

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. Specifically, BX believes ending the revenue sharing agreement and eliminating the associated fee for a product that customers have not chosen to utilize is responsive to market participants and eliminates confusion about offered products.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended. Specifically, the Exchange believes that terminating the revenue sharing agreement and deleting the associated fee in the rulebook will not burden competition since the latency measurement tools are not currently being used by any customers.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Written comments were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Because the foregoing proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to 19(b)(3)(A) of the Act<sup>7</sup> and Rule 19b-4(f)(6) thereunder.<sup>8</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>9</sup> normally does not become operative prior to 30 days after the date of the filing. However, pursuant

to Rule 19b-4(f)(6)(iii),<sup>10</sup> the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay and designate the proposed rule change to become operative upon filing to eliminate confusion on the part of potential customers regarding the availability of the Correlix RaceTeam offering. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. The Exchange represents that there are no customers currently using Correlix's RaceTeam latency measurement service. Therefore, the Commission designates the proposed rule change as operative upon filing with the Commission.<sup>11</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BX-2012-054 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-BX-2012-054. This file number should be included on the subject line if email is used. To help the

Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BX-2012-054 and should be submitted on or before August 22, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

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### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-67507; File No. SR-NASDAQ-2012-090]

#### **Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change To Amend Rule 4626—Limitation of Liability**

July 26, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 23, 2012, The NASDAQ Stock Market LLC ("Nasdaq" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> 17 CFR 240.19b-4(f)(6). Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

<sup>9</sup> 17 CFR 240.19b-4(f)(6).

<sup>10</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>11</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>12</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

rule change as described in Items I and II below, which Items have been prepared by the Exchange.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

### **I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange proposes to amend Rule 4626. The text of the proposed rule change is available at <http://nasdaq.cchwallstreet.com>, at NASDAQ's principal office, and at the Commission's Public Reference Room.

### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

#### *A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

##### **1. Purpose**

##### **I. Introduction**

##### *The Proposal*

Nasdaq is seeking 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. In the weeks since the Facebook IPO, Nasdaq has reviewed the events of May 18 with the goal of proposing a fair and equitable accommodation policy that is consistent with the Exchange Act and Nasdaq's self-regulatory obligations. This proposal reflects Nasdaq's effort (i) to identify the categories of investors and members that Nasdaq's system difficulties caused objective, discernible

harm, and the type and scope of such harm, and (ii) to propose an objectively reasonable and regulatorily balanced plan for accommodating Exchange members and their investor customers for such harm. Nasdaq has undertaken this effort notwithstanding the liability protections afforded by its contractual limitations of liability, common law immunity, and Rule 4626—the rule that Nasdaq proposes to modify.<sup>4</sup>

Rule 4626 limits the liability of Nasdaq and its affiliates with respect to any losses, damages, or other claims arising out of the Nasdaq Market Center or its use and provides for limited accommodations under the conditions specified in the rule.<sup>5</sup> Subsection (b)(1) provides that for the aggregate of all claims made by market participants related to the use of the Nasdaq Market Center during a single calendar month, Nasdaq's payments under Rule 4626 shall not exceed the larger of \$500,000 or the amount of the recovery obtained by Nasdaq under any applicable insurance policy. Subsection (b)(2) states that for the aggregate of all claims made by market participants related to systems malfunctions or errors of the Nasdaq Market Center concerning locked/crossed compliance, trade through protection, market maker quoting, order protection, or firm quote compliance, during a single calendar month Nasdaq's payments under Rule 4626 shall not exceed the larger of \$3,000,000 or the amount of the recovery obtained by Nasdaq under any applicable insurance policy.<sup>6</sup>

On May 18, 2012, Nasdaq experienced system difficulties during the Nasdaq Halt and Imbalance Cross Process (the

"Cross") for the FB IPO. These difficulties delayed the completion of the Cross from 11:05 a.m. until 11:30 a.m. Based on its assessment of the information available at the time, Nasdaq concluded that the system issues would not have any effects beyond the delay itself. In an exercise of its regulatory authority, Nasdaq determined to proceed with the IPO at 11:30 a.m. rather than postpone it.

As a result of the system difficulties, however, certain orders for FB stock that were entered between 11:11:00 a.m. and 11:30:09 a.m. in the expectation of participating in the Cross—and that were not cancelled prior to 11:30:09—either did not execute or executed after 1:50 p.m. at prices other than the \$42.00 price established by the Cross. (Other orders entered between 11:11:00 a.m. and 11:30:09 a.m., including cancellations, buy orders below \$42.00, and sell orders above \$42.00, were handled without incident.) System issues also delayed the dissemination of Cross transaction reports from 11:30 a.m. until 1:50 p.m. At 1:50 p.m., Nasdaq system difficulties were completely resolved. Nasdaq's analysis indicates that only a small percentage of the FB orders received by Nasdaq on May 18 were directly affected by Nasdaq system difficulties.

In the period between 11:30 a.m. and 1:50 p.m., although system issues had prevented Nasdaq from disseminating Cross transaction reports, Nasdaq determined not to halt trading in FB stock. Nasdaq believed that the system issues would be resolved promptly. Moreover, after 11:30 a.m. there was an orderly, liquid, and deep market in FB stock, with active trading on all markets. Halting trading on a market-wide basis in these circumstances would have been unprecedented, and, in Nasdaq's view, unjustified. In any event, in Nasdaq's regulatory judgment, the conditions after 11:30 a.m. did not warrant a halt of trading.

As a result of these unique circumstances, Nasdaq is proposing to accommodate members for losses attributable to the system difficulties on May 18, 2012 in an amount not to exceed \$62 million. Nasdaq also proposes standards for orders to qualify for accommodation. For the reasons explained below, Nasdaq proposes to make accommodation payments in respect of:

1. SELL Cross orders that were submitted between 11:11 a.m. and 11:30 a.m. on May 18, 2012, that were priced at \$42.00 or less, and that did not execute;

2. SELL Cross orders that were submitted between 11:11 a.m. and 11:30

<sup>3</sup> The Commission emphasizes that this notice was solely prepared by Nasdaq. As with all self-regulatory organization rule filings, the representations, views, and opinions contained in the notice are those of Nasdaq. The Commission is publishing the notice pursuant to the Exchange Act and the rules thereunder. The Commission neither makes any findings nor expresses any opinion with respect to Nasdaq's representations and interpretations contained in this notice.

<sup>4</sup> Rule 4626 was adopted on January 13, 2006 as part of Nasdaq's registration as a national securities exchange. Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131). The rule was amended in Securities Exchange Act Release Nos. 54155 (July 14, 2006), 71 FR 41291 (July 20, 2006) (SR-NASDAQ-2006-001); 60794 (October 6, 2009), 74 FR 52522 (October 13, 2009) (SR-NASDAQ-2009-084); and 64365 (April 28, 2011), 76 FR 25384 (May 4, 2011) (SR-NASDAQ-2011-058).

