFMA Letter II; Abelson Letter; Thompson Letter II; Mann Letter; and UBS Letter II, supra note 8.

³⁸ See Citadel Letter and Knight Letter, supra note 4.

³⁹ See Angel Letter, supra note 4. The Angel Letter does not opine on the proposal, but rather comments more generally on what the appropriate parameters of liability should be for national securities exchanges.

and use of a benchmark price of \$40.527; (3) the categories of claim-eligible trading losses; (4) the amount of the accommodation pool; (5) regulatory immunity from private suits and limitations on liability; (6) the applicability of Nasdaq Rule 4626; (7) the impact of approval of the accommodation proposal on pending litigation; and (8) two procedural issues.

A. Release of All Claims Relating to the Facebook IPO Cross

Several commenters expressed concerns that payment to eligible claimants is conditioned upon the member firm executing a release of claims by the firm or its affiliates against Nasdaq for losses associated with the Facebook IPO on May 18, 2012.⁴⁰ Specifically, one commenter indicated that requiring execution of the release as a precondition to participation in the accommodation proposal creates a “fundamentally unfair dilemma” for members.⁴¹ According to the commenter, Nasdaq members must choose to execute a release of claims and participate in the accommodation program, which may not make the member whole, or pursue “cost-and resource-intensive alternative avenues of recovery.”⁴² This commenter believes that members should be able to both participate in the accommodation program and be able to pursue other avenues of recourse. According to this commenter, any recovery under the accommodation program should be “setoff against future claims,” but should not preclude future claims against Nasdaq, especially for claims for losses that are not eligible for compensation under the accommodation program.⁴³ This commenter further stated that any release requirement should be limited to the categories of claim-eligible trading losses—allowing other avenues of recourse

⁴⁰ See UBS Letter I, supra note 4, at 3-4; Vandham Letter, supra note 4, at 3; Knight Letter, supra note 4, at 2; and UBS Letter II, supra note 8 at 3-4.

⁴¹ See UBS Letter I, supra note 4, at 3.

⁴² See id.

⁴³ See UBS Letter II, supra note 8, at 3.

for losses that are not eligible to receive compensation under the accommodation program.⁴⁴

Another commenter noted that releases of claims are typically the product of commercial, arms-length negotiation and not part of a rule imposed by a regulatory authority.⁴⁵ Finally, one commenter suggested that Nasdaq members be given the option to “opt in” to the accommodation program on an order by order basis or a firm by firm basis.⁴⁶

In response, Nasdaq asserted that the release requirement is fair, reasonable, and furthers the objectives of Section 6(b)(5) of the Act⁴⁷ because it is “aimed at avoiding unnecessary litigation and ensuring equal treatment of all members receiving funds under the [accommodation] [p]roposal.”⁴⁸ Moreover, Nasdaq noted that participation in the accommodation program and execution of the release are entirely voluntary.⁴⁹ Accordingly, members that wish to forgo participation in the accommodation program and pursue claims against Nasdaq instead remain free to do so.⁵⁰ Nasdaq also noted that 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.⁵¹ Finally, Nasdaq argued that allowing members to participate in the

⁴⁴ See id.

⁴⁵ See Knight Letter, supra note 4, at 2.

⁴⁶ See Vandham Letter, supra note 4, at 3.

⁴⁷ 15 U.S.C. 78f(b)(5).

⁴⁸ See Nasdaq Letter I, supra note 5, at 5. One commenter observed that the release requirement may actually “deter those who suffered the greatest harm from participating in the Program” which may result in Nasdaq exhausting the \$62 million accommodation pool without significantly reducing Nasdaq’s litigation exposure. See UBS Letter II, supra note 8, at note 5.

⁴⁹ See Nasdaq Letter I, supra note 5, at 5; and Nasdaq Letter II, supra note 9, at 4.

⁵⁰ See id.

