2. Statutory Basis

The MSRB believes that the proposed revisions to the Series 53 examination program are consistent with the provisions of Section 15B(b)(2)(A) of the Act,[8] which authorizes the MSRB to prescribe standards of training, experience, competence, and such other qualifications as the Board finds necessary or appropriate in the public interest or for the protection of investors. Section 15B(b)(2)(A) of the Act also provides that the Board may appropriately classify municipal securities brokers and municipal securities dealers and their associated personnel and require persons in any such class to pass tests prescribed by the Board.

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

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

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

The proposed rule change has become effective pursuant to Section 19(b)(3)(A)(i) of the Act[9] and Rule 19b–4(f)(1) thereunder,[10] in that the proposed rule change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization. MSRB proposes to implement the revised Series 53 examination program on August 1, 2006. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate 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.[11]

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 e-mail to *rule-comments@sec.gov.* Please include File Number SR–MSRB–2006–05 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–MSRB–2006–05. This file number should be included on the subject line if e-mail 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 inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the MSRB. 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–MSRB–2006–05 and should be submitted on or before August 10, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[12]

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. E6–11492 Filed 7–19–06; 8:45 am]

BILLING CODE 8010–01–P

[8] 15 U.S.C. 78o–4(b)(2)(A).

[9] 15 U.S.C. 78s(b)(3)(A)(i).

[10] 17 CFR 240.19b–4(f)(1).

[11] *See* Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C).

[12] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–54155; File No. SR–NASDAQ–2006–001]

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Approving a Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 Thereto Relating to the Nasdaq Market Center

July 14, 2006.

I. Introduction

On February 7, 2006, 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 integrate the operations of the existing Nasdaq Market Center, along with Nasdaq's Brut and INET facilities. On March 29, 2006, Nasdaq submitted Amendment No. 1 to the proposed rule change (''Amendment No. 1''). The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on April 14, 2006.[3] The Commission received twelve comments regarding the proposal.[4]

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 53583 (March 31, 2006), 71 FR 19573 (''Single Book Proposal'').

[4] *See* letter from Kim Bang, Chief Executive Officer, Bloomberg Tradebook LLC (''Bloomberg'') (''Kim Bang'') to Brian G. Cartwright, General Counsel, Commission, dated March 6, 2006 (''Bloomberg Comment Letter I''); letter from Kim Bang, David Cummings, Chief Executive Officer, BATS Trading, Inc. (''BATS'') (''David Cummings''), Ronald Pasternak, President, Direct Edge ECN LLC, and Martin Kaye, Chief Executive Officer, Track ECN (''Track'') (''Martin Kaye'') to Robert L.D. Colby, Acting Director, Division of Market Regulation (''Davision''), Commission, dated March 21, 2006 (''ECN Comment Letter''); letter from Kim Bang to Jonathan G. Katz, Secretary, Commission (''Jonathan Katz''), dated May 5, 2006 (''Bloomberg Comment Letter II''); letter from David Cummings to Christopher Cox, Chairman, Commission (''Chairman Cox''), dated May 5, 2006 (''BATS Comment Letter''); letter from Martin Kaye to Chairman Cox, dated May 5, 2006 (''Track Comment Letter I''); letter from Leonard J. Amoruso, Senior Managing Director and Chief Compliance Officer, Knight Capital Group, Inc. (''Knight'') to Nancy M. Morris, Secretary, Commission (''Nancy Morris''); dated May 5, 2006 (''Knight Comment Letter''); letter from C. Thomas Richardson, Managing Director, Citigroup Global Markets Inc. (''Citigroup'') to Nancy Morris, dated May 17, 2006 (''Citigroup Comment Letter''); letter from Kim Bang to Nancy Morris, dated May 30, 2006 (''Bloomberg Comment Letter II''); letter from David C. Chavern, Vice President, Capital Markets Program, U.S.

Continued

On July 7, 2006, Nasdaq filed Amendment No. 2 to the proposed rule change (''Amendment No. 2''). On July 14, 2006, Nasdaq filed Amendment No. 3 to the proposed rule change (''Amendment No. 3''). This order approves the proposed rule change, as amended by Amendment No. 1. Simultaneously, the Commission is providing notice of filing of Amendment Nos. 2 and 3 and granting accelerated approval of Amendment Nos. 2 and 3.

II. Description

Nasdaq proposes to combine the operations of the existing Nasdaq Market Center with its Brut and INET facilities to create a single integrated system, with a single pool of liquidity (the ''Integrated System'' or ''System''). The Integrated System would only accept automatic executions and would eliminate Nasdaq's current order delivery functionality. The Integrated System is designed to enable Nasdaq to operate its execution system as that of a national securities exchange rather than as a national securities association, pursuant to the Commission order, dated January 13, 2006, approving Nasdaq's application to register as a national securities exchange.[5] In addition, Nasdaq has designed the Integrated System to comply with the requirements of Rules 610 and 611 of Regulation NMS under the Act (''Regulation NMS'').[6]Nasdaq has designated August 28, 2006 as the initial implementation date for this System.[7]

Nasdaq currently operates three execution systems: (1) The Nasdaq Market Center, formerly known as SuperMontage (''NMC Facility''); (2) the Brut ECN, a registered broker-dealer that is a Nasdaq subsidiary (''Brut Facility''); and (3) the INET ECN, which is operated by Brut, LLC, a subsidiary of Nasdaq (''INET Facility'') (collectively, the ''Nasdaq Facilities'').[8] Currently, the Nasdaq Facilities are all linked, but separate, each operating pursuant to independent Commission-approved rules, with the NMC Facility operating under the 4700 Series, the Brut Facility operating under the 4900 Series, and the INET Facility operating under the 4950 Series.

Under the proposal, as amended, Nasdaq seeks to integrate the matching systems of the three Nasdaq Facilities into a single matching system, governed by a single set of rules. To ease the transition for Nasdaq participants, the Integrated System would be accessible through the same connectivity by which users currently access each of the Nasdaq Facilities, and use functionality that is already approved and operating within one or more of the Nasdaq Facilities. For example, the Integrated System would use slightly modified functionality from the INET Facility for order entry, display, processing, and routing, and draw on functionality in the NMC Facility for the opening and closing processes. Participants would remain subject to general obligations applicable to all Nasdaq Facilities, including honoring System trades, complying with all Commission and Nasdaq rules, and properly clearing and settling trades. The proposed rule change, as amended, is designed to ensure Nasdaq's readiness to comply with Regulation NMS and facilitate Nasdaq's operation as a national securities exchange.

As the proposed rule change merges the three Nasdaq Facilities into a single platform, it also simplifies Nasdaq's rules by merging five sets of rules (the 4600, 4700, 4900, 4950, and 5200 Series) into two (the 4600 and 4750 Series). The proposed 4600 Series would govern Nasdaq participants, while the proposed 4750 Series would govern the operation of the Integrated System. The proposed rule change would delete in the following series of rules in their entirety: Series 4700 (Nasdaq Market Center—Execution Services), Series 4900 (Brut Systems), Series 4950 (INET System), and Series 5200 (Intermarket Trading System/Computer Assisted Execution System). The proposed rule change would add new Series 4750 (Nasdaq Market Center—Execution Services) and modify current Series 4600 (Requirements for Nasdaq Market Makers and Other Nasdaq Market Center Participants), including renumbering rules governing participants' obligations to honor trades and to comply with applicable rules and registration requirements.

In addition to reorganizing the rules, and making changes to the Exchange's rules for exchange and Regulation NMS readiness, the proposed rule change, as amended, addresses, among other things, openings and closings, the order display/matching system, order types, time in force designations, anonymity, routing, book processing, adjustment of open orders,[9] and Nasdaq's plan for a phased-in implementation of the proposed rule change.

In Amendment No. 2, because of the extension of certain compliance dates relating to Regulation NMS, Nasdaq proposed to modify certain rules such that their effectiveness would coincide with the Regulation NMS compliance dates announced by the Commission. Amendment No. 2 also contained a number of non-substantive changes and technical corrections to clarify the proposal.

In Amendment No. 3, Nasdaq proposed to schedule the implementation of the System beginning August 28, 2006.[10] Nasdaq described its planned phase-in schedule for the Integrated System and intention to test the System during the month of July and early in August prior to the transition. Then, beginning August 28, 2006, Nasdaq would transition Nasdaq-listed securities in three groups over a three-week period with 15 to 30 Nasdaq-listed stocks the first week, an additional 100–200 Nasdaq-listed stocks the second week, followed by the remaining Nasdaq-listed stocks the third week. Following the transition of Nasdaq stocks, Nasdaq would transition all non-Nasdaq-listed securities (*i.e.*, NYSE, American Stock Exchange (''Amex''), and regional-listed stocks). Nasdaq noted that it plans to monitor the implementation and adjust the schedule as needed to maintain an orderly transition.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment Nos. 2 and 3 are 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

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Chamber of Commerce (''USCC'') to Nancy Morris, dated June 8, 2006 (''USCC Comment Letter''); letter from David Colker, National Stock Exchange (''NSX'') to Chairman Cox, dated June 20, 2006 (''NSX Comment Letter''); letter from Kim Bang to Nancy Morris, dated June 23, 2006 (''Bloomberg Comment Letter IV''); and letter from Martin Kaye to Chairman Cox, dated July 3, 2006 (''Track Comment Letter II'').

5 *See* Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (''Exchange Application Order'').

6 *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

7 *See* Amendment No. 3.

8 In its Single Book Proposal, Nasdaq noted that, until January 31, 2006, INET ATS, Inc. was a registered broker-dealer and a member of the NASD. On February 1, 2006, the INET broker-dealer and a member of the NASD. On February 1, 2006, the INET broker-dealer was merged into the Brut broker-dealer which is a member of the New York Stock Exchange (''NYSE''). Nasdaq states that it will continue to operate the Brut Facility and INET Facility under the rubric of a single broker-dealer until the Integrated System is fully operational. *See* Single Book Proposal at 19589.

9 *See supra* note 3.

10 The Commission notes that Amendment No. 3 replaces the August 14, 2006 implementation date that Nasdaq had proposed in Amendment No. 2.

• Send an e-mail to *rule-comments@sec.gov.* Please include File Number SR–NASDAQ–2006–001 on the subject line.

Paper Comments

• Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–NASDAQ–2006–001. This file number should be included on the subject line if e-mail 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 inspection and copying in the Commission's Public Reference Room. 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–2006–001 and should be submitted on or before August 10, 2006.

IV. Summary of Comments Received

The Commission received twelve comment letters, representing seven different entities, on the proposed rule change.[11] Five of the seven commenters either directly or indirectly operate electronic communications networks (''ECNs''). Each of the ECN commenters opposed the proposed rule change. The remaining two commenters did not directly support or oppose the proposal.