<sup>5</sup> Rule 4626(a) provides that except as set forth in the accommodation portion of the rule, "Nasdaq and its affiliates shall not be liable for any losses, damages, or other claims arising out of the Nasdaq Market Center or its use. Any losses, damages, or other claims, related to a failure of the Nasdaq Market Center to deliver, display, transmit, execute, compare, submit for clearance and settlement, adjust, retain priority for, or otherwise correctly process an order, Quote/Order, message, or other data entered into, or created by, the Nasdaq Market Center shall be absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the Nasdaq Market Center."

<sup>6</sup> Rule 4626 was amended in 2011 to the current version. See Securities Exchange Act Release No. 64365 (April 28, 2011), 76 FR 25384 (May 4, 2011) (SR-NASDAQ-2011-058) (notice of filing and immediate effectiveness).

a.m. on May 18, 2012, that were priced at \$42.00 or less, and that executed at a price below \$42.00;

3. BUY Cross orders priced at exactly \$42.00 and that were executed in the Cross but not immediately confirmed; and

4. 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 customer<sup>7</sup> 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.<sup>8</sup>

The modifications proposed in this rule change are not intended to and do not affect the limitations of liability set forth in Nasdaq's agreements or SEC-sanctioned rules, or those limitations or immunities that bar claims for damages against Nasdaq as a matter of law. Rather, as noted above, they reflect Nasdaq's determination to adopt a fair and equitable accommodation policy that takes into account the impacts of Nasdaq's system issues on the investing public and members.

In the two sections that follow, Nasdaq provides: (i) Background information concerning Nasdaq's IPO process generally, the system difficulties Nasdaq experienced with the Facebook IPO process on May 18, 2012, and the impacts that those system difficulties had on certain orders; and (ii) Nasdaq's accommodation proposal, including the standards to be applied to claims for accommodation, the rationale for those standards, the proposed procedure for the submission and evaluation of claims, and the proposed payment process.

## II. Background

### *The IPO Cross Process*

The Nasdaq Cross, which is set forth in Nasdaq Rule 4753 (Nasdaq Halt and Imbalance Crosses), was developed in consultation with market participants and is designed to provide fair executions for investors to begin secondary market trading in IPO shares. The purposes of the Cross are set forth in the filings with the Commission that

implemented Rule 4753.<sup>9</sup> In approving the Cross, the Commission found that the Cross process, as described in Nasdaq's filing seeking approval of the Cross, "should provide useful information to market participants and increase transparency and order interaction at the opening," and "should result in the public dissemination of information that more accurately reflects trading in a particular security."<sup>10</sup> The Commission additionally concluded that the Cross, as described in Nasdaq's filing, is consistent with the requirements of the Act and the rules and regulations thereunder generally, and particularly with the requirement that rules be designed to facilitate transactions in securities and to remove impediments to and perfect the mechanism of a free and open market.<sup>11</sup> The Commission also found that the Cross, as described in Nasdaq's filing, was "based on the Nasdaq opening cross, which the Commission approved in a prior filing."<sup>12</sup>

The Cross is an open and transparent process that identifies a single price based on supply and demand as represented by orders submitted to the Cross process. The Cross process is integrated with the Nasdaq order book to provide a smooth transition for orders from the Cross to continuous trading.

In the Cross process, all members have the ability to enter orders and observe the evolution of the prospective auction price through Nasdaq's dissemination of auction imbalance information, and thereby to participate in the price discovery process. Cross-eligible shares determine the auction price as the price nearest to the offering price that will execute all market order shares, all limit order shares with superior prices to the auction price,<sup>13</sup> and as many limit order shares as possible with limit prices equal to the auction price.<sup>14</sup>

<sup>9</sup> See Securities Exchange Act Release Nos. 53488 (March 15, 2006), 71 FR 14272 (March 21, 2006) (SR-NASD-2006-015); 54248 (July 31, 2006), 71 FR 44738 (August 7, 2006) (SR-NASDAQ-2006-019).

<sup>10</sup> Securities Exchange Act Release No. 53687 (April 20, 2006), 71 FR 24878 (April 27, 2006) (SR-NASD-2006-015).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* (citing Securities Exchange Act Release 50405 (September 16, 2004), 69 FR 57118 (September 23, 2004) (SR-NASD-2004-071)).

<sup>13</sup> An order with a superior price is, in the case of a buy order, an order with a limit higher than the auction price, and in the case of a sell order, an order with a limit lower than the auction price.

<sup>14</sup> The Cross algorithm sets the auction price by determining the price that will maximize the number of shares executed and, in the case of multiple prices providing the same maximum number of shares executed, selecting the price nearest to the offering price consistent with all

Nasdaq begins accepting Cross orders at the system start time of 7:00 a.m. During the interval between the system start time and the start of the Display-only period, orders can be entered or cancelled freely, and information on Cross orders is not publicly disseminated. The Display-only period begins 15 minutes prior to the scheduled release time of the IPO. Once the Display-only period begins, Nasdaq disseminates indicative information about the auction price and auction volume via Net Order Imbalance Indicator ("NOII") messages on Nasdaq's public data feeds at five-second intervals.<sup>15</sup> Members may enter and cancel orders during the Display-only period. As the effects of order entry and cancellation are disseminated to the public, participants may respond with further order entry, modification, or cancellation instructions. Over the course of the Display-only period, market participants develop an understanding of the state of supply and demand, changes in the indicative price typically become smaller, and the indicative volume typically increases.

The Display-only period can be extended (up to six times) in five-minute increments. During the extension period, imbalance information continues to be disseminated and orders may be entered or canceled. It is relatively common for the Display-only period of an IPO to be extended.

Once there are no further five-minute extensions of the Display-only period, the IPO Cross executes, the Nasdaq official opening price is disseminated, a bulk trade execution is sent to the consolidated tape, and messages confirming individual executions for Cross-executed shares are sent to market participants. In accordance with market participants' instructions, orders not executed in the Cross are either canceled or populate the Nasdaq electronic order book.

Nasdaq believes that the benefits of the Cross include optimizing an opening price and allowing investors to cancel their orders at the last possible moment before a Cross is calculated. Moreover, as the Commission found when it approved the Cross, the Cross process, as described in Nasdaq's filing, was designed as described above to promote just and equitable principles of trade, 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

superior priced orders executing. See Rule 4753(b)(2).

<sup>15</sup> See Rule 4753(b)(1).

<sup>7</sup> For purposes of the rule, unless stated otherwise, the term "customer" shall be construed to include any unaffiliated entity upon whose behalf an order is entered, including any unaffiliated broker or dealer.