⁵¹ See id.

accommodation program without releasing Nasdaq from other claims related to the Facebook IPO Cross would, in effect, “subsidize the costs of future litigation against itself.”⁵²

B. Nasdaq’s Uniform Benchmark Price

Several commenters expressed concern with Nasdaq’s calculation and use of the uniform benchmark price of \$40.527 to determine the amount of compensation owed to a member under the accommodation proposal.⁵³ Generally, these commenters stated that, contrary to Nasdaq’s assertion, a “reasonably diligent member” would not have mitigated losses during the first forty-five minutes after execution reports were delivered to firms.⁵⁴ More specifically, two commenters stated that the uniform benchmark price should be based on a VWAP of Facebook stock on Monday, May 21, 2012.⁵⁵

In response, Nasdaq reasserted that the use of the VWAP of Facebook stock during the 45 minute window after 1:50 p.m. is appropriate as the benchmark price because 45 minutes provided members enough time to identify and mitigate any unexpected losses or unanticipated

⁵² See Nasdaq Letter I, supra note 5, at 5. Nasdaq stated that it “is not prepared to make the accommodation it proposes to members that are unwilling to accept that accommodation in full satisfaction of any claims they might otherwise assert against Nasdaq.” See Nasdaq Letter II, supra note 9, at 4.

⁵³ See Triad Letter, supra note 4, at 1-3; Vandham Letter, supra note 4, at 2; Bram Letter, supra note 4, at 1; and Citi Letter, supra note 4, at 2 and 10. According to Nasdaq, the forty-five minutes after execution reports were delivered “would have been ample time for a reasonably diligent member to have identified any unexpected customer losses or unanticipated customer positions, and taken steps to mitigate or liquidate them.” See Notice, supra note 3, at footnote 24.

⁵⁴ See Triad Letter, supra note 4, at 1-3; Vandham Letter, supra note 4, at 2; Bram Letter, supra note 4, at 1; and Citi Letter, supra note 4, at 2 and 10.

⁵⁵ See Triad Letter, supra note 4, at 1; and Citi Letter, supra note 4, at 2 (stating that the benchmark price should be the VWAP of Facebook stock between the opening price on Monday, May 21, 2012 and the price at noon on that same day).

positions.⁵⁶ Nasdaq argued that an objective benchmark, rather than a subjective benchmark premised on an evaluation of each individual member's circumstances and trading decisions, is necessary to avoid inconsistent and potentially discriminatory distributions under the accommodation proposal.⁵⁷ Additionally, because Nasdaq is not prepared to increase the size of the \$62 million accommodation pool, Nasdaq believes that "a change in the benchmark price would actually reduce the funds available to claimants that acted quickly to mitigate their losses, for the benefit of those that did not."⁵⁸

C. Nasdaq's Categories of Claim-Eligible Trading Losses

Several commenters stated that the types of orders eligible to receive compensation under the accommodation proposal are too narrowly defined.⁵⁹ Two commenters believe that Nasdaq should provide compensation for losses resulting from "downstream operational, technological and customer issues."⁶⁰ One commenter stated that Nasdaq's system failures, specifically the failure to deliver execution reports for more than two hours after trading began, "caused direct

⁵⁶ See Nasdaq Letter I, supra note 5, at 3. Specifically, Nasdaq noted that: (i) all orders and cancellations, including those entered between 11:11 a.m. and 11:30 a.m., were "executed, cancelled, or released into the market" by 1:50 p.m.; (ii) confirmations of all trades and cancellations had been disseminated to members by 1:50 p.m.; and (iii) Nasdaq began reporting a firm bid and ask to the tape and all data feeds were operating normally by 1:50 p.m. See id. at 3-4. Nasdaq also stated that it issued a "System Status message" informing members that all systems were operating normally at 1:57 p.m. See id. at 4.

⁵⁷ See Nasdaq Letter II, supra note 9, at 4.

⁵⁸ See id.

⁵⁹ See UBS Letter I, supra note 4, at 2-3; Citi Letter, supra note 4, at 7-10; Vandham Letter, supra note 4, at 3; and UBS Letter II, supra note 8, at 3.

⁶⁰ See UBS Letter I, supra note 4, at 3. See also UBS Letter II, supra note 8, at 3; and Citi Letter, supra note 4, at 7-10 (noting that "[i]n some cases, investors submitted multiple redundant orders based on the belief that the orders were not going through" and "[i]n other cases, investors submitted cancelations before receiving order confirmations, but were stuck with the stock.").

and severe damage” to the commenter and other market participants and led to direct trading losses.⁶¹ Another commenter argued that customer orders entered before 11:11 a.m. on May 18, 2012, that were “cancel/replaced” between 11:11 a.m. and 11:30:09 a.m. should be treated differently from other orders entered during such time and should be entitled to full compensation.⁶²