Bloomberg submitted four comment letters. The Bloomberg Comment Letter I was submitted prior to Nasdaq's submission of Amendment No. 1. In that letter, Bloomberg commented on one provision of the proposal that would have prohibited members from charging access fees triggered by the execution of a quotation within the System.[12] Bloomberg suggested that such a provision would violate Section 6(e)(1) of the Act,[13] which states that ''no national securities exchange may impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members.'' In addition, the Bloomberg Comment Letter I asserted that the Form 19b–4 did not adequately discuss or justify the burdens on competition with respect to the proposed prohibition on fees.[14] Bloomberg recommended that Nasdaq withdraw the provision of the proposal regarding the prohibition of fees. In Amendment No. 1, Nasdaq eliminated its proposal to prohibit members from charging access fees.[15]

In its second comment letter, Bloomberg objected to proposed Nasdaq Rule 4623(b)(5), which would eliminate the order delivery functionality from Nasdaq's rules, because it would expose ECNs to the risk of dual liability.[16] Bloomberg said that dual liability was ''a risk that in the past the Commission found to justify requiring Nasdaq to provide order delivery as opposed to execution delivery.'' [17] Bloomberg opined that eliminating the order delivery functionality, and thereby requiring all Nasdaq participants to accept automatic execution, would force ECNs to ''abandon their current business models and begin to act, involuntarily, as dealers;'' currently, unlike market makers, ECNs act as agency brokers and do not carry inventory or act as principal.[18] Bloomberg also asserted that because ECNs do not earn a market maker's bid-ask spread, being forced to ''eat'' an execution could ''never be profitable'' for ECNs.[19] Bloomberg concluded that this aspect of the proposal would force ECNs out of the Nasdaq market. Bloomberg questioned how investors and the national market system would be well served by eliminating the competitive liquidity and investor choices provided by ECNs from the Nasdaq platform.[20]

The Bloomberg Comment Letter II took issue with Nasdaq's claim that the order delivery functionality of ECNs made Nasdaq less competitive by slowing its execution services. Bloomberg stated that Nasdaq's claim did not include any data or factual support, and was ''incredible on its face.'' [21] Bloomberg noted that Nasdaq market participants entering orders could effectively choose to have their orders sent to automatic execution participants; thus, if order delivery ECNs were consistently slower or less efficient, they would suffer dire business consequences.[22] The comment letter also noted that Nasdaq itself routes orders to other market centers, such as Archipelago, and that there was no indication that this routing slowed down its system. Bloomberg stated that its typical response time to incoming Nasdaq orders was 5–20 milliseconds. Bloomberg posited that slow quotation updates, rather than order delivery delays, were the true cause of Nasdaq's system slowdowns. Bloomberg noted that the Nasdaq Quotation Dissemination Service feed had latencies of 500 milliseconds or more during periods of high market activity.[23]

Bloomberg also disagreed with Nasdaq's characterization of the Division's response to Question 5 of its Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS.[24] In the Single Book Proposal, Nasdaq stated that it did not believe that it could offer order delivery functionality and also satisfy Question 5's standard of continuously providing ''a response to incoming orders that does not significantly vary between orders handled entirely within the SRO trading facility and orders delivered to the ECN.'' [25] In Bloomberg's view, Question

[11] *See supra* note 4. Other than the Bloomberg Comment Letter I, all the comment letters discussed not only SR–NASDAQ–2006–001, but SR–NASD–2006–048 as well. In NASD–2006–048, Nasdaq propoess to charge an order delivery fee of 10 cents per 100 shares to order delivery participants on its system. *See* Securities Exchange Act Release No. 53644 (April 13, 2006), 71 FR 20149 (April 19, 2006) (''Order Delivery Fee Proposal''). The summary here focuses on the comment letter discussions relating to SR–NASD–2006–001, rather than those relating to the Order Delivery Fee Proposal.

[12] Bloomberg Comment Letter I at 1–2.

[13] 15 U.S.C. 78f(e)(1).

[14] Boomberg Comment Letter I at 2–4.

[15] *See infra* Section V.

[16] Bloomberg Comment Letter II at 1.

[17] Bloomberg Comment Letter II at 8–9, note 7 (citing Securities Exchange Act Release No. 43863 (January 19, 2001), 66 FR 8020 (January 26, 2001) (''SuperMontage Order'')), *See also* ECN Comment Letter at 3.

[18] Bloomberg Comment Letter II at 4; *see also* Citigroup Comment Letter at 1.

[19] Bloomberg Comment Letter II at 4.

[20] Bloomberg Comment Letter II at 2, 10. Bloomberg noted that the ''independent ECNs'' at risk represent some 15% of the total Nasdaq volume.

[21] Bloomberg Comment Letter II at 5.

[22] Bloomberg Comment Letter II at 5–6.

[23] Bloomberg Comment Letter II at 6–8.

[24] Division of Market Regulation (''Division''), Responses to Frequently Asked Questions Concerning Rule 611 and Rule 610 of Regulation NMS, dated January 27, 2006 (''NMS FAQs'') (available at *http://www.sec.gov/divisions/marketreg/rule611faq.pdf*).

[25] Single Book Proposal at 19591, citing NMS FAQs at Question 5.

5 does not ''authorize Nasdaq to drop order delivery without considering the factors the Division cited.'' Bloomberg believed that the Division suggested that Nasdaq could ''continue to deliver orders to an ECN as long as Nasdaq's order-handling performance does not significantly vary between orders handled entirely within the SRO trading facility and orders delivered to the ECN.'' [26] Rather than considering whether it could meet the conditions outlined by the Division in its NMS FAQs relating to order delivery functionality, Bloomberg believed that Nasdaq chose not to confront the issue. Bloomberg believed that the ''facts demonstrate that there is no valid basis for Nasdaq's proposed deletion of order delivery to ECNs that can respond within milliseconds.'' [27]

Bloomberg also argued that the proposed rule change was inconsistent with the Act, in that Nasdaq's analysis of the proposal's impact on competition failed to consider ''the liquidity that ECN participants provide to investors, the advantage this brings to investors and the internal discipline and drive to innovation within Nasdaq itself that is provided by the ECNs.''[28]

Bloomberg posited that the proposed rule change was inconsistent with Section 6(b)(5) of the Act [29] because it discriminated unfairly against ECNs in that the only order delivery participants on Nasdaq are ECNs. Bloomberg also opined that the proposed rule change was inconsistent with Nasdaq's obligations under the Act to promote a free and open market and a national market system. In addition, Bloomberg believed that the proposal would violate Section 6(b)(8) of the Act [30] by imposing burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Act. Finally, Bloomberg noted that Section 3(f) of the Act [31] requires the Commission to consider whether the proposed rule change would promote competition.[32]

In its comment letter, Citigroup stated its belief that the National Association of Securities Dealers, Inc.'s (''NASD'') Alternative Display Facility (''ADF'') currently does not provide a viable alternative to the Nasdaq platform. Citigroup cited the ADF's connectivity costs, inability to quote NYSE- and Amex-listed securities, and inability to display sub-penny quotations to four decimal places for sub-$1.00 securities. In addition, Citigroup asserted that the ADF was a more expensive facility for ECNs, because it charged for quotation updates and did not have a general revenue sharing plan. Citigroup also believed that the ADF provided inadequate order protection because it would not provide an aggregate top-of-the-book quotation with protection under Rule 611 of Regulation NMS.[33]

In support of its claim that the ADF is not a viable alternative to Nasdaq, Citigroup noted that daily volume on the ADF averaged approximately fifteen million shares compared to the total daily volume of approximately 1.7 billion shares for Nasdaq securities.[34] Finally, Citigroup said that the Commission, in response to various ADF-related comments in the Nasdaq exchange application context,[35] indicated that the ADF was not a viable alternative to the Nasdaq Market Center.[36]

In its third comment letter, responding to Nasdaq's initial comment response letter,[37] Bloomberg endorsed the ''main thrust'' of Citigroup's comment letter, in particular supporting Citigroup's assertion that the ADF was not a viable alternative to Nasdaq, pointing to the ADF's connectivity issues and its lack of capability to provide an aggregate top-of-book quotation under Rule 611 of Regulation NMS.[38] Bloomberg also reiterated its disagreement with Nasdaq's assertion that retaining order delivery would slow down the Nasdaq market.[39] In addition, Bloomberg emphasized that several other ECNs shared their concerns about the proposal.[40]

Bloomberg stated that, contrary to Nasdaq's assertions in its initial comment response letter, the existing platform of the NSX is not a viable venue for multiple participants, particularly in light of its limited capacity. While acknowledging that BATS had moved from Nasdaq to NSX, Bloomberg pointed out that, notwithstanding that BATS is a very new ECN and has a relatively light share volume, BATS experienced a significant decrease in trading volume following its move to NSX. In addition, Bloomberg argued that, because the current NSX platform is unable to attribute quotes for multiple participants, market participants might be required to build temporary connectivity to each ECN participating in NSX, which would divert the industry's attention and resources at a time when implementation of Regulation NMS and industry consolidation issues were already pushing programming capacity to its limits.[41]

Bloomberg also believed that Nasdaq, in its initial comment response letter, misstated the Commission's duties under the Act. Bloomberg opined that the Act put a special burden on self-regulatory organizations (''SROs'') if an SRO such as Nasdaq wished to change an existing rule or system. Bloomberg believed that Nasdaq must demonstrate that such change is lawful, does not unfairly discriminate among members, and that any resulting burden on members is necessary or appropriate in furtherance of the purposes of the Act, which Bloomberg contrasted with an SRO's own commercial purposes. In addition, Bloomberg believed that whether other national securities exchanges had similar systems should not be relevant to the Commission's analysis.[42]

Bloomberg also posited that the data Nasdaq provided in its initial comment response letter pertaining to order delivery transactions was contextually insufficient. Bloomberg pointed to the speed of Nasdaq's quotation updates as a factor in order failures, and noted that Nasdaq had not provided data regarding the speed of quotation updates during high volume openings and closings. Bloomberg also suggested that, rather than removing order delivery functionality from its system, Nasdaq should establish rules to mandate faster quotation updates. In addition, Bloomberg proposed that Nasdaq could prevent some ECN outliers from exceeding its 5-second response time rule by mandating a 500-millisecond or even 50-millisecond rule.[43]

Bloomberg also noted that, based on public statements of Nasdaq and the Commission, an order delivery ECN would have reasonably believed that either order delivery functionality would remain on the Nasdaq system indefinitely or an order delivery ban would not occur until the fall of 2006 at the earliest.[44] Bloomberg contended that it was not seeking to slow down Nasdaq's Single Book Proposal, but rather Nasdaq had accelerated the

[26] Bloomberg Comment Letter II at 7.

[27] Bloomberg Comment Letter II at 7–8.

[28] Bloomberg Comment Letter II at 8.

[29] 15 U.S.C. 78f(b)(5).

[30] 15 U.S.C. 78f(b)(8).

[31] 15 U.S.C. 78c(f).

[32] Bloomberg Comment Letter II at 9–11.

[33] Citigroup Comment Letter at 2–3.

[34] Citigroup Comment Letter at 3.

[35] *See supra* note 5.

[36] Citigroup Comment Letter at 3, quoting Exchange Application Order at 57–58 (referring to comments from the Securities Industry Association and Instinet).

[37] *See infra* note 75.

[38] Bloomberg Comment Letter III at 1.

[39] Bloomberg Comment Letter III at 2.

[40] Bloomberg Comment Letter III at 2.

[41] Bloomberg Comment Letter III at 2–3.