<sup>8</sup> All claims allegedly attributable to system errors on May 18, 2012 not directly involving the FB IPO Cross will continue to be evaluated and adjudicated under Nasdaq Rule 4626(b)(1) using Nasdaq's existing processes and subject to Nasdaq's existing limitation of liability.

public interest in various ways.<sup>16</sup> The Commission further noted that “[i]n approving the proposed rule change, the Commission \* \* \* considered its impact on efficiency, competition, and capital formation.”<sup>17</sup>

*The Facebook IPO Cross on May 18, 2012*

At 10:45:00 a.m. on May 18, 2012 the Display-only period for Facebook began, with a scheduled release time of 11:00:00 a.m. The first NOII message disseminating indicative information about the upcoming IPO cross was distributed at 10:45:05 a.m. with an indicative price of \$50.00 and indicative volume of 4,461,419 shares. At approximately 10:57:53 a.m., the initially scheduled release time of 11:00:00 a.m. was extended to 11:05:00 a.m. There were no further extensions.

The NOII messages continued at 5-second intervals until the last message at 11:05:05 a.m. From 11:00:30 a.m. onward, the NOII messages displayed an indicative price of \$42.00. The last NOII message was distributed at 11:05:05 a.m. with an indicative price of \$42.00 and indicative volume of 72,189,277 shares.

The Cross process in FB did not operate as expected. At approximately 11:05:10 a.m., Nasdaq attempted to conclude the quoting period, execute the Cross and print the opening trade to the tape. Initiating this procedure instructed the Cross application to run its final calculation to match buy and sell interest and then print the opening trade to the tape. As a protection to ensure the integrity of the IPO process, the system is designed to recalculate the IPO auction if the matching engine's view of the auction book has changed between the time of the final calculation and the printing of the opening trade. In other words, the system is designed to ensure that cancellations submitted while the Cross is calculating, and up until the last moment before the Cross is completed, are accounted for in the Cross.

After the initial calculation of the Cross was completed, but before the opening trade was printed, additional order modifications were received by the system, changing the auction order book. As designed, the system recalculated the Cross to factor in the new state of the book. Again, changes were received before the system could print the opening trade, which resulted

in additional re-calculations. This condition persisted, resulting in further delay of the opening print.

Nasdaq continued to receive new order, cancel, and replace messages, and they were added to the Cross order book. New order, cancel, and replace messages received before approximately 11:11:00 a.m. were acknowledged and incorporated into the Cross order book in real time.

Upon concluding shortly before 11:30 a.m. that a system modification would resolve all system issues, Nasdaq, in an exercise of its market oversight obligations, determined to proceed with the IPO. At 11:30:09 a.m., Nasdaq completed the Cross, printed approximately 75.7 million shares at \$42.00 to the tape, and opened continuous trading in Facebook.<sup>18</sup>

At the time Nasdaq implemented the system modification, its expectation was that substantially all Cross-eligible orders received prior to the Cross would participate in the Cross and that all Cross transaction confirmation messages would be disseminated immediately thereafter. This turned out not to be the case.

First, only orders received prior to 11:11:00 a.m. participated in the 11:30:09 a.m. Cross. Of the orders entered between 11:11:00 a.m. and 11:30:09 a.m., some were cancelled by members before the Cross.<sup>19</sup> Others were entered into the market at 11:30:09 a.m., and the remainder were either cancelled or released into the market at 1:50 p.m.<sup>20</sup>

Second, Cross transaction confirmation messages were not disseminated until 1:50 p.m. When Nasdaq became aware of the fact that confirmations were not being delivered, Nasdaq determined not to suspend trading in FB stock because at that time price discovery was occurring in an orderly fashion in the continuous market. Indeed, active, deep, and liquid trading was taking place in FB stock on

Nasdaq and trading in FB stock was proceeding as well on ten other markets and in over-the-counter trading.<sup>21</sup> Nasdaq systems operated normally in handling all of the FB orders entered and executed after the Cross.

The circumstances described above affected market participants differently depending on the prices of their orders and whether they were buyers or sellers.

In spite of the absence of confirmation messages, Nasdaq believes that market participants—based on all of the information available at the time, their experience with Nasdaq crosses, and established trading priorities—would reasonably have had certain expectations for the execution or non-execution of their orders. Nasdaq printed approximately 75.7 million shares at \$42.00 to the tape at 11:30 a.m. In addition, fair and orderly continuous trading on other markets opened in close proximity to the \$42.00 established by the Cross, and the price of FB moved in an orderly manner above and below \$42.00 throughout the trading day, with more than 500 million shares traded.<sup>22</sup> The following analysis reflects Nasdaq's assessments as to market participants' reasonable expectations and the nature of their potential losses.

Accordingly, any buy or sell order received up until 11:30:09 a.m. and priced at a level at which it could not be filled in a Cross with a publicly disseminated price of \$42.00 (*i.e.*, a buy order below \$42.00 and a sell order above \$42.00) was not disadvantaged. Market participants who submitted such orders could not reasonably have expected such orders to be executed. Accordingly, those orders experienced no loss attributable to the Nasdaq system issues.<sup>23</sup>

<sup>21</sup> See, e.g., Securities Exchange Act Release No. 22554 (October 23, 1985), 50 FR 43825 (October 29, 1985) (SR-NYSE-85-38) (stating that when determining whether to halt trading, an exchange must weigh against a potential reason for a halt “the need to provide investors with a liquid market within which to buy or sell securities whenever they choose,” and that while decisions to halt or delay trading “necessarily depend upon the circumstances of each particular situation,” an “Exchange will in all cases be guided by its intention to maintain a fair, orderly and continuous market in its listed securities, insofar as reasonably practicable under the circumstances”).

<sup>22</sup> As discussed herein, Nasdaq's subsequent analysis has confirmed that \$42.00 was the appropriate opening price.

<sup>23</sup> Some orders inadvertently benefitted from Nasdaq system issues. For example, buy orders that were entered between 11:11 a.m. and 11:30 a.m. and priced at \$42.00 and above were not filled in the Cross. Had these orders been executed in the Cross or returned to customers at 11:30 a.m. instead of being held until 1:50 p.m., they might have been filled at prices at or above \$42.00 as the price of FB stock ran up to \$45 immediately after 11:30 a.m.

Continued

<sup>16</sup> Securities Exchange Act Release No. 53687 (April 20, 2006), 71 FR 24878 (April 27, 2006) (SR-NASD-2006-015) (finding the Cross consistent with Section 15A of the Act, 15 U.S.C. 78o-3, in general, and Section 15A(b)(6) of the Act, 15 U.S.C. 78o-3(b)(6), in particular).

<sup>17</sup> *Id.* at n.5 (citing 15 U.S.C. 78c(f)).

<sup>18</sup> An initial calculation of the Cross was attempted at approximately 11:05:09 a.m. Had that calculation of the Cross completed, it still would have resulted in an opening price of \$42.00.

<sup>19</sup> Cancellations received during that interval were processed in real time, resulting in Nasdaq assuming in its error account the cancelled buy and sell positions. Nasdaq's net error account position was a short position of 3,070,430 shares. Using the services of an unaffiliated third-party broker in accordance with Nasdaq's then-proposed, and since approved Rule 4758(d), Nasdaq thereafter sold this short position, resulting in an inadvertent gain of approximately \$10.8 million. This gain will be returned in full to customers through the accommodation proposal set forth in this filing.