Another commenter observed that the accommodation proposal provides no direct compensation to “ordinary retail investors” and does not guarantee that retail investors would receive any compensation for losses.⁶³ Because Nasdaq’s proposal contemplates paying retail customers through Nasdaq member broker-dealers, the commenter expressed concern that there is no guarantee that compensation will ultimately be passed back to the retail investor, especially in instances where the member’s “customer” is another broker-dealer.⁶⁴

Nasdaq responded by stating that the question before the Commission is only whether the proposal is consistent with the requirements of the Act.⁶⁵ Nasdaq asserted that commenters have not argued that the proposal “discriminates unfairly” among members or that it is otherwise inconsistent with the requirements of the Act.⁶⁶ Nasdaq stated its belief that none of the

⁶¹ See UBS Letter I, supra note 4, at 3; UBS Letter II, supra note 8, at 3 (urging the Commission to condition approval of the accommodation proposal on expansion of the categories of losses eligible for compensation).

⁶² See Vandham Letter, supra note 4, at 3. The commenter believes that Nasdaq’s failure to properly account for cancel/replaced orders resulted in Nasdaq “taking the profits generated from certain clients to distribute amongst a larger group.” See id.

⁶³ See Thompson Letter I, supra note 4, at 3-4; and Thompson Letter II, supra note 8, at note 1.

⁶⁴ See Thompson Letter I, supra note 4, at 11. See also Thompson Letter II, supra note 8, at note 1.

⁶⁵ See Nasdaq Letter I, supra note 5, at 2.

⁶⁶ See id. But see Robinson Letter, supra note 8, at 1; Abelson Letter, supra note 8, at 2; and Mann Letter, supra note 8, at 1 (all generally stating each commenter’s belief that

comments provide a basis for the Commission to determine that a modification to the methodology and criteria it proposed “is necessary to remedy any inconsistency with the Exchange Act.”⁶⁷ With respect to retail investors, Nasdaq stated that its accommodation proposal would benefit retail investors with eligible claims even though Nasdaq has no direct relationship with them.⁶⁸ Nasdaq noted that the accommodation proposal requires each member to submit an attestation detailing the amount of compensation provided or to be provided by the member to its customers.⁶⁹ Moreover, Nasdaq pointed out that accommodation payments are to be made in two tranches with the first tranche going toward retail customer claims.⁷⁰

D. \$62 Million Accommodation Pool is Insufficient

Several commenters argued that the proposed \$62 million accommodation pool is an insufficient amount to compensate market participants harmed by Nasdaq’s systems issues.⁷¹ One commenter expressed concern that the second tranche of payments, which would provide compensation for covered proprietary losses⁷² (the majority of this commenter’s losses), may not

anything less than full compensation for his losses is inconsistent with the “just and equitable principles of trade” and is therefore inconsistent with the requirements of the Act); see also Triad Letter, supra note 4, at 2; Vandham Letter, supra note 4, at 1, 3; UBS Letter I, supra note 4, at 2-3; Thompson Letter I, supra note 4, at 3-4 (generally arguing for greater compensation to market participants for their losses).

⁶⁷ See Nasdaq Letter I, supra note 5, at 4.

⁶⁸ See id. at 8.

⁶⁹ See id.

⁷⁰ See id.

⁷¹ See UBS Letter I, supra note 4, at 2 (estimating that its losses are “in excess of \$350 million” and describing Nasdaq’s proposal to pay \$62 million in the aggregate as “woefully inadequate”); Thompson Letter I, supra note 4, at 4 and 20; Thompson Letter II, supra note 8, at note 1; and UBS Letter II, supra note 8, at 2-4.

⁷² See supra notes 26, 30-34 and accompanying text.

be reimbursed at all as claims for customer losses disbursed in the first tranche will likely exhaust the entire accommodation pool.⁷³

Nasdaq responded that commenters' objections to the amount of compensation are "unpersuasive" because the Commission has already determined that rules, such as existing Nasdaq Rule 4626, limiting exchange liability are consistent with the Act.⁷⁴ Furthermore, according to Nasdaq, if the accommodation proposal is disapproved, the current (much lower) limitation on liability of \$500,000 would apply.⁷⁵ Nasdaq emphasized that members who believe the amount of compensation offered is insufficient or otherwise dislike the accommodation proposal may elect not to participate.⁷⁶ Nasdaq stated that it is not prepared to increase the size of the \$62 million dollar accommodation pool.⁷⁷ According to Nasdaq, the purpose of the accommodation 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 [accommodation] [p]roposal"⁷⁸ Nasdaq stated that "[t]he purpose of the [accommodation] [p]roposal 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."⁷⁹ As to one commenter's concern that the accommodation pool will be exhausted before any payments are made in the second tranche for

⁷³ See UBS Letter II, supra note 8, at 2-4.