[42] Bloomberg Comment Letter III at 4–6.

[43] Bloomberg Comment Letter III at 6–8.

[44] Bloomberg Comment Letter III at 8–9.

timing of the new system's roll-out. In addition, Bloomberg noted that the roll-out of the Single Book Proposal is not necessary to the commencement of Nasdaq's operation as an exchange and ''would visit needless disruption and dislocation not only on the independent ECNs but on the market as a whole'' and would ''unfairly disadvantage independent ECNs and regional exchange competitors, such as NSX.'' [45]

Bloomberg also believed that the elimination of order delivery functionality would burden competition for order flow in Nasdaq-listed securities. Bloomberg claimed that Nasdaq acquired INET and Brut ''with a view to curtailing competition for order flow in Nasdaq securities'' and was now ''attempting to perfect its monopoly by crushing the remaining independent ECNs.'' [46] Finally, Bloomberg believed that Nasdaq, in its initial comment response letter, misstated the Commission's authority when it said that the Commission lacked the statutory authority to provide a delay. Bloomberg believed that the Commission has clear authority to require Nasdaq to provide an adequate transition period in its proposal, and could request that Nasdaq amend its proposal to build in such a delay.[47]

The remaining ECN commenters each endorsed the positions set forth in the Bloomberg Comment Letter II.[48] Some commenters also expressed their concern not only about short-term market dislocation and disruption,[49] but also regarding the long-term loss of investor choice.[50] In particular, Bloomberg stated that, since Nasdaq's acquisition of the Brut and INET ECNs in the past two years, trading in the Nasdaq market had become more concentrated and less competitive. Bloomberg opined that Nasdaq was driving other ECNs off its system to allow it ''to charge monopoly rents for access to its market and for market data.'' [51] In addition, some of the commenters felt that Nasdaq's proposal represented a for-profit exchange using the regulatory process to eliminate competition.[52]

Bloomberg also noted that it did not believe that requiring Nasdaq to maintain its order delivery functionality would imply an affirmative obligation for other national securities exchanges to provide the same.[53] Finally, Bloomberg and Track requested that if the Commission decided to approve the proposed rule change, more time should be given to the ECNs to find another venue to operate their business.[54] Similarly, the USCC encouraged the Commission to, as a matter of good process, ''consider the need for appropriate transition periods'' should the proposed rule change be adopted.[55]

In response to Nasdaq's fourth comment letter regarding technical difficulties relating to INET's participation in the NSX,[56] NSX submitted a comment letter to describe its relationship with Nasdaq and INET, in particular noting that NSX's dissemination of quotations for Nasdaq may be slow because of Nasdaq's own internal system delays.[57] NSX also noted that it intended to build a robust, state-of-the-art trading system that should help minimize future problems related to the capacity of, or linkage to, its market.[58]

On June 23, 2006, Bloomberg submitted its fourth comment letter, welcoming the USCC Comment Letter's call for an appropriate transition period, and describing Nasdaq's third and fourth response letters [59] as containing misleading statements and false assertions.[60] Bloomberg believed that Nasdaq's characterization in its third comment letter that the two ECNs operating on NSX (BATS and INET) were cohabitating with little disruption contrasted with Nasdaq's fourth response letter which stated that the NSX platform was experiencing severe capacity overages and delays.[61] In addition, Bloomberg said that Nasdaq's claim in its fourth comment letter that the Commission had ordered INET to cease quoting in NSX by September 1, 2006 was untrue, noting that the Commission merely recognized a Nasdaq representation that it would cease quoting in NSX and the correct date was September 30, 2006.[62] Bloomberg emphasized that the difference between the two dates was crucial, and stated that the ''Commission understood that additional time beyond September 30, 2006 might be prudent and necessary.'' [63]

Bloomberg also reiterated its prior arguments regarding the need for business certainty and that Nasdaq had given the expectation that its Single Book Proposal would be rolled out in December 2006. Bloomberg said that, because of the resulting uncertainty and confusion of Nasdaq's earlier proposed roll-out date, ECNs have had to explore and develop, at substantial cost, a number of competing alternative scenarios; for example, Bloomberg has explored an interim migration to another platform, temporarily participating in Nasdaq while trying to prevent double execution, and ultimately migrating to an exchange platform that offers order delivery and quotation display. Bloomberg stated that the lack of certainty has ''impeded sound business planning and threatens to constrict investor choice and the development of sound market alternatives.'' [64]

Bloomberg also disputed Nasdaq's statement regarding its participation in Nasdaq's Opening and Closing Crosses, stating that it has had to develop special facilities to integrate during such times with Nasdaq and that, during those limited periods, Bloomberg simply operates as an order-routing system.[65] In addition, Bloomberg also disputed various characterizations by Nasdaq, including its NSX participation, percentage of total Nasdaq trading volume attributable to order delivery executions, and the data Nasdaq presented with regard to Bloomberg's response times in early May 2006.[66] Bloomberg also again suggested that Nasdaq could enforce its 5-second response time rule or even impose a more stringent 50-millisecond rule.[67] Finally, Bloomberg believed that, contrary to Nasdaq's assertions in its response letters, it was proper for the Commission to consider comment letters received after the comment period deadline had expired.[68]

On July 3, 2006, Track submitted a second comment letter to clarify to the Commission that it was still a participant in the Nasdaq Market Center, reiterate its comments submitted previously as part of the ECN Comment

[45] Bloomberg Comment Letter III at 9–10.

[46] Bloomberg Comment Letter III at 10.

[47] Bloomberg Comment Letter III at 10–11.

[48] *See* BATS Comment Letter, Track Comment Letter I, Knight Comment Letter.

[49] *See* BATS Comment Letter, Track Comment Letter I at 1, Bloomberg Comment Letter II at 2.

[50] *See* BATS Comment Letter, Bloomberg Comment Letter II at 2.

[51] *See* Bloomberg Comment Letter II at 2.

[52] *See* BATS Comment Letter, Track Comment Letter I at 1, Bloomberg Comment Letter II at 1, 3.

[53] *See* Bloomberg Comment Letter II at 11.

[54] *See* Bloomberg Comment Letter II at 11 (delay in the effective date); Track Comment Letter I at 2 (phased-in approach).

[55] *See* USCC Comment Letter at 1–2.

[56] *See infra* note 99.

[57] *See* NSX Comment Letter at 1–2.

[58] *See* NSX Comment Letter at 1–2.

[59] *See infra* Nasdaq Response Letter III and Nasdaq Response Letter IV, notes 92 and 99.

[60] *See* Bloomberg Comment Letter IV at 1–2 and 4–5.

[61] *See* Bloomberg Comment Letter IV at 2.

[62] *See* Bloomberg Comment Letter IV at 3 (citing Nasdaq Rule 4720).

[63] *See* Bloomberg Comment Letter IV at 3.

[64] *See* Bloomberg Comment Letter IV at 4.

[65] *See* Bloomberg Comment Letter IV at 5.

[66] *See* Bloomberg Comment Letter IV at 5–7.

[67] *See* Bloomberg Comment Letter IV at 7–8.

[68] *See* Bloomberg Comment Letter IV at 8.

Letter, and support the comment letters of Citigroup, USCC, and Bloomberg.[69] Track emphasized that Bloomberg was not the sole party objecting to aspects of the Single Book Proposal, but that it and other ECNs were interested parties as well. Track stated that it continued to execute significant business through Nasdaq's platform. In addition, it noted that only one percent of its volume was on the ADF, which it did not believe was a viable place to conduct its business. Track believed that NSX's trading platform currently under development, which it expected to include order delivery functionality, would be a viable alternative. However, Track noted that the new NSX platform was not scheduled to be ready until September 2006. Adding in two months to ramp up its volume on the new system, Track requested that it be able to continue to operate on Nasdaq's platform until the NSX platform is operational and capable of handling the volumes of business required by the ECNs. Track also noted that it planned to begin testing on the new platform in July 2006.[70] Track stated that its only issue with the Single Book Proposal was Nasdaq's decision to accelerate its roll-out timetable for its integrated system because it provided too brief a period for migration to workable venues, and that ''[a]ll other matters with regard to Nasdaq's Exchange status are not at issue with Track ECN.'' [71]

V. Nasdaq's Response to Comments

In Amendment No. 1, Nasdaq addressed the Bloomberg Comment Letter I and the ECN Comment Letter. Nasdaq revised its statement on burden on competition to state that it operates in an intensely competitive global marketplace where its ability to compete is ''based in large part on the quality of its trading systems, the overall quality of its market and its attractiveness to the largest number of investors, as measured by speed, likelihood and cost of executions, as well as spreads, fairness, and transparency.'' [72] Nasdaq asserted that its Single Book Proposal would have a pro-competitive effect by reducing overall trading costs, increasing price competition, and spurring further initiative and innovation among market centers and market participants. In addition, Nasdaq believed that its discontinuation of the order delivery functionality was pro-competitive, because such functionality harmed its competitiveness vis-à-vis other exchanges and reduced the overall quality of its marketplace.

Nasdaq also defended its proposal to require all of its participants to accept automatic execution by eliminating its order delivery functionality. Nasdaq stated that its order delivery functionality is unique among exchanges and that no other exchange offers order delivery to its participants. Nasdaq asserted that such functionality is ''expensive, complex, and detrimental to system performance, thereby increasing the cost and complexity of Nasdaq's trading systems and decreasing its performance.'' Nasdaq also believed that order delivery discourages order flow providers from sending orders to Nasdaq for processing because market participants cannot predict whether their orders will be delivered or automatically executed, thereby hurting Nasdaq's ability to compete with other markets.[73]

In addition, Nasdaq noted that, within its own system, the presence of order delivery negatively impacts the competition between market makers, ECNs/alternative trading systems (''ATSs''), and agency broker-dealers, because market makers and agency broker-dealers (who are required to participate in Nasdaq via automatic execution) view themselves as disadvantaged relative to ECNs and ATSs that can choose to participate either via automatic execution or order delivery. Nasdaq believed that removing the order delivery functionality would level the playing field between its market participants. Finally, Nasdaq noted that its ability to provide the fastest, fairest, and most efficient system possible was particularly important given the Commission's adoption of Regulation NMS.[74]

On May 8, 2006, Nasdaq again responded to the comments regarding the proposed rule change.[75] Nasdaq stated that the Single Book Proposal would ''benefit investors by offering a faster, fairer, more efficient and more transparent system that executes trades in strict price/time priority; promote competition by allowing Nasdaq to increase efficiency, decrease overall trading costs, and provide better service to market participants; promote the development of the national market system by integrating separate trading systems into a single pool of exchange liquidity for market participants to access; and improve regulation by complying with the Regulation NMS Access and Order Protection Rules to prevent locked and crossed markets and trade throughs.'' [76] Nasdaq contended that Bloomberg's sole dispute with the Single Book Proposal was Nasdaq's proposal to eliminate the order delivery functionality that is available only to ECNs and available only on Nasdaq.[77]

Nasdaq stated that Bloomberg was unable to identify any requirement in the Act that a national securities exchange offer order delivery functionality, and noted that no other exchange has been required to, or chosen to, offer such functionality. Nasdaq stated that any requirement to offer such functionality should apply equally to all SRO markets.[78] In addition, Nasdaq rejected Bloomberg's claim that it was unfairly discriminating against ''independent'' ECNs to the advantage of its own ECN facilities (*i.e.*, Brut and INET), because this proposal would integrate the Brut and INET execution facilities with the Nasdaq Market Center into a single trading platform.[79]

Nasdaq emphasized that its proposal would not exclude ECNs but rather it would welcome them to participate in Nasdaq provided that they accept automatic execution. Nasdaq opined that the ECN commenters' systems were fully automated, and that they had declined to participate in Nasdaq via automatic execution to ''isolate orders within [their] own system[s] and to preserve internal executions as much as possible.'' [80] Nasdaq also noted that several agency brokers participate in Nasdaq, accept automatic executions, and manage their risk of double executions by cancelling their quote or order on Nasdaq before matching an order internally.[81]

Nasdaq stated that Bloomberg could conduct its business elsewhere and that the Act does not require Bloomberg to post its orders in Nasdaq. As an example, Nasdaq noted that other ECNs have elected to move their business to regional exchanges or the ADF. Nasdaq said that Bloomberg's contention was based on the false premise of a Nasdaq monopoly, and that Bloomberg was a privileged Nasdaq participant, as opposed to a ''prisoner'' of Nasdaq's system.[82]

Nasdaq reiterated its concerns about the delay in executions caused by order

[69] *See* Track Comment Letter II at 1.