<sup>20</sup> Had all Cross-eligible orders, including those entered between 11:11:00 a.m. and 11:30:09 a.m., participated in the Cross, the Cross would still have taken place at \$42.00.

Conversely, sellers who entered orders priced at \$42.00 or less should reasonably have expected that their orders had been executed in the Cross. Nasdaq had continuously indicated through NOII messages the relative proportion of buy and sell interests, providing information as to the likelihood of a buy or sell order being executed. Such sellers whose orders were received by Nasdaq before 11:11 a.m. had their orders executed in the Cross, consistent with expectations and previous market practice. Therefore, they were not disadvantaged and experienced no loss attributable to Nasdaq system issues.

The analysis is different for market participants who entered such orders between 11:11 a.m. and 11:30 a.m. Buyers who entered orders priced higher than \$42.00 during that interval did not receive messages that their orders had not executed in the Cross until 1:50 p.m. Yet, they were precluded from buying at their expected \$42.00 price and instead bought at the lower open market prices then available, if their orders were executed at all. Accordingly, these buyers also experienced no loss attributable to the Nasdaq system issues.

Sellers who entered orders priced at \$42.00 or less between 11:11 a.m. and 11:30 a.m. did not receive messages that their orders had not been executed in the Cross until 1:50 p.m. Such sell orders did not execute at their expected \$42.00 price in the Cross, but instead sold at the lower continuous market prices available at or after 1:50, if they executed at all. Thus, these market participants experienced losses reasonably attributable to the Nasdaq system issues.

Market participants who entered Cross-only eligible buy orders priced exactly at \$42.00 that executed in the Cross but that were not confirmed until 1:50 p.m. could not have been sure whether their orders had been executed because the number of buy and sell limit order shares priced at the clearing price and wishing to be matched in the Cross is never exactly equal. Consequently, in the interval between 11:30 a.m. and 1:50 p.m., these buyers may have purchased shares in the continuous market, and upon receiving Cross execution messages at 1:50 p.m., they may have experienced an unexpected long position. The sale of such an unexpected long position at a

lower price would have occasioned a loss.

Buyers who entered orders priced higher than \$42.00, which they did not subsequently cancel, should reasonably have expected that their orders had been executed in the Cross. As noted, Nasdaq had continuously indicated through NOII messages the relative proportion of buy and sell interests, providing information as to the likelihood of a buy or sell order being executed. Such buyers whose orders were received by Nasdaq before 11:11 a.m. had their orders executed in the Cross, consistent with expectations and previous market practice. Therefore, they were not disadvantaged and experienced no loss attributable to Nasdaq system issues.

Finally, there are market participants who entered eligible buy orders for customers that were priced above \$42.00 and that were executed in the Cross but not confirmed until 1:50 p.m., but for which the customer requested and received an out from the member and for which the member submitted a request to cancel the order to Nasdaq prior to 1:50 p.m. When the member received confirmation of the execution of the customer's order at 1:50 p.m., the member held shares for which it no longer had a recipient. Nasdaq believes that members who took such actions were reasonably attempting to assist their own customers in responding to the delayed dissemination of Cross transaction reports, and that such members further attempted to communicate their actions to Nasdaq through the submission of cancellations. In this category, however, the outcome was affected not only by Nasdaq system issues, but also by the member's affirmative decision not to await the dissemination of confirmations. Accordingly, Nasdaq believes that a portion of the associated losses should be borne by the members. Thus, Nasdaq is proposing an accommodation equaling only 70% of the member's qualifying loss amount with respect to this category.

### III. Accommodation Proposal

#### *Accommodation Standards*

Nasdaq's proposal is to provide accommodation within a framework that seeks to replicate what the expected execution prices of orders would have been had the Cross not experienced unexpected and unprecedented difficulties, limited by 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. Thus, Nasdaq

proposes to make accommodation payments in respect of:

(i) SELL Cross orders that were submitted between 11:11 a.m. and 11:30 a.m. 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. and 11:30 a.m. 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 customer 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.

These are the situations in which Nasdaq has concluded that its systems issues could have impacted market participants' reasonable expectations in an objectively discernible manner. In these situations, Nasdaq proposes to offer as an accommodation the loss differential for a qualified order—that is, the difference between the price that was reasonably expected and the subsequent execution price actually obtained, or the price available at the point when the market participant could have taken steps to mitigate its losses or otherwise adjust its position.

As described above, Nasdaq believes that it reasonably determined not to suspend the IPO or halt trading in FB stock, and Nasdaq's FB-related systems issues were fully resolved at 1:50 p.m., when Nasdaq disseminated all delayed Cross execution confirmation messages. At that point, Nasdaq believes that member firms were in possession of all the information needed to evaluate their positions and obligations to customers, and take steps accordingly.

Accordingly, for the orders described in (i), (iii), and (iv) above, Nasdaq proposes to establish a uniform benchmark price of \$40.527, the price at which Nasdaq has concluded a reasonably diligent member could have obtained shares to mitigate any unexpected losses or to liquidate unanticipated positions coming out of the Cross. Nasdaq calculated this price using the volume-weighted average price of FB stock during the first 45 minutes of trading after execution reports were delivered to firms

The delay instead gave participants the opportunity either to cancel their orders after 11:30 a.m., as many did, or to execute at a lower price when the cancellations and remaining non-cancelled orders were released into the market at 1:50 p.m.

(i.e., 1:50 p.m. to 2:35 p.m.).<sup>24</sup> Using \$40.527 as the uniform benchmark price results in a maximum loss of \$1.473 per share per order.

For the orders described in (ii) above, Nasdaq proposes to offer as an accommodation the difference between the price that was reasonably expected (i.e., \$42.00) and the execution price actually obtained, because the immediate execution of these orders precluded a member from taking reasonable actions to mitigate losses.

Nasdaq believes that this method provides a reasonable time period for firms to have taken actions to mitigate losses after receiving the Cross transaction reports, as well as a reasonable maximum loss price parameter for determining accommodation payments. Additional alleged losses incurred beyond that benchmark price, regardless of their cause, will remain the responsibility of the member. If a member suffered a lesser loss than that calculated based on the foregoing method, based on the difference between the expected execution price of the order in the Cross process establishing an opening print of \$42.00 and the actual execution price received, the member shall not receive more than the lesser actual loss suffered. A member's direct trading losses, as calculated in accordance with these parameters, are referred to in the proposed rule as the "Member's Share."