⁷⁴ See Nasdaq Letter I, supra note 5, at 2.

⁷⁵ See id.

⁷⁶ See id. at 2-3; and Nasdaq Letter II, supra note 9, at 4.

⁷⁷ See Nasdaq Letter II, supra note 9, at 4.

⁷⁸ See Nasdaq Letter I, supra note 5, at 4.

⁷⁹ See id. Nasdaq expanded on this point in its second response letter, emphasizing that the proposal is designed to compensate members for "only those losses directly attributable to the systems issues experienced by Nasdaq" and not "to address specific members' individual problems." See Nasdaq Letter II, supra note 9, at 3.

covered proprietary losses, Nasdaq stated that it believes that the \$62 million “will be sufficient fully to compensate valid claims under the terms” of the accommodation proposal.⁸⁰ Moreover, Nasdaq argued, that it believes “the proposed prioritization of payment in favor of members who have or will pass compensation on to their customers is consistent with the Act.”⁸¹

E. Regulatory Immunity from Private Suits and Limitations on Liability

A number of commenters asserted that Nasdaq is not entitled to immunity from liability because it was acting in its “for profit” capacity in its handling of the Facebook IPO, rather than acting in its “regulatory capacity” as a self-regulatory organization.⁸² However, several commenters stated their belief that the broader issues of regulatory immunity and limitations on exchange liability should be considered separately from Nasdaq’s accommodation proposal.⁸³

Nasdaq responded that the Commission’s task with regard to the accommodation proposal is only to determine whether the proposed rule change is consistent with the Act, and the Commission does not need to address the issue of regulatory immunity to do so.⁸⁴

F. Applicability of Nasdaq Rule 4626

According to one commenter, market participants’ losses “resulted not from the type of ordinary system failures contemplated by Rule 4626 . . . , but rather from a known design flaw that resulted in a similar technology issue dating back to Fall 2011, as well as Nasdaq’s high-

⁸⁰ See Nasdaq Letter II, supra note 9, at 4.

⁸¹ See id.

⁸² See Citi Letter, supra note 4, at 2-4 and 12-15; SIFMA Letter I, supra note 4, at 2-4; Thompson Letter I, supra note 4, at 8-10; Thompson Letter II, supra note 8, at note 1; and UBS Letter II, supra note 8, at 4-5.

⁸³ See Citadel Letter, supra note 4, at 2; Knight Letter, supra note 4, at 2; Thompson Letter II, supra note 8, at note 2; UBS Letter II, supra note 8, at 4-5; SIFMA Letter II, supra note 8, at 3.

⁸⁴ See Nasdaq Letter I, supra note 5, at 6-7.

risk, profit-oriented behavior prior to and during the IPO . . .”⁸⁵ This commenter argued that it is improper to use Rule 4626 to create an accommodation fund in connection with the Facebook IPO because the losses suffered in connection with the IPO do not fall within the parameters of Rule 4626.⁸⁶

Nasdaq emphasized in response that Rule 4626 is a pre-existing Commission approved rule and that the rule squarely applies to Nasdaq’s systems issues related to the Facebook IPO.⁸⁷

G. Impact on Pending Litigation

Two commenters expressed concern that Commission approval of the accommodation proposal might negatively impact other adjudications of disputes with Nasdaq regarding the Facebook IPO.⁸⁸ The commenters expressed concern that courts or other adjudicative bodies might interpret Commission approval of the accommodation proposal as defining or approving the classes of eligible claimants as restricted only to market participants who submitted one of the four enumerated Cross order types.⁸⁹ Nasdaq did not specifically respond to commenters’ concerns on this issue.

H. Procedural Concerns

⁸⁵ See Citi Letter, supra note 4, at 4, and 15-16.

⁸⁶ See id.

⁸⁷ See Nasdaq Letter I, supra note 5, at 5-6.

⁸⁸ See Thompson Letter I, supra note 4, at 4-8; and Entwistle Letter, supra note 4, at 2. See also Thompson Letter II, supra note 8, at 2-3.