[70] *See* Track Comment Letter II at 2.

[71] *See* Track Comment Letter II at 2.

[72] *See* Single Book Proposal at 19596.

[73] *Id.*

[74] *See* Single Book Proposal, *supra* note 3.

[75] *See* Letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq to Morris, dated May 8, 2006 (''Nasdaq Response Letter I'').

[76] Nasdaq Response Letter I at 1.

[77] Nasdaq Response Letter I at 2.

[78] Nasdaq Response Letter I at 2.

[79] Nasdaq Response Letter I at 2.

[80] Nasdaq Response Letter I at 3.

[81] Nasdaq Response Letter I at 3, note 6.

[82] Nasdaq Response Letter I at 4.

delivery. Nasdaq stated that order delivery interactions were more time consuming than automatic execution interactions, and that unlike automatic execution, orders delivered to an ECN could be rejected if the shares had been accessed by an ECN's direct subscribers. Nasdaq also presented data relating to order delivery during the week of March 13, 2006, which included a so-called ''expiration Friday'' on March 17th. During that week, Nasdaq stated that: 100 percent of automatic execution orders that Nasdaq attempted to execute actually executed; 14 percent of total orders that Nasdaq delivered to order delivery participants failed to execute and for one order delivery participant the overall failure rate exceeded 25 percent; 55.6 percent of orders delivered to order delivery participants prior to 9:30:15 failed to execute; 27.9 percent of orders delivered to order delivery participants between 9:30:15 and 9:30:30 failed to execute; 12.7 percent of orders delivered to order delivery participants between 9:30:30 to 3:59:30 failed to execute; and prior to 9:30:15, three order delivery participants had mean response times of over four, nine, and twenty seconds per order during that week.[83]

In addition to the time and response issues, Nasdaq stated that it was costly to maintain the order delivery functionality because it demanded ''disproportionate system capacity and unique specifications, requirements, and programming not available to or needed by the vast majority of Nasdaq participants * * *.'' Nasdaq emphasized that these are costs no other SRO incurs. Nasdaq also believed that ECN response times and rejection rates created strong disincentives for market participants to use Nasdaq's systems because of the uncertainty and reduced speed of an order execution.[84] In addition, Nasdaq believed that time and response issues would be exacerbated under Regulation NMS, and expressed concern again about order delivery making Nasdaq a ''slow'' market or exposing it to ''self-help'' declarations by other trading centers.[85]

Finally, Nasdaq objected to Bloomberg's request for a delay in the effective date of an approval. Nasdaq believed that this would simply ''delay the time when investors receive the benefits offered by a faster, fairer, more efficient and more transparent system.'' [86] In addition, Nasdaq noted that BATS was able to shift its order flow to the NSX in a matter of weeks, and that Nasdaq's filing provides Bloomberg with over three months to make the system changes needed for similar migration. Nasdaq also stated that there was no requirement under the Act to ''accommodate the business schedule of any individual market participant'' as it negotiated ''a beneficial arrangement to post quotes in another venue'' and that the Commission was directed by Section 19(b) of the Act to ''determine promptly whether a rule proposal is consistent with the Act and to approve or reject it accordingly.''[87]

On May 26, 2006, Nasdaq submitted to the Commission a second letter, responding to the Citigroup Comment Letter.[88] Nasdaq requested that the Commission disregard Citigroup's comment letter because Nasdaq asserted that it was untimely filed and was an attempt to use the statutory notice and comment period to delay consideration of the Single Book Proposal.[89] Nonetheless, Nasdaq responded to the substantive elements of the letter and disputed the assertions by Citigroup regarding the ADF's viability. In particular, Nasdaq noted that the predecessor of Citigroup's current OnTrade ECN, NexTrade, had been quoting on the ADF for over three years. Nasdaq also disputed Citigroup's assertion that the ADF's cost of connectivity was an ''economic disincentive,'' instead characterizing it as ''a cost of doing business'' and stating that Nasdaq's order routing technology supports connectivity to any ADF participant whose quotation is displayed through the ADF in the consolidated quotation.[90] Nasdaq also reiterated that, like Bloomberg, Citigroup failed to mention that scores of agency brokers participate on Nasdaq systems and accept automatic executions, managing their dual liability risks by cancelling their quotations or orders on Nasdaq prior to matching their orders internally. Finally, Nasdaq asserted that Citigroup misstated that there would be no alternative facility for NYSE- and Amex-listed securities and distorted the Commission's statements in the Exchange Application Order, noting that it believed that the passage cited by Citigroup related to the Commission's requirement that there be an alternative facility for non-Nasdaq stocks prior to Nasdaq's operation as an exchange.[91]

On June 8, 2006, Nasdaq submitted to the Commission a third letter, responding to the Bloomberg Comment Letter III.[92] In this letter, Nasdaq reiterated its belief that Bloomberg could participate in Nasdaq via automatic execution, that Bloomberg was technologically capable of quoting in the NASD ADF ''in a matter of days,'' and that Bloomberg did in fact have a number of alternatives to being an order delivery participant in Nasdaq.[93] Nasdaq also disagreed with Bloomberg's description of NSX's current operation and pointed out that two ECNs, INET and BATS, operate in that market with little disruption.[94] In addition, Nasdaq reiterated the critical nature of its Single Book Proposal, given the competition it faces both in the United States and abroad. Nasdaq stated that Single Book would be ''lightning fast'' and produce faster, more certain executions. In addition, Nasdaq stated that the proposal would transform its market into a strict price-time priority venue, promote competition, decrease overall trading costs, provide better service to market participants, and allow Nasdaq to comply with the access and order protection provisions of Regulation NMS.[95]

Nasdaq also stated that Bloomberg has a negative impact on Nasdaq's competitiveness, pointing to the period immediately following the market's opening as an example.[96] Nasdaq noted that, during the first week of May 2006, during the trading period prior to 9:30:15 am, Bloomberg's mean response time to delivered orders was over 5 seconds per order.[97] Finally, Nasdaq disagreed with Bloomberg's contention that eliminating order delivery was discriminatory, stating that it did not see ''how requiring all market participants to use identical automatic functionality [could] be considered discriminatory.'' [98]

On June 9, 2006, Nasdaq submitted to the Commission a fourth letter, describing INET's technological problems in NSX.[99] Nasdaq stated that, on June 8, 2006, senior officers of the

[83] Nasdaq Response Letter I at 5–6.

[84] Nasdaq Response Letter I at 6.

[85] Nasdaq Response Letter I at 6.

[86] Nasdaq Response Letter I at 6.

[87] Nasdaq Response Letter I at 7.

[88] *See* Letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq to Morris, dated May 26, 2006 (''Nasdaq Response Letter II'').

[89] Nasdaq Response Letter II at 1–2.

[90] Nasdaq Response Letter II at 2.

[91] Nasdaq Response Letter II at 2.

[92] *See* Letter from Jeffrey S. Davis, Senior Associate General Counsel, Nasdaq to Morris, dated June 8, 2006 (''Nasdaq Response Letter III'').

[93] Nasdaq Response Letter III at 2–3, 4–5.

[94] Nasdaq Response Letter III at 3.

[95] Nasdaq Response Letter III at 3–4.

[96] Nasdaq Response Letter III at 4.

[97] Nasdaq Response Letter III at 4.

[98] Nasdaq Response Letter III at 4–5.

[99] *See* Letter from Edward S. Knight, Executive Vice President and General Counsel, Nasdaq to Cox, dated June 9, 2006 (''Nasdaq Response Letter IV'').

NSX notified Nasdaq that the NSX was ''experiencing severe capacity overages and quotation delays in its core systems * * * [and] * * * requested that Nasdaq cause INET to cease sending quotations to the NSX and stated that NSX was considering terminating INET's ability to send quotations to NSX.'' [100] Nasdaq stated that the possibility of future technology failures was increasing as message traffic has increased significantly across the industry. Nasdaq stated that it was taking all available, prudent steps to avoid future disruptions, and that approval of the Single Book Proposal would enable it to remove all quotations from NSX and avoid such technology failures.[101]

VI. Commission's Findings and Order Granting Accelerated Approval of Amendment Nos. 2 and 3

As discussed fully throughout this approval order, the Commission has carefully reviewed the proposed rule change, as amended, the comment letters, and Nasdaq responses, and finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.[102] Specifically, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act [103] in that it is designed 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 is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by the Act matters not related to the purposes of the Act or the administration of the exchange. The Commission also finds that the proposed rule change, as amended, is consistent with Section 6(b)(8) of the Act [104] in that it does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

A. Elimination of Order Delivery Function

Nasdaq's proposal would require that all Nasdaq participants accept automatic executions and would eliminate order delivery processing in the newly integrated system. Nasdaq's primary rationale for this aspect of the proposal is as follows:

- Order delivery functionality is expensive, complex, and detrimental to its system and decreases system performance and no other national securities exchange is required to provide this service;
- Order delivery functionality hampers Nasdaq's ability to compete by discouraging order flow providers from sending orders to Nasdaq because market participants cannot predict whether their orders will be delivered or automatically executed;
- Order delivery functionality negatively impacts competition between market makers, ECNs/ATSs, and agency broker-dealers, because market makers and agency broker-dealers (who are required to participate in Nasdaq via automatic execution) are disadvantaged relative to ECNs and ATSs that can choose to participate either via automatic execution or order delivery;
- Nasdaq's system is completely voluntary and ECNs are not required to quote or participate in Nasdaq; and
- In light of the competition fostered by Regulation NMS, Nasdaq needs to provide the fastest, fairest, and most efficient system.