Alleged losses from other causes shall not be considered eligible for accommodation payments under the proposed rule change. Thus, for example, Nasdaq does not propose to make accommodation payments in respect of alleged losses attributable to: orders received after the commencement of continuous regular trading in FB; individual member firm technology issues or system failures, or member firm operational issues or operational failures; affirmative trading actions taken by member firms on their own behalf or to accommodate their customers after the Cross, except as otherwise provided in the proposed rule; alleged or speculative lost trading opportunities or alleged or speculative lost business profits of any description; non-marketable Cross orders for which, based on their price, there was no reasonable expectation that orders had

been executed; and a member firm's failure to adequately and appropriately mitigate losses or adjust trading positions. Nasdaq is not asking any firm to offset its claims under these criteria with any economic gains experienced because of the relevant system issues as outlined at footnote 23.

Examples of how the accommodation standards would apply are below.

*Example 1:* A member submitted an IPO Cross order to SELL 1000 shares priced at market (i.e., willing to sell at any price or otherwise equivalent to \$0.01) with a Time in Force (TIF) of Immediate or Cancel (IOC), entered at 11:15 a.m. Because the order was priced lower than the opening price, it should have been filled at \$42.00 in the Cross, but failed to execute because it was entered after 11:11 a.m. Nasdaq transmitted the order confirmation of the failure to the member at 1:50 p.m., at which time the member covered its position (i.e., sold the 1000 shares it had expected to sell in the Cross) at a price of \$41.15. Because the member was able to sell its shares at a higher price than the benchmark price Nasdaq has established (\$40.527), the member will be accommodated for the difference between the opening price and the covering execution's price. The amount of loss is  $1000 \times (\$42.00 - \$41.15) = \$850.00$ .

*Example 2:* A member submitted an IPO Cross order to SELL 1000 shares priced at market with a TIF of IOC, entered at 11:15 a.m. Because the order was priced lower than the opening price, it should have been filled at \$42.00 in the Cross, but failed to execute because it was entered after 11:11 a.m. Nasdaq transmitted the order confirmation message noting the failure to execute to the member at 1:50 p.m., but the member did not cover its position until later in the day at an average price of \$39.00. Because the member's covering execution price was lower than the benchmark price Nasdaq has established (\$40.527), the member will be accommodated for the difference between the opening price and the benchmark price. The amount of loss is  $1000 \times (\$42.00 - \$40.527) = \$1,473.00$ .

*Example 3:* A member submitted an IPO Cross order to SELL 1000 shares priced at market with a TIF of DAY, entered at 11:15 a.m. Because the order was priced lower than the opening price, it should have been filled at \$42.00 in the Cross, but failed to execute in the Cross because it was entered after 11:11 a.m. The order was entered into the continuous book at 1:50 p.m., at which time it executed at a price of \$41.05. Nasdaq transmitted the order confirmation message to the member at 1:50 p.m. Because the order executed at an inferior price to the opening price, the member will be accommodated for the difference between the opening price and the actual execution price. The amount of loss is  $1000 \times (\$42.00 - \$41.05) = \$950.00$ .

*Example 4:* A member submitted an IPO Cross order to SELL 1000 shares priced at market with a TIF of DAY, entered at 11:15 a.m. Because the order was priced lower than the opening price, it should have been filled at \$42.00 in the Cross, but failed to execute in the Cross because it was entered after

11:11 a.m. The order was entered into the continuous book at 1:50 p.m., at which time it executed at a price of \$40.00. Nasdaq transmitted the order confirmation message to the member at 1:50 p.m. Because the order executed at an inferior price to the opening price, the member will be accommodated for the difference between the opening price and the actual execution price. The amount of loss is  $1000 \times (\$42.00 - \$40.00) = \$2,000.00$ .

*Example 5:* A member submitted an IPO Cross order to SELL 1000 shares priced at market with a TIF of DAY, entered at 11:15 a.m. Because the order was priced lower than the opening price, it should have been filled at \$42.00 in the Cross, but failed to execute in the Cross because it was entered after 11:11 a.m. The member cancelled the order at 12:30 p.m., after the Cross had taken place at 11:30:09 a.m. but before the order was delivered to the continuous book or a confirmation message was delivered. The order cancelled back to the member at 1:50 p.m. based on the request sent at 12:30 p.m. Because the member's order should have been executed in the Cross, the fact that the member cancelled the order at 12:30 p.m. is not relevant for purposes of determining that the order was directly disadvantaged, and the member will be accommodated for the difference between the opening price and the benchmark price. The amount of loss is  $1000 \times (\$42.00 - \$40.527) = \$1,473.00$ .

*Example 6:* A member submitted an IPO Cross order to BUY 1000 shares priced at \$42.00 with a TIF of DAY, entered at 11:00 a.m. The order was filled at \$42.00, but because the order's price was exactly the opening price, the member could not have reasonably known that the order was filled until 1:50 p.m. As a result, the member acquired an unexpected long position of 1000 shares that resulted in a loss when the position was covered at a price of \$40.15. Because the member's covering execution price was worse than the benchmark price Nasdaq has established (\$40.527), the member will be accommodated for the difference between the opening price and the benchmark price. The amount of loss is  $1000 \times (\$42.00 - \$40.527) = \$1,473.00$ .

*Example 7:* A member submitted an IPO Cross order to BUY 1000 shares at \$42.00 with a TIF of IOC, entered at 11:15 a.m. The order was not filled at \$42.00 because it was entered after 11:11 a.m., but because the order's price was exactly the opening price, the member could not have reasonably known that the order was not filled until 1:50 p.m. As a result, the member discovered it unexpectedly lacked 1000 shares at 1:50 p.m. At that time, the member could have purchased shares at prices lower than the opening price. Consequently, the member was not directly disadvantaged by Nasdaq's system error and there is no loss amount.

*Example 8:* A member submitted an IPO Cross order to BUY 1000 shares at \$42.50 with a TIF of IOC, entered at 11:15 a.m. The order was not filled at \$42.00 because it was entered after 11:11 a.m., but because the order's price was higher than the opening price, the member should have expected the order was filled until it received a confirmation to the contrary at 1:50 p.m. As a result, the member discovered it

<sup>24</sup> Trading firms typically process and determine actions on trading messages within seconds or less. Given the volume of messages at issue here and Nasdaq's delay in disseminating them, Nasdaq has concluded that 45 minutes 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.

unexpectedly lacked 1000 shares at 1:50 p.m. At that time, the member could have purchased shares at prices lower than the opening price. Consequently, the member was not directly disadvantaged by Nasdaq's system error and there is no loss amount.

*Example 9:* A member submitted an IPO Cross order for a customer to BUY 1000 shares at \$42.50 with a TIF of IOC, entered at 11:05 a.m. and a cancel request was submitted by the member before 1:50 p.m. for the order. The order was filled at \$42.00 as expected. Because it was priced higher than the opening price, the member should have expected that the order was filled, which was confirmed electronically at 1:50 p.m. In light of the confirmation delay, however, the member received a request to cancel the order from the customer prior to 1:50 p.m., accommodated that request by allowing the customer to cancel the order, and sent a cancellation request for the order to Nasdaq before 1:50 p.m. When confirmation of the customer's order execution in the Cross was received by the member at 1:50 p.m., the member held a long position of shares for which it no longer had a recipient. Although the decision to accommodate the customer's cancellation request was exclusively that of the member, Nasdaq has determined to provide a limited accommodation amount equaling 70% of the member's loss up to maximum loss amount of  $0.70 \times 1000 \times (\$42.00 - \$40.527) = \$1,031.10$ .