⁸⁹ See Thompson Letter I, supra note 4, at 4-8; and Entwistle Letter, supra note 4, at 2. One commenter also expressed concern about the potential impact of Commission approval on pending litigation with respect to: (i) Nasdaq’s claim of immunity; (ii) the causes and effects of Nasdaq’s system issues; (iii) the validity of Nasdaq’s uniform benchmark price as an estimate of Facebook’s stock price in the absence of any Nasdaq systems issues; (iv) the types and categories of losses that should or should not be recognized as compensable; and (v) various other factual and legal assumptions the commenter believes Nasdaq’s accommodation proposal contains. See Thompson Letter II, supra note 8, at 2.

Several commenters raised procedural concerns regarding the implementation of the accommodation proposal.⁹⁰ Two commenters noted that Nasdaq should waive the one-year time limit to bring actions against Nasdaq in Sections 18(H) and 19 of its Service Agreement given the amount of time it could take to implement the compensation process set forth in the proposed rule change.⁹¹ Four commenters stated that Nasdaq member firms should not be required to release Nasdaq from liability before member firms receive notice of a final payment amount pursuant to the accommodation proposal.⁹²

Nasdaq responded that commenters' requests to extend the one-year time limit for members to bring claims against Nasdaq improperly ask the Commission to interfere with existing contractual relationships that have no bearing on whether Nasdaq Rule 4626 should be amended.⁹³ As for concerns that claimants might have to release their claims against Nasdaq prior to receiving compensation under the accommodation proposal, Nasdaq represents that the release will become effective upon payment.⁹⁴

⁹⁰ See Citi Letter, supra note 4, at 16; SIFMA Letter I, supra note 4, at 5; Knight Letter, supra note 4, at 2; and SIFMA Letter II supra note 8, at 3.

⁹¹ Section 18(H) 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.” See SIFMA Letter I, supra note 4, at 5; see also Citi Letter, supra note 4, at 16; and SIFMA Letter II, supra note 8, at 3.

⁹² See SIFMA Letter I, supra note 4, at 5-6; Citi Letter, supra note 4, at 16; Knight Letter, supra note 4, at 2; and UBS Letter II, supra note 8, at 4. See also SIFMA Letter II supra note 8, at 2.

⁹³ See Nasdaq Letter I, supra note 5, footnote 11. Nasdaq believes that members who voluntarily choose to proceed with their claims outside of the accommodation proposal “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.” See id.

⁹⁴ See id. at footnote 9. Nasdaq also stated that it intends to implement the accommodation proposal such that a member would be aware of the results of its claim prior to being

IV. Discussion and Commission Findings

As described above, commenters have raised a number of concerns about the proposed rule change, many contending that it is not a fair or equitable approach to compensating market participants harmed by Nasdaq's system issues. Nasdaq has explained, however, that it did not design the proposed rule change to compensate all claims of loss suffered by market participants relating to Nasdaq's system difficulties with the Cross.⁹⁵ Rather, Nasdaq, in the accommodation proposal, is proposing to change a Nasdaq rule that in its current form strictly limits the amount of compensation that may be paid to users of the Nasdaq Market Center. In considering whether to approve the proposed rule change, the Commission takes into account the existing circumstances and the manner in which the current Nasdaq rules would operate if the Commission disapproved the proposed rule change.⁹⁶

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁹⁷ Specifically, the Commission finds that the proposed rule change is consistent with Section

required to execute a release. See id. See also, SIFMA Letter II, supra note 8, at 2 (stating that this commenter appreciated Nasdaq's clarification on this issue).

⁹⁵ See supra notes 78 to 79 and accompanying text. Several commenters observed that the accommodation proposal will indeed not result in full compensation for their losses. See, e.g., supra notes 71-73 and accompanying text. Commenters also noted that some market participants have brought legal actions alleging claims against Nasdaq based on system difficulties encountered during the Facebook IPO. See Thompson Letter I, supra note 4, at 3; and Entwistle Letter, supra note 4, at 1. The Commission notes that approval of this proposed rule change has no bearing on claims made in any pending litigation against Nasdaq related to systems difficulties encountered during the Facebook IPO.

⁹⁶ While commenters have suggested various modifications to the accommodation proposal that would, in their view, make it better, the Commission's authority is only to approve or disapprove the change as proposed by Nasdaq. See generally Section 19(b) of the Act.