Nearly all of the commenters opposed the proposed elimination of Nasdaq's order delivery functionality.[105] The commenters suggested that the proposal was inconsistent with Sections 6(b)(5) [106] and 6(b)(8) of the Act [107] in that it unfairly discriminated between brokers or dealers and imposed a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The main assertions by the commenters are as follows:

- The automatic execution requirement would expose ECNs to dual liability risks;
- The automatic execution requirement would force ECNs out of the Nasdaq market and have a negative impact on their customers;
- The costs to move to another facility would be burdensome for ECNs;
- There are no viable alternatives, including the NASD ADF and regional exchanges, to participation in Nasdaq;
- Nasdaq is using its regulatory status to perfect a monopoly over Nasdaq-listed securities; and
- Order delivery does not have a negative impact on the performance of Nasdaq's system, nor would it place Nasdaq at any undue risk in light of Regulation NMS.

The Commission finds that this proposal does not unfairly discriminate among market participants, nor does it impose any burden on competition that is not necessary or appropriate in furtherance of the Act.

1. Competition Issues

The Commission believes that the Single Book Proposal is an appropriate initiative by Nasdaq to enhance the quality of its exchange through integrating its three trading platforms into a single unified system, to add efficiency in executions and to increase overall market transparency. The Commission has long held the view that ''competition and innovation are essential to the health of the securities markets. Indeed, competition is one of the hallmarks of the national market system.'' [108] The Commission notes that the notion of competition is inextricably tied with the notion of economic efficiency, and the Act seeks to encourage market behavior that promotes such efficiency, lower costs, and better service in the interest of investors and the general public.[109] Therefore, the Commission believes that the appropriate analysis to determine a proposal's competitive impact is to weigh the proposal's overall benefits and costs to competition based on the particular facts involved, such as examining whether the proposal would promote economically efficient execution of securities and fair competition between and among exchange markets and other market centers, as well as fair competition between the participants of a particular market.

The Commission notes that Nasdaq operates in a competitive global exchange marketplace for listings, financial products, and market services and competes in such an environment with other market centers, including national securities exchanges, ECNs, and other alternative trading systems, for the privilege of providing market and listing services to broker-dealers and issuers. Within Nasdaq's systems, ECNs and ATSs compete with market

[100] Nasdaq Response Letter IV at 1.

[101] Nasdaq Response Letter IV at 1–2.

[102] 15 U.S.C. 78f(b).

[103] 15 U.S.C. 78f(b)(5).

[104] 15 U.S.C. 78f(b)(8).

[105] *See, e.g.*, Bloomberg Comment Letter II at 9; Knight Comment Letter at 2; Track Comment Letter I at 1.

[106] 15 U.S.C. 78f(b)(5).

[107] 15 U.S.C. 78f(b)(8).

[108] *See* SuperMontage Order at 8049.

[109] 15 U.S.C. 78c(f).

makers and agency broker-dealers for retail and institutional order flow. Thus, the Commission views Nasdaq as an individual market as well as a piece of the larger, overall market structure.

The ECN's opposition to the instant proposal is that it will cause a disruption to their manner of doing business, and such operational changes are potentially burdensome and costly. Under the proposal, ECNs that choose to continue operating in Nasdaq will have to accept automatic executions and internally manage their quotes to prevent dual executions of the same order, while ECNs that opt to use another SRO facility to display their order flow may face reduced connectivity and higher costs. That a proposed rule change to an SRO's trading system requires a market participant to reevaluate its business model, develop new technology, or reprogram its current systems is not something that is unique to Nasdaq and moreover is not something that is unique to ECNs. Invariably, any proposed rule change to a fundamental function of an SRO market (*e.g.*, display, execution, trade-reporting, etc.) will require certain changes by the affected market participants; and more than likely such changes must be effectuated by a technological solution in an increasingly automated national market system.

As stated above, ECNs currently using Nasdaq's order delivery functionality may continue to participate in Nasdaq via automatic execution. Rather than excluding ECNs, Nasdaq is simply requiring ECNs to participate in Nasdaq on an automatic execution basis, as other participants are currently required to do. According to Bloomberg, order delivery is necessary because unlike market makers, ECNs act as agency brokers and do not carry inventory or act as principal. Without the order delivery functionality, Bloomberg contends that ECNs would be exposed to dual liability.[110] Bloomberg says that ECNs would be involuntarily forced to act as dealers and abandon their current business models.[111] Nasdaq responds that ECNs could participate as Nasdaq automatic execution participants as agency brokers by managing dual liability risks by cancelling their quote/order on Nasdaq before matching the order internally.[112] This risk management objective could be technologically achieved by ECNs giving priority to execution of the publicly displayed order in Nasdaq rather than the order flow that is only internally available on the ECN books to its subscribers.[113] In fact, Nasdaq asserts that agency-brokers on its system currently operate and manage their dual liability risks in that manner. The various ECN comment letters opposing the elimination of Nasdaq's order delivery functionality have not disputed the validity of this claim.

Nasdaq has also stated that its current order delivery functionality is costly to operate and requires disproportionate system capacity, unique specifications, and additional programming. In addition, Nasdaq has emphasized that, though ECNs may provide an automated evaluation and response to orders, the time required to send message traffic back and forth between Nasdaq and ECNs involves delays that do not exist in the case of automatic executions. This potential for delay, as well the possibility that an order could be rejected by an order delivery ECN, gives a measure of uncertainty to orders entered on Nasdaq, which may impede Nasdaq's ability to compete with other markets and provide faster executions with increased certainty.[114]

Nasdaq has stated legitimate regulatory and operational reasons for eliminating the order delivery service. For instance, Nasdaq is concerned that order delivery may cause the System to be deemed ''slow'' under Rule 611 of Regulation NMS. Although it appears that under most operating conditions, order delivery may not pose a significant risk that the System would be a ''slow'' market or expose it to the election of the ''self-help'' exception under Rule 611(b)(1) of Regulation NMS, Nasdaq raises legitimate concerns that, during periods of increased market activity or system stress, the order delivery functionality could place its market at risk.

The Commission recognizes ECNs could pose differing levels of risk to the Integrated System and that normally ECNs may, as Bloomberg commented, generally be able to respond within 5–20 milliseconds;[115] however, Nasdaq has valid concerns over the response times of its market participants and the potential for such response times to negatively impact its entire market. Thus, the prospect of a single participant's slow response time affecting the protected quotation status of the entire market under Regulation NMS is a valid consideration in Nasdaq's determination of whether it is best to retain the order delivery functionality.

ECNs also assert that the proposal is unfairly discriminatory and it imposes a burden on competition that is not necessary or appropriate in furtherance of the Act because it would force ECNs to leave the Nasdaq market to operate either in another SRO facility or the NASD ADF. The commenters argue there are no viable alternatives for the ECN business model in the marketplace, and thus the Nasdaq order delivery service, which accommodates the ECN business model, must be preserved. The Commission does not share this view.

As an initial matter, the Commission notes that the Act does not require Nasdaq to retain a market structure that supports the business operations of ECNs. Further, ECNs may post their orders in an SRO other than Nasdaq. The Commission believes that ECNs have a variety of options if they determine that, as a result of this proposal, they should forego Nasdaq participation. For example, ECNs may decide to post their liquidity to another SRO. In the past ECNs such as BATS, Brut, Instinet, Island, INET, Archipelago, and Attain have moved some or all of their activities from Nasdaq to other trading venues. Specifically, INET quotes on NSX; more recently, BATS has also moved from Nasdaq to NSX. Archipelago, through ArcaEx, became the equities trading facility of the Pacific Exchange, Inc. Other ECNs, including OnTrade (and its predecessor, NexTrade), quote in the NASD's ADF. Before Brut's purchase by Nasdaq, Brut quoted on the Boston Stock Exchange.

Accordingly, ECNs that do not want to operate under the Nasdaq's Exchange Rules have other options at this time, and other alternatives for ECNs to participate as order delivery systems are emerging. Thus, while ECNs may not view the presently available alternatives to Nasdaq to be as appealing as participating on Nasdaq via order delivery, the Commission nevertheless believes viable alternatives to Nasdaq participation exist for ECNs.

a. Alternatives to Nasdaq. In their comment letters, ECNs have been particularly critical of the capabilities of the NASD ADF and suggested that it does not constitute a true viable alternative to the Nasdaq market because it lacks: (1) An execution facility; (2) adequate order protection and quote attribution; (3) favorable revenue sharing plans; (4) sub-penny quoting up to four decimal places for securities priced less than $1.00; and (5) connectivity to ECN participants.

[110] Bloomberg Comment Letter II at 4.

[111] *See, e.g.*, Bloomberg Comment Letter II at 4.

[112] *See* Nasdaq Response Letter I at 3, note 6.

[113] Nasdaq Response Letter I at 3, note 6.

[114] Nasdaq Response Letter I at 4–6. *See also* Nasdaq Response Letter III at 3–5.

[115] *See, e.g.*, Bloomberg Comment Letter II at 7–8.

However, the Commission, on various occasions, has determined that the NASD ADF provides an alternative quotation facility for Nasdaq securities.[116] The NASD ADF does not have all the advantages and liquidity of an active exchange like Nasdaq, and thus may not currently be the *optimal* facility for an ECN and its particular business model; nonetheless, the NASD ADF facility has the basic requirements of a quotation facility for Nasdaq securities, thus providing market participants a venue other than Nasdaq in which to display their quotes.

The history of ECN participation in Nasdaq is instructive. Nasdaq began as a quotation, and then trading reporting, facility of the NASD, where quotes and trades of securities not listed on an exchange could be displayed. Later, Nasdaq displayed quotes and trades of exchange-listed stocks. Nasdaq satisfied the NASD's obligation to operate a system to collect quotes and trades arising under now Rules 601 and 602 of Regulation NMS.[117]

In 1996, the Commission adopted the Order Handling Rules,[118] enabling ECNs to comply with a requirement to publicly display market maker quotes entered into the ECN by communicating these quotes to an SRO that was willing to display them in the consolidated quote system. The Commission said that if no SRO was willing to accept these quotes, it would take steps to ensure that these ECN quotes were included in the consolidated quote by an SRO.[119]

Nasdaq, as the competing market maker quotation system for non-exchange listed stocks operated on behalf of the NASD, chose at that time to accept ECN quotes in its system. Nasdaq accommodated the ECN order delivery preferences at their own displayed size even though market makers in Nasdaq were required (against their wishes) to accept automatic execution at an NASD-imposed 1,000-share automatic execution size.[120]

Nasdaq subsequently eliminated the required 1,000-share automatic execution size, but retained automatic execution for market makers.[121] In SR–NASD–99–53,[122] Nasdaq recast its execution system as the SuperMontage system, accepting orders directly from agency brokers, subject to automatic execution. In response to criticisms raised by ECNs, SuperMontage retained an order delivery functionality for ECNs.