*Example 10:* A member submitted an IPO Cross order to BUY 1000 shares at \$42.50 with a TIF of IOC, entered at 11:05 a.m. The order was filled at \$42.00 as expected. Because it was priced higher than the opening price, the member should have expected that the order was filled, which was confirmed electronically at 1:50 p.m. As a result of the delay in confirmation, however, the member purchased additional shares before the confirmations arrived. This resulted in an unintended long position of 1000 shares. Although the member incurred a loss when covering the unintended position, Nasdaq correctly executed the member's order and the member should have expected the original IPO Cross order to be filled because of its price. Consequently, the member was not directly disadvantaged by Nasdaq's system error and there is no loss amount.

*Example 11:* A member submitted an IPO Cross order to BUY 1000 shares at \$42.50 with a TIF of IOC, entered at 11:05 a.m. The order was filled at \$42.00 as expected. Because it was priced higher than the opening price, the member should have expected that the order was filled, which was confirmed electronically at 1:50 p.m. Later in the day, the member sold the position at \$40.00. The member claims that it would have been able to sell at a higher price if had received the confirmation sooner. Nasdaq correctly executed the member's order. The claim of loss is premised on an alleged or speculative lost trading opportunity rather than the actual failure by Nasdaq to process an order correctly. Consequently, the member was not directly disadvantaged by Nasdaq's system error and there is no loss amount.

### *Procedure for Submission and Evaluation of Claims*

All members seeking accommodation under this proposal will be required to submit their claims to Nasdaq in writing not later than seven days after the approval of the proposed rule change by the Commission. Such notice of approval will be publicly posted by Nasdaq on its Nasdaq Trader Web site at <http://www.nasdaqtrader.com> and provided directly to all member firms via an Equity Trader Alert. All claims that have been timely submitted will be evaluated by the Financial Industry Regulatory Authority ("FINRA") applying the accommodation standards set forth herein. FINRA may request such supplemental information as FINRA deems necessary to assist FINRA's evaluation of the claims. FINRA's role will be limited to measuring data against the benchmarks established by this filing to ascertain the eligibility and value of each member's claims under those benchmarks. FINRA staff assessing the claims will not be involved in providing regulatory services to any Nasdaq market and they will not have purchased Facebook stock during Nasdaq's IPO opening process or currently own Facebook stock. In addition, as discussed below, FINRA will prepare a report for Nasdaq on its analysis of the eligibility of claims that will be provided to the public members of FINRA's Audit Committee.

Once it has completed its review, FINRA shall 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.<sup>25</sup> Thereafter, Nasdaq will file with the Commission a rule proposal setting forth the amount of eligible claims submitted and its intention to pay such claims up to \$62 million. In no event shall Nasdaq make any payments on claims until the rule proposal setting forth the amount of eligible claims becomes effective and final.

### *Payment Process*

Nasdaq's business and legal relationships are with its members, not its members' customers. Nasdaq has no contractual or other relationships with its members' customers, and generally does not possess information about interactions between a member and its customer that may underlie members' trading activity. Nevertheless, Nasdaq is

<sup>25</sup> In accordance with the established policies of these Boards, any directors with a financial interest in the accommodation process will be expected to recuse themselves from consideration of the analysis.

mindful that member's customers have been impacted by the processing of member orders in the FB Cross. Thus, for example, to the extent that a member order reflected a customer order, and the member order was not executed in the manner expected, the customer order may not have been filled, or may have been filled at an unexpected price. Nasdaq is also aware of public reports that some members experienced their own system issues on May 18, 2012 that were unrelated to Nasdaq's system issues, and that those members' issues may have had an impact on the members' customers. To the extent that a member receiving accommodation hereunder had customers that incurred losses, Nasdaq believes that accommodation payments received by members from Nasdaq should be used for the benefit of such customers.

Accordingly, Nasdaq proposes that all accommodation payments proposed in this filing be contingent upon a member's submission to Nasdaq, not later than seven days after the effective date of the rule proposal described above detailing the amount of eligible claims, of an attestation detailing:

(i) 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 Inc. on May 18, 2012 ("Customer Compensation"), and

(ii) The extent to which the losses reflected in the Member's Share<sup>26</sup> 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 ("Covered Proprietary Losses").

Failure to provide the required documentation within the specified time limit will void the member's eligibility to receive an accommodation under the modified rule. Each member shall be required to maintain books and records that detail the nature and amount Customer Compensation and Covered Proprietary Losses. Nasdaq, through FINRA, its regulatory services provider, would expect to examine the accuracy of member's attestation at a later date.

Accommodation payments under this subsection will be made in two tranches of priority, subject to the maximum total payout of \$62 million:

(i) First, if the member has provided Customer Compensation, the member will receive an amount equal to the

<sup>26</sup> Defined specifically as a member's direct trading losses calculated in accordance with paragraphs (b)(3)(A) and (B) of the proposed rule.



lesser of the Member's Share or the amount of Customer Compensation. For example, if a Member's Share was \$1 million, and the member had paid, or had committed to pay, compensation to its customers of at least \$1 million, the member's expected accommodation would be \$1 million. On the other hand, if the Member's Share was \$1 million, but the member had paid, or committed to pay, only \$500,000 in compensation to its customers, the member's expected accommodation in the first tranche would be only \$500,000. This approach reflects Nasdaq's belief that accommodation with respect to members' trades on behalf of customers (other than broker-dealers trading on a proprietary basis) should be paid first, and should be paid only to the extent of the member's own compensation to customers.

(ii) Second, the member will receive an amount with respect to Covered Proprietary Losses; provided, however, that the sum of payments to a member under the rule shall not exceed the Member's Share. Although Nasdaq recognizes that firms engaging in proprietary trading may have incurred losses, it believes that payments to them should occur after payments with respect to losses on behalf of customers. If a member had both Covered Proprietary Losses and losses associated with customer business, it may receive distributions under both tranches. For example, if a Member's Share was \$1 million, the member had \$300,000 in Covered Proprietary Losses, and the member had provided \$300,000 in Customer Compensation, the member's expected accommodation would be \$600,000 in total. Alternatively, if the member had \$300,000 in Covered Proprietary Losses and had provided \$700,000 or more in Customer Compensation, the member's expected accommodation would be \$1 million.

In the event that the amounts calculated under tranche (i) exceed \$62 million, accommodation will be prorated among members eligible to receive accommodation under tranche (i) based on the size of the amounts payable under tranche (i). In the event that tranche (i) is paid in full and the amounts calculated under tranche (ii) exceed the funds remaining from the \$62 million accommodation pool, such funds will be prorated among members eligible to receive accommodation under tranche (ii) based on the size of the amounts payable under tranche (ii). If a member's eligibility to receive funds is voided for any reason under this rule, and the funds payable to other members must be prorated, the funds available to

pay other members will be increased accordingly.