⁹⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

6(b)(5) of the Act,⁹⁸ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Existing Nasdaq rules state that Nasdaq and its affiliates are not liable for any losses, damages, or other claims arising out of the Nasdaq Market Center or its use.⁹⁹ However, as noted above,¹⁰⁰ Nasdaq Rule 4626(b) currently allows Nasdaq to compensate users of the Nasdaq Market Center for certain types of losses directly resulting from its systems' actual failures. Under current Nasdaq Rule 4626(b)(1), payment for all such claims made by all market participants during a single calendar month cannot exceed the larger of \$500,000 or the amount of recovery obtained by Nasdaq under any applicable insurance policy.¹⁰¹ While the accommodation proposal is not designed to, and would not, compensate all claims of loss suffered by market participants relating to Nasdaq's system difficulties with the Cross,¹⁰² the Commission notes that the accommodation proposal would create a means of providing significantly more compensation for eligible claims, outside of litigation, than would otherwise be available under existing Nasdaq Rule 4626(b). Accordingly, approval of the proposed rule

⁹⁸ 15 U.S.C. 78f(b)(5).

⁹⁹ See Nasdaq Rule 4626(a).

¹⁰⁰ See supra notes 11-12 and accompanying text.

¹⁰¹ See Nasdaq Rule 4626(b)(1).

¹⁰² See supra note 79 and accompanying text.

change will make more funds available to compensate investors and Nasdaq members under Nasdaq's rules, which the Commission believes is in the public interest.¹⁰³

The Commission believes that the proposal sets forth objective and transparent processes to determine eligible claims and how such claims would be paid to Nasdaq members that elect to participate in the accommodation plan. Specifically, Nasdaq proposes to provide additional compensation beyond that available under existing Rule 4626(b)(1) for claims of realized or unrealized direct trading losses arising from four specific categories of Cross orders.¹⁰⁴ Also, as noted above, proposed Nasdaq Rule 4626(b)(3)(B) would set forth the methods for calculating the amount of losses for each of the four categories of Cross orders.¹⁰⁵ In addition, proposed Nasdaq Rule 4626(b)(3)(D) specifies the time period for a member to submit its claim and provides that FINRA would process and evaluate the claims.¹⁰⁶ Proposed Nasdaq Rule 4626(b)(3)(E) sets forth details regarding FINRA's review process, the timing of payments by Nasdaq, and the manner of payment (i.e., in cash).¹⁰⁷

As discussed in more detail above, several commenters objected to limiting compensation under the accommodation proposal to the four categories of Cross orders.¹⁰⁸ Further, several commenters questioned the adequacy of the amount of compensation that would be provided to Nasdaq members under the accommodation proposal as well as the calculation and use of the

¹⁰³ Several commenters questioned the adequacy of the amount of compensation that would be provided to Nasdaq members under the accommodation proposal as well as the calculation and use of the benchmark price in determining the amount of loss repayable under the accommodation proposal. See supra notes 53-55, 71 and accompanying text.

¹⁰⁴ See proposed Nasdaq Rule 4626(b)(3)(A).

¹⁰⁵ See supra notes 18-20 and accompanying text.

¹⁰⁶ See supra notes 21-23 and accompanying text.

¹⁰⁷ See supra notes 23-24 and accompanying text.

¹⁰⁸ See supra notes 59-64 and accompanying text.

benchmark price in determining the amount of loss repayable under the accommodation proposal.¹⁰⁹ In determining that approval of the accommodation proposal is consistent with the Act, the Commission is not reaching any conclusion on the overall adequacy of the amount of the compensation pool, the benchmark price used, or other limitations on eligibility.

In order to receive compensation under proposed Nasdaq Rule 4626(b)(3), a member must timely submit to Nasdaq an attestation detailing the amount of customer compensation and covered proprietary losses.¹¹⁰ The proposal would further require the member to maintain books and records that detail the nature and amount of customer compensation and covered proprietary losses.¹¹¹ The Commission believes that the proposed attestation and recordkeeping requirements should help incentivize Nasdaq members to accurately determine the amount of customer compensation and covered proprietary losses and submit claims accordingly. Moreover, payments made pursuant to proposed Nasdaq Rule 4626(b)(3) would be made in two tranches - a member would first receive an amount equal to the lesser of the member's share or the amount of customer compensation,¹¹² and then receive an amount with respect to covered proprietary losses.¹¹³ The Commission believes that, because the accommodation proposal would accommodate members for customer losses before accommodating members for proprietary losses, the accommodation proposal should encourage members to compensate their customers for customer losses related to the Facebook IPO.