Because of concerns raised about the monopoly position of Nasdaq as the residual quote and trade facility of the NASD, in approving the SuperMontage, the Commission conditioned its operation on the NASD's creation of an alternate display facility that would permit NASD members to operate outside of Nasdaq and still comply with their regulatory obligations under the Order Handling Rules and Regulation ATS.[123] The Commission also required that the NASD ADF be designed to identify through the central processor the identity of the NASD member that is the source of each quote and provide a market neutral linkage to the Nasdaq and other marketplaces, but not an execution service.[124] Later, in approving a pilot program for the operation of the NASD ADF, the Commission re-stated the purpose first raised in the SuperMontage Order that the ''ADF * * * permits registered market makers and registered ECNs to display their best-priced quotes or customer limit orders * * * through the NASD. ADF market participants are required to provide other ADF market participants with direct electronic access to their quote * * *. The ADF also serves as a trade reporting and trade comparison facility. The ADF will therefore allow market participants to satisfy their order display and execution access obligations under the Order Handling Rules and Regulation ATS.''[125] The D.C. Circuit Court of Appeals later stated that the NASD ADF is an alternative display facility that was created to ''provide an alternative outlet in which market participants that did not wish to use SuperMontage could fulfill their order display and trading reporting obligations under SEC regulations.''[126]

Subsequently, the NASD and Nasdaq chose to sunder their relationship, and Nasdaq registered as a separate national securities exchange.[127] The NASD satisfies its obligations for Nasdaq securities under Rules 601 and 602 of Regulation NMS through the ADF.

One commenter, Citigroup, suggested that the Commission ''recently indicated that ADF is not a viable alternative to the Nasdaq Market Center; referring to comments received in response to the Nasdaq application for registration as an exchange.'' In this regard, the Commission believes that its response to Nasdaq exchange application comments has been misconstrued. The Commission did not intend to imply that the ADF is not a viable alternative to the Nasdaq Market Center. Instead, in response to the aforementioned comments the Commission reiterated its general belief, a theme initially voiced in the SuperMontage Order and again in the order approving the operation of the NASD ADF, that it would not be ''consistent with the Exchange Act to allow the NASD to separate from the [Nasdaq] facilities by which it satisfies its regulatory obligations without having alternative means to do what the Exchange Act and the rules thereunder require. Accordingly, the Nasdaq Exchange may not begin operating as a national securities exchange and cease to operate as a facility of the NASD until NASD has the means to fulfill its regulatory obligations.''[128] In the Exchange Application Order, the Commission clearly articulates the statutory and regulatory obligations the NASD must be able to satisfy prior to Nasdaq commences operation as a national securities exchange.[129] In pertinent part, the NASD must represent to the Commission that control of Nasdaq through the Preferred D Share is no longer necessary because the NASD can fulfill through means other than Nasdaq systems or facilities its obligations with respect to CTA Plan securities under Section 15A(b)(11) of the Act, Rules 602 and 603 of Regulation NMS, and the national market system plans, *i.e.*, the CTA Plan, CQ Plan, Nasdaq UTP Plan, the ITS Plan, and the Order Execution Quality Disclosure Plan, in which the NASD will participate.[130]

Thus, while Citigroup cites to the comparative various operational differences of the NASD ADF versus the Nasdaq Market Center from a business perspective, the only regulatory requirement referenced in its letter is

[116] *See, e.g.,* Securities Exchange Act Release No. 45156 (December 14, 2001), 67 FR 388 (January 3, 2002).

[117] 17 CFR 242.601–02.

[118] Securities Exchange Act Release Nos. 37619A (September 6, 1996), 61 FR 48290 (''Order Handling Rules'').

[119] *Id.*

[120] *See* Securities Exchange Act Release Nos. 42344 (January 14, 2000), 65 FR 3987 (January 25, 2000) (NASD–99–11).

[121] *See* Securities Exchange Act Release Nos. 45998 (May 29, 2002), 67 FR 39759 (June 10, 2002) (NASD–2001–66).

[122] *See* SuperMontage Order, *supra* note 17.

[123] *See* Order Handling Rules, *supra* note 118 and Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (''Regulation ATS'').

[124] SuperMontage Order at 8024.

[125] *See* Securities Exchange Act Release No. 46429 (August 29, 2002), 67 FR 56862.

[126] *Domestic Securities, Inc.* v. *Securities and Exchange Commission,* 333 F.3d 239, 248–249 (D.C. Cir. 2003).

[127] *See supra* note 5.

[128] *See* Exchange Application Order at 3564.

[129] *See* Exchange Application Order at 3562–64, 3566. The Commission recently modified the requirements for Nasdaq's operation as an exchange. *See* Securities Exchange Act Release No. 54085 (June 30, 2006), 71 FR 38910 (July 10, 2006).

[130] *See* Securities Exchange Act Release No. 54085 (June 30, 2006), 71 FR 38910 (July 10, 2006).

the ability of the NASD to accept quotes in non-Nasdaq listed securities, which is a pre-condition to the separation of Nasdaq from NASD and Nasdaq's Exchange operation that must be achieved by virtue of the NASD's plan participation.

The Commission recognizes that participation in the NASD ADF may require additional connectivity and related development costs for certain market participants. Again, the notion that innovation or change to a market's structure or manner of operation will require the use of technological or developmental resources is neither novel nor unforeseen. In fact, in approving Rule 610 of Regulation NMS (*i.e.*, the Access Rule) the Commission extensively discussed the connectivity requirements for participants in the NASD ADF. The Regulation NMS Order reads, in pertinent part,[131]

> The NASD is not * * * statutorily required to provide an order execution functionality in the ADF. As a national securities association, the NASD is subject to different regulatory requirements than a national securities exchange * * *.The Exchange Act does not expressly require an association to establish a facility for executing orders against the quotations of its members, although it could choose to do so. The Commission believes that market makers and ECNs should continue to have the option of operating in the OTC market, rather than on an exchange or The NASDAQ Market Center. As noted in the Commission's order approving Nasdaq's SuperMontage trading facility, this ability to operate in the ADF is an important competitive alternative to Nasdaq or exchange affiliation * * *.

The Commission further stated that:

> [R]ule 610(b)(1) requires all trading centers that choose to display quotations in an SRO display-only quotation facility to provide a level and cost of access to such quotations that is substantially equivalent to the level and cost of access to quotations displayed by SRO trading facilities. Rule 610(b) therefore may cause trading centers [*e.g.*, ECNs] that display quotations in the ADF to incur additional costs to enhance the level of access to their quotations and to lower the cost of connectivity for market participants seeking to access their quotations.

Thus, the Commission has contemplated the costs related to linking to and operating in the NASD ADF and who may appropriately bear such costs.

The Commission notes that, in addition to the ADF, other SROs such as NSX may eventually offer ECNs an order delivery quote functionality.[132] NSX, in response to Nasdaq Response Letter IV,[133] stated that it intended to undertake a major trading system initiative to prepare itself for the market structure changes and growth in volume anticipated with the implementation of Regulation NMS.[134] This NSX statement is in accord with the Commission's belief that efforts to improve the national market system via technological innovations is, and will continue to be, a market-wide phenomenon that will ultimately ensure that ECNs have a variety of viable options not only from a regulatory perspective, but from an operational and business perspective as well.

Accordingly, the Commission continues to encourage the innovation of the NASD ADF, SRO facilities, ECNs, and market participants in general that would enhance participation and interaction between markets and order flow within the national market system. Nonetheless, the Commission also believes that Nasdaq must have the flexibility to rework its structure to permit appropriate responses to the rapidly changing marketplace. Congress noted that the Commission should seek to "enhance competition and to allow economic forces, interacting with a fair regulatory field, to arrive at appropriate variation in practices and services." [135] In the Commission's view, as an exchange in competition with other markets, Nasdaq has the right to seek a more efficient model of doing business. While ECNs may desire certain functionality accommodating their current mode of participating in the Nasdaq market, Nasdaq, like other exchanges and market participants, must be permitted to innovate and adjust to the dynamic nature of today's securities industry, within the requirements of the Act.

The Commission recognizes that ECNs as a group have been among the most innovative market participants in recent years, introducing a number of novel trading tools and strategies. In addition, ECNs have benefited investors by providing cheaper and faster access to valuable liquidity. However, the Commission does not believe that the elimination of Nasdaq's order delivery functionality must or should necessarily have a deleterious impact on ECNs or the national market system as a whole.

b. *Nasdaq's Position as SRO.* Some of the commenters contended that this proposal is an attempt by Nasdaq to use its position as an SRO and as a for-profit entity to "crush" its ECN competition.[136] Specifically, some commenters aver that Nasdaq's acquisitions of the Brut and INET ECNs set this strategy in motion and this proposal would enable Nasdaq to "perfect its monopoly." Bloomberg, in its second comment letter, asserted that Nasdaq seeks to eliminate the order delivery functionality for independent ECNs "while preserving it for Nasdaq's own ECN facilities," namely Brut and INET, thereby giving its own ECNs a competitive advantage.[137] However, the Commission notes that under this proposal Nasdaq would integrate the Brut and INET execution systems with the Nasdaq Market Center, utilizing the INET platform; only Brut's broker-dealer routing functionality would continue upon the unification of the three trading platforms. Thus, this proposal could not advantage Nasdaq-affiliated ECNs over other ECNs because Nasdaq-affiliated ECNs would not exist. In addition, the Commission notes that Nasdaq's acquisitions of Brut and INET were reviewed and approved by the Commission as positive developments in the ever-changing, dynamic market environment.[138]

The Commission agrees with Nasdaq's statement that there is no explicit requirement in the Act for a national securities exchange to offer order delivery participation in their execution systems.[139] The Commission does not believe that Nasdaq must continue to offer order delivery functionality to meet its obligations in the Act and the rules and regulations thereunder. Although the order delivery functionality has been a part of Nasdaq's trading platform, the Commission does not believe Nasdaq is required to retain the functionality going forward, particularly given the legitimate regulatory reasons for its discontinuation provided by Nasdaq

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[131] *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37542 (June 29, 2005).

[132] Bloomberg also questioned the viability of NSX as a potential venue alternative to Nasdaq due primarily to a lack of system capacity. *See* Bloomberg Comment Letter III at 2–3.

[133] *See supra* note 82.

[134] Specifically, NSX stated that it intends to implement a new state-of-the-art trading system, "NSX Blade," that would increase its systems capacity ten-fold and "establish a new standard for speed in the securities industry." NSX stated that broker-dealers would be able to connect to its system "through industry-standard FIX protocol or connect through any of the major extranets." Thus, NSX has represented that it intends to address the capacity and linkage concerns which Bloomberg believes make NSX an inadequate venue alternative to the Nasdaq Market Center. *See* NSX Comment Letter at 2.

[135] *See* S. Rep. No. 94–75, 94th Cong., 1st Sess. 7 (1975) at 8.

[136] *See, e.g.*, Track Comment Letter I at 1; and Bloomberg Comment Letter II at 1, 5, 8.

[137] Bloomberg Comment Letter II at 1.

[138] *See* Securities Exchange Act Release Nos. 51326 (March 7, 2005), 70 FR 12521 (March 14, 2005) and 52902 (December 7, 2005), 70 FR 73810 (December 13, 2005).

[139] Nasdaq Response Letter at 2.

including that the functionality could pose significant risks and costs.

In addition, Nasdaq endured significant cost in 2005 to acquire INET [140] and, through the Single Book Proposal, Nasdaq seeks to use the INET platform as the basis for its Integrated System going forward in order to provide a faster and more efficient system with greater capacity. As competition increases both in the United States and globally, and with the Commission's approval of Regulation NMS, nearly all national securities exchanges are in the process of transforming their systems to better compete. Through implementation of its Single Book Proposal, Nasdaq seeks to maximize the advantages of the INET trading platform—faster executions and increased certainty.