Final payment of any accommodation payment also will be conditioned on the execution by the member firm of a formal release of claims against Nasdaq for losses associated with FB that are related in any way to the Cross or other errors, omissions, actions, or failures to act on the part of Nasdaq on May 18, 2012. The release will be required not later than fourteen days after the effective date of the rule proposal described above detailing the amount of eligible claims. The purposes of imposing the release requirement notwithstanding the limitations of liability and immunities, which apply in any event pursuant to Nasdaq's rules and agreements and/or otherwise as a matter of law, are to avoid the disruption and expense of unnecessary litigation in connection with the Cross and to ensure equal treatment of all claimants. Nasdaq further notes that the program proposed herein is a voluntary step taken by Nasdaq to provide a substantial and unprecedented accommodation to its members, and that participation in the program is likewise voluntary on the part of members. Nasdaq believes that it would be inequitable to approve Nasdaq's voluntary program without also allowing it to establish conditions that promote certainty and finality.<sup>27</sup>

#### IV. Solicitation of Comments

This proposed rule change is being published for public comment. Nasdaq will give due consideration to all comments submitted during the comment period, but notes that comments advocating different approaches should include a complete exposition of potentially relevant information, including any impacts that the following, among other things, may have had on alleged harms:

- Market participants' own trading decisions and strategies;
- Non-Nasdaq technology issues, which Nasdaq understands affected certain market participants on May 18, 2012;
- Obligations to customers or order delivery firms;
- Regulatory obligations; and
- Market data issues.

Failure to provide adequate detail will negatively impact Nasdaq's ability to respond to or otherwise evaluate a comment.

<sup>27</sup> Cf. Section 405(c)(3)(B)(i) of the Air Transportation Safety and System Stabilization Act (requiring release by persons receiving compensation with respect to airline crashes on September 11, 2001).

#### 2. Statutory Basis

Nasdaq believes that the accommodation proposal is consistent with Section 6(b) of the Exchange Act<sup>28</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>29</sup> in particular, because the proposal is designed to promote just and equitable principles of trade, 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.

Nasdaq believes that the proposal to expand its accommodation policy in this unique set of circumstances will balance several important goals in keeping with the foregoing statutory objectives.

First, Nasdaq acknowledges that the system issues that first came to light during the FB IPO Cross had an impact on certain of its members during the period from 11:11 a.m. to 1:50 p.m. on May 18, 2012. As a result, Nasdaq believes that the public interest would be served by an accommodation policy that quantifies and provides compensation for customer losses that were directly attributable to those system issues in an objectively discernible manner. Specifically, Nasdaq believes that the public interest would be served by Nasdaq making accommodation payments in respect of the four specific categories of Cross orders, listed above, for which Nasdaq has concluded that its systems issues could have impacted market participants' reasonable expectations in an objectively discernible manner. Nasdaq further believes that the public interest would be served by Nasdaq providing as an accommodation the loss differential for a qualified order—that is, the difference between the price that was reasonably expected and the subsequent execution price actually obtained, or the price available at the point when the market participant could have taken steps to mitigate its losses or

<sup>28</sup> 15 U.S.C. 78f(b) (setting forth the prerequisites for registration as a national securities exchange).

<sup>29</sup> 15 U.S.C. 78f(b)(5) (requiring that an exchange's rules 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, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange").



otherwise adjust its position (in situations when it was possible for the market participant to take such steps).

Second, Nasdaq believes that it is important to recognize the regulatory policy objectives underlying Rule 4626 and ensure that they are not compromised. Hundreds of billions of dollars of securities transactions are matched through the systems of Nasdaq and other exchanges every day. Through the operation of those systems, exchanges provide invaluable services in support of capital formation, price discovery, and investor protection. If exchanges could be called upon to bear all costs associated with system malfunctions and the varying reactions of market participants taken in their wake, the potential would exist for a single catastrophic event to bankrupt one or multiple exchanges, with attendant consequences for investor confidence and macroeconomic stability. Alternatively, the cost of providing exchange services would have to rise dramatically for all investors to cover this material and new risk.<sup>30</sup> In addition, exchanges would be less inclined to implement innovative systems<sup>31</sup> consistent with the goals of Section 6(b)(5) of the Act.<sup>32</sup>

<sup>30</sup> Trading costs in the United States are among the lowest in the world, and thus a contributor to economic growth. See, e.g., Michael S. Pagano, *Which Factors Influence Trading Costs in Global Equity Markets?*, The J. of Trading, Winter 2009, at 7; Ian Domowitz et al., *Liquidity, Volatility, and Equity Trading Costs Across Countries and Over Time*, 4 Int'l Fin. 221 (Summer 2001); Asli Demirgüç-Kunt & Ross Levine, *Bank-based and Market-based Financial Systems: Cross-country Comparisons* 51 (The World Bank Working Paper No. 2143, July 1999).

<sup>31</sup> Securities Exchange Act Release No. 14777 (May 17, 1978) (SR-CBOE-78-14) (in proposing a limitation on liability, CBOE explained that an exchange "cannot proceed with innovative systems and procedures for the execution, clearance, and settlement of Exchange transactions \* \* \* unless it is protected against losses which might be incurred by members as a result of their use of such systems," and further that "[t]o the extent [a limitation of liability rule] enables the Exchange to proceed with innovative systems, competition should be enhanced"); see also Securities Exchange Act Release No. 58137 (July 10, 2008), 73 FR 41145 (July 17, 2008) (SR-NYSE-2008-55) (explaining that exchange's limitation of liability rule encourages vendors to provide services to the exchange, which results in faster and more innovative products for order entry, execution, and dissemination of market information).

<sup>32</sup> 15 U.S.C. 78f(b)(5) (requiring that an exchange's rules 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,

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.<sup>33</sup>

Moreover, if the potential for such catastrophic losses existed, as noted above, it would need to be reflected in the fees charged by exchanges to market participants in a manner that is not currently the case, making trading more expensive for all investors all the time. Rather, as the Commission has recognized, provisions such as Rule 4626 reflect the view that risks associated with system malfunctions should be allocated among all exchange members, rather than being borne solely by the exchange. Indeed, this view is consistently reflected in the limitation of liability rules common among United States exchanges.<sup>34</sup> And, this view is reflected in Nasdaq's proposal to condition any accommodation payment on the execution of a release of claims against Nasdaq for FB-related losses arising from the Cross, because this condition is aimed at avoiding unnecessary litigation and ensuring equal treatment of all claimants.