¹⁰⁹ See supra notes 53-55, 71 and accompanying text.

¹¹⁰ See proposed Nasdaq Rule 4626(b)(3)(F).

¹¹¹ See id.

¹¹² See supra note 25 (defining "customer compensation").

¹¹³ See proposed Nasdaq Rule 4626(b)(3)(G). See also supra notes 26 (defining "covered proprietary losses") and 30-35 and accompanying text (explaining how funds are to be allocated).

Lastly, in order to receive payments under proposed Nasdaq Rule 4626(b)(3), within 14 days after the effective date of a separate proposed rule change setting forth the amount of eligible claims, a member must execute and deliver to Nasdaq a release of all claims by the member or its affiliates against Nasdaq or its affiliates for losses that arise out of, are associated with, or relate in any way to the Facebook IPO Cross or to any actions or omissions related in any way to that Cross.¹¹⁴ As discussed above, several commenters opposed the proposed waiver of claims.¹¹⁵ However, although a member must execute a release of claims in order to receive any payment under proposed Nasdaq Rule 4626(b)(3), participation in the accommodation program is voluntary, which means a member is free to elect not to submit a claim for compensation under the accommodation program and choose instead to pursue other remedies.¹¹⁶

For the reasons discussed in this section, the Commission finds that Nasdaq's proposal to amend its existing Rule 4626 to increase the amount of compensation Nasdaq is authorized to provide from \$500,000 to \$62 million for certain types of claims arising in connection with the Facebook IPO on May 18, 2012, is consistent with the Section 6(b)(5) of the Act. In reaching its conclusion, the Commission is relying on the representations made by Nasdaq in its accommodation proposal, but is not making any determinations regarding the accuracy of the facts as represented by Nasdaq, and notes that certain commenters have contested Nasdaq's representation of the facts. In addition, the Commission is not expressing any view with respect

¹¹⁴ See proposed Nasdaq Rule 4626(b)(3)(H).

¹¹⁵ See supra notes 40-46 and accompanying text.

¹¹⁶ The Commission notes that Nasdaq intends to implement the accommodation proposal such that a member would be aware of the results of its claim prior to being required to execute a release and that Nasdaq represents that the release will become effective upon payment. See supra note 94 and accompanying text.

to any issue other than whether the proposed rule change is consistent with Section 19(b) of the Act. For example, as discussed above, several commenters questioned whether Nasdaq should be entitled to immunity from liability based on its actions with respect to the Facebook IPO.¹¹⁷ Other commenters argued that the question of whether regulatory immunity applies should be considered separately from this proposed rule change.¹¹⁸ Whether regulatory immunity should apply to Nasdaq in connection with its actions related to the Facebook IPO is outside the scope of the proposed rule change and the Commission's consideration of such proposed rule change. Similarly, as discussed in more detail above, several commenters expressed concern that approval of the proposed rule change could potentially impact pending litigation with Nasdaq regarding the Facebook IPO.¹¹⁹ The Commission emphasizes that this approval order addresses only whether the proposed change to Nasdaq's existing accommodation rule is consistent with Section 19(b) of the Act. The Commission also notes that, given the amount of time it could take to implement the compensation process set forth in the proposed rule change, several commenters urged Nasdaq to waive the one-year time limit set forth in Nasdaq's service agreement within which members must bring actions against Nasdaq.¹²⁰ Because Nasdaq's service agreement is not before the Commission as a part of this proposed rule change, the Commission expresses no view with respect to whether Nasdaq should provide an exception under the service agreement. Finally, in issuing this order, the Commission is expressing no view as to whether Nasdaq or any other person may have violated the federal securities laws or

¹¹⁷ See supra note 82 and accompanying text.

¹¹⁸ See supra note 83 and accompanying text.

¹¹⁹ See supra notes 88-89 and accompanying text.

¹²⁰ See supra note 91 and accompanying text.

any other laws, any rule or regulation thereunder, or the rules of Nasdaq or any other self-regulatory organization, in connection with the Facebook IPO.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹²¹ that the proposed rule change (SR-NASDAQ-2012-090) be, and hereby is, approved.

By the Commission.

Kevin M. O'Neill
Deputy Secretary

¹²¹ 15 U.S.C. 78s(b)(2).