As Nasdaq prepares to commence operations as a national securities exchange, the Commission believes that providing order delivery functionality is not required of Nasdaq, as with any other exchange. If another exchange deems such functionality to be advantageous for its operation as an exchange, it may choose to add it. Notwithstanding the valuable contributions that ECNs bring to the national market system in terms of liquidity and innovation, the Commission does not believe that the Act requires the Nasdaq exchange to continue to separately provide functionality to accommodate the particularized business choices of the ECN participants.

2. Claims of Unfair Discrimination

Some of the commenters assert that the elimination of the order delivery functionality in the proposed rule change, as amended, is inconsistent with Section 6(b)(5) of the Act because it would discriminate unfairly against independent ECNs vis-à-vis all other Nasdaq members and it would not promote a free and open market and a national market system.[141] The Commission disagrees. ECNs have been the only Nasdaq participants with the option to use the Nasdaq order delivery service; all other Nasdaq market participants, *i.e.*, market makers, order entry firms, and UTP Exchanges, are currently required to accept automatic executions. Nasdaq has also maintained other features of its market exclusively for the benefit of ECNs (*e.g.*, the ability to charge quote access fees.) While the Commission approved these ''ECN-friendly'' measures and found them to be consistent with the Act, these same provisions were never imposed upon Nasdaq by the Commission or deemed to be requirements under the Act.

During its development as a quote facility of the NASD, Nasdaq had taken a series of actions to accommodate ECN participation and their particularized business model. In certain respects, ECNs have enjoyed a privileged status in the Nasdaq market compared to agency brokers and market maker participants by virtue of their ability to, amongst other things, accept order delivery instead of automatic execution. The Commission does not believe that, in removing the order delivery functionality, the instant proposal would result in unfair discrimination between customers, issuers, brokers, or dealers. Because Nasdaq has previously accommodated ECNs, changing features such as the order delivery function will necessarily impact ECNs disproportionately. However, the Commission disagrees with the suggestion that it logically follows that such disproportionate impact is per se equivalent to unfair discrimination under the Act. In this case, the Commission believes the proposed rule change is consistent with the Act and it does not unfairly discriminate between ECNs and other Nasdaq market participants. Nasdaq is eliminating a disparate treatment between ECNs and the other Nasdaq market participants by requiring that all participants accept automatic execution to increase the efficiency and competitiveness of the Nasdaq exchange.

3. Automatic Execution Function

The Commission notes that in numerous instances it has approved automatic execution within the national market system in general, and Nasdaq in particular. For instance, in the SuperMontage Order, the Commission affirmed that automatic execution is a reasonable way for Nasdaq to improve market efficiency and provide many benefits to a marketplace, particularly speed and certainty of executions.[142] The SuperMontage Order said that automatic execution also would promote investor confidence by increasing the likelihood that orders of moderate size from large and small investors alike will be filled almost instantaneously, improve the accuracy of Nasdaq's pricing systems, promote the timeliness of trade reporting, and help alleviate locked and crossed markets.[143] Most recently, in approving Rule 611 of Regulation NMS, the Commission clearly enunciated a view that automated markets and automated quotes (*i.e.*, automatic execution functionality), combined with access to such markets and quotes was an important attribute in a national market system.[144]

To this end, Rule 611 of Regulation NMS only protects from trade-throughs automated quotations of automated markets. An automated quotation is a quotation that, among other things, is displayed and is immediately accessible through automatic execution, and that immediately and automatically cancels any unexecuted portion of an order marked as immediate-or-cancel without routing the order elsewhere.[145] In Question 5 of the Division's NMS FAQs, the Division said that an SRO trading facility that displays the quotations of order delivery ECNs can meet the requirements of the definition of an automated quotation only if such quotations are closely integrated within the SRO trading facility.[146] In its comment letter, Bloomberg asserted that Nasdaq's interpretation of the response to Question 5 of the Division's NMS FAQs was wrong, in that the Division did ''not authorize Nasdaq to drop order delivery without considering the factors the Division cited.'' [147] The Commission believes that Bloomberg has misinterpreted the Division's response to Question 5. The response does not address an exchange dropping its order delivery functionality. Instead, the response relates to whether a market supporting order delivery could be considered ''automated,'' and if its quote could be ''protected'' under Regulation NMS. The Division's answer is intended to clarify how a market would comply with Regulation NMS and does not control whether Nasdaq keeps or discards its order delivery functionality.

[140] In its third comment response letter, Nasdaq stated that it spent close to $1 billion in 2005 to acquire INET from Reuters. Nasdaq Response Letter III at 3.

[141] Bloomberg Comment Letter II at 10.

[142] SuperMontage Order at 8049.

[143] SuperMontage Order at 8049–50.

[144] *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

[145] Rule 600(b)(3) of Regulation NMS defines an automated quotation to mean a ''quotation displayed by a trading center that: (i) Permits an incoming order to be marked as immediate-or-cancel; (ii) immediately and automatically executes an order marked as immediate-or-cancel against the displayed quotation up to its full size; (iii) immediately and automatically cancels any unexecuted portion of an order marked as immediate-or-cancel without routing the order elsewhere; (iv) immediately and automatically transmits a response to the sender of an order marked as immediate-or-cancel indicating the action taken with respect to such order; and (v) immediately and automatically displays information that updates the displayed quotation to reflect any change to its material terms. 17 CFR 242.600(b)(3).

[146] NMS FAQs at Question 5.

[147] Bloomberg Comment Letter II at 7.

4. Implementation Date

In Bloomberg Comment Letter III, Bloomberg stated that it and other order delivery ECNs had been led by Nasdaq to believe that the Nasdaq Market Center's order delivery functionality would be available until at least fall of 2006 at the earliest, if not on an ongoing basis.[148] Bloomberg requested that, should the Commission decide to approve the Single Book Proposal, the Commission delay the effective date of the rules to provide ECNs an opportunity to migrate to another venue.[149] The USCC also encouraged the Commission to, as a matter of good process, ''consider the need for appropriate transition periods'' should the proposed rule change be adopted.[150] Similarly, Track requested a phased-in approach to the rules should they be adopted.[151] In response to commenter concerns and in order to provide ECNs with adequate time to program their systems for participation in Nasdaq or migration to another venue,[152] Nasdaq has agreed to delay its implementation and roll-out of the Single Book Proposal until August 28, 2006.[153]

In the Commission's approval of Nasdaq's exchange application in January 2006, the Commission emphasized that Nasdaq's approval was based on a set of rules with price/time priority.[154] In addition, the Commission noted in the Exchange Application Order that the two ECNs that Nasdaq had recently acquired—Brut and INET—both applied rules that required their orders to be executed in price/time priority.[155] As discussed above, the Single Book concept of integrating the three Nasdaq Facilities was discussed by the Commission in the Exchange Application Order and the Commission believed that such an integration would be beneficial, though the Commission permitted the three Nasdaq Facilities to operate separately for a temporary period, until September 30, 2006, because the Brut and INET facilities had only been recently acquired by Nasdaq.

The Commission notes that Nasdaq, independent of its exchange application and as a NASD subsidiary at the time, had already proposed to integrate its three facilities by September 30, 2006 in its filing to establish the rules governing the operation of its INET System.[156] In the INET Order the Commission approved Nasdaq's proposed commitment to integrate as of September 30, 2006;[157] however, that date was not mandated by the Commission. In addition, the plain language of the INET Order, NASD Rule 49545(b)(2), and the Exchange Application Order makes clear that September 30, 2006 was the latest date that Nasdaq, pursuant to its commitment, could integrate its trading facilities. Neither the INET Order nor the Exchange Application Order required that integration be delayed until September 30, 2006, or prohibited Nasdaq integrating its systems at an earlier date.

The Commission believes that astute market participants, such as Bloomberg, could have reasonably anticipated the strong possibility of Nasdaq operating on an automatic-execution only basis prior to September 30, 2006, based on: (1) Nasdaq's anticipated operation as an exchange with executions based on price-time priority for all of Nasdaq's order flow, (2) Nasdaq's acquisition of Brut and INET, both of which are automatic-execution facilities, and (3) Regulation NMS where the Commission clearly enunciated a view that automated markets and automated quotes (*i.e.*, automatic execution functionality), combined with access to such markets and quotes was an important attribute in a national market system.

In addition, formal notice of Nasdaq's intention to create an Integrated System based on automatic executions prior to September 30, 2006 was clearly given on February 7, 2006, the day Nasdaq filed the Single Book Proposal with the Commission. At that time, Nasdaq proposed to commence operation of the Integrated System by as early as May 2006. Bloomberg submitted an initial comment letter opposing the proposed rule change dated March 6, 2006, which suggested that it would take three to six months to complete the systems work required to adapt to a new venue.[158] The Commission understands that BATS has already made and implemented its plans to migrate its liquidity to NSX.[159] In addition, in response to comments for a transitional phase-in period,[160] Nasdaq has proposed to commence its phased-in implementation of the Integrated System based on automatic executions on August 28, 2006;[161] which is almost seven months after the proposal was filed, and nearly six months since Bloomberg's initial comment letter. The Commission believes that order delivery ECNs have had sufficient time to make alternate plans for quoting in the ADF or another SRO.

Section 19(b)(1) of the Act[162] requires a SRO to the file with the Commission ''any proposed rule change in, addition to, or deletion from the rules of such self-regulatory organization * * * accompanied by a concise general statement of the basis and purpose of such proposed rule change. Such proposed rule change must be filed in accordance with the requirements of Rule 19b–4 under the Act.[163] The Commission believes that Nasdaq has filed the Single Book Proposal in accordance with the requirements of the Act and its rules and regulations thereunder.

The Commission believes that Nasdaq has met all of the procedural requirements for the instant proposed rule change and provided the public in general and interested parties in particular with adequate notice and opportunity to comment under the Act. The Commission believes that the Integrated System will promote competition and bring investors and the national market system benefits through the efficiencies and transparencies brought about through a single liquidity pool with price/time priority. The Commission believes that, given the notice provided by Nasdaq's filings, it is consistent with the Act for Nasdaq to implement the Integrated System as proposed.

B. Operation as a National Securities Exchange

The Commission notes that, under the Single Book Proposal, Nasdaq's trading platform would have an integrated quote/order book operated in accordance with a unified price/time priority execution algorithm. In the Exchange Application Order, the Commission acknowledged that, because of the recent nature of Nasdaq's Brut and INET acquisitions and because

[148] Bloomberg Comment Letter III at 8–11.

[149] Bloomberg Comment Letter II at 11; *see also* Bloomberg Comment Letter III at 11.

[150] *See* USCC Comment Letter at 1–2.

[151] Track Comment Letter I at 2.

[152] *See* Bloomberg Comment Letter II at 11; Bloomberg Comment Letter III at 11; USCC Comment Letter at 1–2; and Track Comment Letter I at 2.

[153] *See* Amendment No. 3.

[154] Exchange Application Order at 3558–59.