The level of accommodation being offered under this proposed rule change is unprecedented in its size. Although Nasdaq is voluntarily seeking in this instance to provide accommodation up to \$62 million for losses associated with the FB IPO Cross that were the direct result of the system issues that came to light on May 18, 2012, Nasdaq does not believe that the purposes of the Act related to the operation of the national market system would be well served by allocating to exchanges responsibility for losses attributable to other factors, such as the failure of members to mitigate losses in a timely and reasonable manner, or by effecting a wholesale modification to the risk and loss allocations underlying Rule 4626 and the similar rules of other exchanges that reflect the exchanges' exercise of the regulatory authority and obligations delegated to exchanges by the Act.<sup>35</sup> In

or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange").

<sup>33</sup> See, e.g., BATS Exchange and BATS-Y Exchange Rules 11.16; C2 Options Exchange Rule 6.42; CBOE Options Exchange Rule 6.7; CME Rule 578; EDGA and EDGX Rules 11.12; ISE Rule 705; NASDAQ OMX PHLX Rule 3226; NASDAQ OMX BX Rule 4626; NYSE Rules 17 and 18; NYSE MKT Rule 905NY; NYSE Arca (Options) Rule 14.2; NYSE Arca (Equity) Rule 13.2; One Chicago Rule 421.

<sup>34</sup> *Id.*

<sup>35</sup> As reflected in the proposed rule change, however, Nasdaq does believe that the public

this regard, it bears noting that in light of those regulatory duties, exchanges are also immune from civil liability for claims for damages caused by actions taken in connection with the discharge of their regulatory duties.<sup>36</sup>

Nasdaq further believes that, consistent with Section 6(b)(5) of the Act,<sup>37</sup> its proposal will promote just and equitable principles of trade and protect investors and the public interest by establishing a fair process through which affected members may submit claims for losses covered by the modified accommodation policy. Nasdaq believes that by establishing the objective benchmarks set forth in this filing, and allowing FINRA to act as a neutral third party and measure data against those benchmarks to ascertain the value of each member's claims under those benchmarks, will enhance the transparency of the process and minimize the potential for conflicts of interest. Nasdaq further believes that its proposed process for distributing accommodation payments will benefit investors and promote the public interest by providing incentives for members to use accommodation funds for the benefit of investors. Specifically, Nasdaq believes that its proposal will benefit investors and promote the public interest by: (i) requiring a claimant to submit to Nasdaq an attestation detailing the compensation the member has Provided or will provide to its customers, and detailing the extent to which the member incurred the losses covered by the proposed accommodation payment when trading for its own account; and (ii) providing for accommodation payments to be made in tranches that prioritize payments based on the extent to which the claimant has compensated its customers.

interest and the purposes of the Act related to the operation of the national market system would be well served by: (i) Providing that the first 45 minutes of trading after confirmation reports were delivered to firms was a reasonable time period for firms to have taken actions to mitigate losses, and therefore is a reasonable period on which to base the maximum loss price parameter for determining accommodation payments; and (ii) providing an accommodation of 70% of the qualifying loss amount for the fourth category of orders for which Nasdaq proposes to make accommodation payments, given that the losses in that category were affected not only by Nasdaq's system issues but also by the members' affirmative decisions to take actions with respect to customer orders rather than await the dissemination of confirmation reports.

<sup>36</sup> See, e.g., *DL Capital Group, LLC v. Nasdaq Stock Market, Inc.*, 409 F.3d 93 (2d Cir. 2005); *Sparta Surgical Corp. v. NASD*, 159 F.3d 1209 (9th Cir. 1998).

<sup>37</sup> 15 U.S.C. 78f(b)(5).

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

Written comments were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve or disapprove such proposed rule change, or
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2012-090 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2012-090. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2012-090 and should be submitted on or before August 22, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>38</sup>

**Kevin M. O'Neill,**  
*Deputy Secretary.*

[FR Doc. 2012-18704 Filed 7-31-12; 8:45 am]

**BILLING CODE 8011-01-P**

## **DEPARTMENT OF TRANSPORTATION**

### **Office of the Secretary**

[Docket DOT-OST-2009-0116]

#### **Application of Key Lime Air Corporation for Commuter Authority**

**AGENCY:** Department of Transportation.

**ACTION:** Notice of Order To Show Cause (Order 2012-7-5); Docket DOT-OST-2009-0116.

**SUMMARY:** The Department of Transportation is directing all interested persons to show cause why it should not issue an order finding Key Lime Air Corporation fit, willing, and able, and awarding it a Commuter Air Carrier Authorization.

**DATES:** Persons wishing to file objections should do so no later than August 6, 2012.

**ADDRESSES:** Objections and answers to objections should be filed in Docket DOT-OST-2009-0116 and addressed to U.S. Department of Transportation, Docket Operations, (M-30, Room W12-140), 1200 New Jersey Avenue, SE.,

West Building Ground Floor, Washington, DC 20590, and should be served upon the parties listed in Attachment A to the order.

**FOR FURTHER INFORMATION CONTACT:** Vanessa R. Balgobin, Air Carrier Fitness Division (X-56, Room W86-487), U.S. Department of Transportation, 1200 New Jersey Avenue SE., Washington, DC 20590, (202) 366-9721.

Dated: July 6, 2012.

**Susan L. Kurland,**  
*Assistant Secretary for Aviation and International Affairs.*

[FR Doc. 2012-18741 Filed 7-31-12; 8:45 am]

**BILLING CODE P**

## **DEPARTMENT OF TRANSPORTATION**

### **Federal Motor Carrier Safety Administration**

#### **Sunshine Act Meetings; Unified Carrier Registration Plan Board of Directors**

**AGENCY:** Federal Motor Carrier Safety Administration (FMCSA), DOT.

**TIME AND DATE:** August 2, 2012, 12 noon to 3 p.m., Eastern Daylight Time.

**PLACE:** This meeting will take place telephonically. Any interested person may call 877.820.7831, passcode, 908048 to participate in this meeting.

**STATUS:** Open to the public.

**MATTERS TO BE CONSIDERED:** The Unified Carrier Registration Plan Board of Directors (the Board) will continue its work in developing and implementing the Unified Carrier Registration Plan and Agreement and to that end, may consider matters properly before the Board.

**FOR FURTHER INFORMATION CONTACT:** Mr. Avelino Gutierrez, Chair, Unified Carrier Registration Board of Directors at (505) 827-4565.

Issued on: July 27, 2012.

**Larry W. Minor,**  
*Associate Administrator for Policy.*

[FR Doc. 2012-18887 Filed 7-30-12; 4:15 pm]

**BILLING CODE 4910-EX-P**

## **DEPARTMENT OF TRANSPORTATION**

### **Federal Railroad Administration**

[Docket Number FRA-2003-15754]

#### **Notice of Public Hearing: Reading Blue Mountain and Northern Railroad**

The Reading Blue Mountain and Northern Railroad (RBMN) has petitioned the Federal Railroad Administration (FRA) seeking the approval of the proposed

<sup>38</sup> 17 CFR 200.30-3(a)(12).