[155] Exchange Application Order at 3558, note 137. *See also* Securities Exchange Act Release Nos. 52902 (December 7, 2005), 70 FR 73810 (December 13, 2005) (''INET Order'') and 51326 (March 7, 2005), 70 FR 12521 (March 14, 2005) (''Brut Order'').

[156] *See* Securities Exchange Act Release No. 52723 (November 2, 2005), 70 FR 67513 (November 7, 2005)(''INET Notice'').

[157] *See* INET Order at 73811.

[158] Bloomberg Comment Letter I at 11.

[159] *See* Nasdaq Response Letter II.

[160] *See* Track Comment Letter I at 2; USCC Comment Letter at 1–2; and Bloomberg Comment Letter IV at 1.

[161] *See* Amendment No. 3.

[162] 15 U.S.C. 78s(b)(1).

[163] 17 CFR 240.19b–4.

of the reliance by participants on the continued availability of those ATSs, it was in the public interest for Brut and INET to be available for a limited period while Nasdaq worked to integrate them with its NMC Facility.[164] The Commission stated that ''it is beneficial for orders in the same securities directed to an exchange to interact with each other'' and that ''[s]uch interaction promotes efficient exchange trading and protects investors by assuring that orders are executed pursuant to a single set of priority rules that are consistently and fairly applied.'' [165] The Commission permitted the Exchange to operate three separate trading platforms—namely the NMC Facility, Brut Facility, and INET Facility—for a temporary period prior to September 30, 2006. This proposed rule change, as amended, would enable Nasdaq to satisfy its Commission-approved commitment to integrate its three trading facilities prior to September 30, 2006.

In addition, Nasdaq's Single Book Proposal will allow the Exchange to program its system to operate in compliance with the Exchange Application Order in additional ways. For example, the Integrated System would not accept reports of transactions occurring outside the Integrated System, would interact with the network processors for the various national market system plans in compliance with Commission rules governing exchanges, and would fulfill Nasdaq's new role as an exchange in the national market system plans, including the national market system plan governing the Intermarket Trading System (''ITS Plan''). In addition, under the Single Book Proposal, Nasdaq itself (rather than its individual members) would be bound by the obligations of the ITS Plan, maintain a single two-sided quotation, and be responsible for trade-through compliance. The Commission notes that the proposed rules change, as amended, cannot be operational until Nasdaq has satisfied all the conditions set forth by the Commission in the Exchange Application Order.[166]

C. Regulation NMS

The Commission believes that the proposed rule change should allow Nasdaq to comply with the requirements of Regulation NMS.[167] In proposed Nasdaq Rule 4613(e), Nasdaq proposes to adopt a rule with regard to locked and crossed markets. The Exchange has also designed its proposed Book Processing [168] and Order Routing [169] rules to comply with the requirements of Regulation NMS. These proposed rules include permitting users to designate orders meeting the requirements of Rule 600(b)(30) of Regulation NMS [170] as intermarket sweep orders, which would allow orders so designated to be automatically matched and executed without reference to protected quotations at other trading centers.

In addition, Nasdaq has proposed to implement routing options that its believes are consistent with Rules 610 and 611 of Regulation NMS. Nasdaq also proposed rules intended to ensure its compliance with Rule 612 of Regulation NMS (*i.e.*, accepting sub-penny prices in $0.0001 increments for securities priced less than $1.00 a share and rejecting orders in sub-penny increments for securities priced $1.00 or more per share).[171] The Commission also notes that proposed Nasdaq Rule 4756(c)(4) addresses situations where Nasdaq has reason to believe it is not capable of displaying automated quotations, including adopting policies and procedures for communicating to both its members and other trading centers about such a situation, as well as receiving and responding to notices of other trading centers electing the ''self-help'' exception under Rule 611(b)(1) of Regulation NMS.

D. Other Rules

The proposed rule change, as amended, would merge five current sets of rules (the 4600, 4700, 4900, 4950, and 5200 Series) into two (the 4600 and 4750 Series), with the proposed 4600 Series governing System participants and the proposed 4750 Series governing the operation of the Integrated System. In addition to reorganizing the rule set, and making changes to the Exchange's rules for exchange and Regulation NMS readiness, the proposed rule change, as amended, addresses, among other things, openings and closings, the order display/matching system, order types, time in force designations, anonymity, routing, book processing, adjustment of open orders, and Nasdaq's proposed phase-in plan for the proposed rules.

E. Impact on Efficiency, Competition, and Capital Formation

Section 3(f) of the Act requires that the Commission consider whether Nasdaq's proposal will promote efficiency, competition, and capital formation.[172] As discussed in more detail above, the Commission has carefully considered whether the proposal will promote efficiency, competition and capital formation and has concluded that the Single Book Proposal should encourage competition and should not impede the development of other trading systems or market innovation. The Commission believes that the Single Book Proposal is an appropriate undertaking by Nasdaq to enhance the quality of its market by providing more information to investors, promoting greater efficiency in executions, and increasing overall market transparency. While the Single Book Proposal should provide a central means for accessing liquidity in Nasdaq and non-Nasdaq stocks, it does not represent an exclusive means, nor does it prevent broker-dealers from seeking alternative order routing and execution services. In addition, the Commission believes that the proposal should promote competition and capital formation by providing its market participants with several quote and order management options (*e.g.*, Discretionary Orders, Reserve Orders, Pegged Orders, and Minimum Quantity Order), including order types which will enable market participants to operate in the post-Regulation NMS trading environment, such as Intermarket Sweep Orders, Price to Comply Orders, and Price to Comply Post Orders.

F. Accelerated Approval of Amendment Nos. 2 and 3

As set forth below, the Commission finds good cause to approve Amendment Nos. 2 and 3 to the proposed rule change, as amended, prior to the thirtieth day after the amendments are published for comment in the **Federal Register** pursuant to Section 19(b)(2) of the Act.

In Amendment No. 2, Nasdaq modifies the proposed rule language to reflect the Commission's extension of certain compliance dates relating to Regulation NMS. Specifically, Nasdaq is modifying proposed rules to reflect that such rules would not become effective until the applicable Regulation NMS implementation date of May 21, 2007. Such rules include Rule 4613(e) (pertaining to locked and crossed markets), Rule 4751(f) (pertaining to order types), and Rule 4755 (pertaining to intermarket sweep orders). The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after

[164] *Id* at 3559.

[165] *Id.*

[166] Exchange Application Order at 3566.

[167] *See supra* note 6.

[168] *See* proposed Nasdaq Rule 4757.

[169] *See* proposed Nasdaq Rule 4758.

[170] 17 CFR 242.600(b)(30).

[171] Single Book Proposal at 19592. *See also* proposed Nasdaq Rule 4613(a)(1)(B).

[172] 15 U.S.C. 78c(f).

publication in the **Federal Register**. The Commission believes this is a reasonable approach in light of the extension of Regulation NMS compliance dates and should help to ensure that the appropriate Nasdaq rules are in place at the time that Regulation NMS compliance is required.

In Amendment No. 2, Nasdaq also is making several technical corrections to the proposed rule change, for example, eliminating typographical and underlining errors. These changes are non-substantive and technical in nature and are necessary to clarify the proposal. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the **Federal Register** because they better clarify Nasdaq's rules, which should assist members' ability to comply with their requirements, and assist investors in understanding their application and scope.

In Amendment No. 3, in response to the comments filed by the U.S. Chamber of Commerce, Bloomberg, and others, Nasdaq proposes to commence a phased-in implementation of the Integrated System on August 28, 2006.[173] In addition, Amendment No. 3 describes Nasdaq's plan to test securities on the System during July and early August 2006 and phase-in the operation of the Integrated System with an initial three-week transition period for Nasdaq-listed stocks, followed by non-Nasdaq-listed stocks.

The Commission finds good cause to accelerate approval of this change prior to the thirtieth day after publication in the **Federal Register**. The Commission finds that the change in the proposed implementation of the Integrated System to a later date than that originally proposed and published for comment and later than that proposed by Amendment No. 2, as well as the allowance of a testing period and phased-in period, would provide a longer transition period for Nasdaq market participants and other participants in the national market system. The delay until August 28, 2006 and the phase-in period should help to ensure that there is an orderly transition to the Integrated System and provide Nasdaq's market participants, including many of the commenters, opportunity to decide whether to continue participating in Nasdaq, or to elect to move their business elsewhere. The Commission notes that August 28, 2006 represents a period of nearly seven months from the original filing date of this proposed rule change. The Commission also notes that, notwithstanding Nasdaq's proposed August 28, 2006 implementation date, the proposed rules change, as amended, cannot be operational until Nasdaq has satisfied all the conditions set forth by the Commission in the Exchange Application Order.[174] The Commission believes that August 28, 2006 should provide market participants with adequate time to prepare for the Implemented System, and would also permit Nasdaq to meet its commitment to fully integrate its three trading facilities on or before September 30, 2006.

VII. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[175] that the proposed rule change (File No. SR–NASDAQ–2006–001), as amended by Amendment Nos. 1, 2, and 3, be, and hereby is, approved.

By the Commission.

Nancy M. Morris,

Secretary.

[FR Doc. 06–6366 Filed 7–19–06; 8:45 am]

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[173] The Commission notes that Amendment No. 3 replaces the August 14, 2006 implementation date that Nasdaq had proposed in Amendment No. 2.

[174] Exchange Application Order at 3566. The Commission recently modified the requirements for Nasdaq's operation as an exchange. *See* Securities Exchange Act Release No. 54085 (June 30, 2006), 71 FR 38910 (July 10, 2006).

[175] 15 U.S.C. 78s(b)(2).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–54130; File No. SR–NYSEArca–2006–20]

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of a Proposed Rule Change Relating to Schedule of Fees and Charges

July 11, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on May 17, 2006, NYSE Arca, Inc. (''NYSE Arca'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On May 26, 2006, the Exchange filed Amendment No. 1 to the proposed rule change. On June 30, 2006, the Exchange filed Amendment No. 2 to the proposed rule change. On July 7, 2006, the Exchange filed Amendment No. 3 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend the Trade Related Charges section of the Schedule of Fees and Charges (''Schedule''). The text of the proposed fee schedule is available on the NYSE Arca's Web site *http://www.archipelago.com*, at the NYSE Arca's Office of the Secretary, 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, as amended. The text of these statements may be examined at the places specified in Item IV below. The NYSE Arca 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

The purpose of the proposed rule change, as amended, is to amend the Trade Related Charges section of the Schedule. NYSE Arca proposes to combine two existing fees associated with Linkage Orders.[4] The Exchange also proposes to add additional language to footnotes 4 and 5 of the Trade Related Charges section of the Schedule in order to explain that the existing Broker Dealer Surcharge also applies to Linkage Orders.

Presently orders received via the Linkage, other than Satisfaction Orders, are assessed a $0.21 transaction fee and

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Form 19b–4 dated July 7, 2006 (''Amendment No. 3''). Amendment No. 3 replaced the original filing and Amendment Nos. 1 and 2 in their entirety.

[4] Linkage Orders are orders that are routed through the Intermarket Linkage System (''Linkage'') as permitted under the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage. *See* Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).