

not completely executed in Primex. To the extent the exposure concludes and there is a portion of the order remaining, that balance will be converted by the System to an order that is forwarded to SuperSoes (for Nasdaq National Market securities), SuperMontage, or ITS/CAES (for exchange-listed securities, provided the participant also is an ITS/CAES market maker). A Participant's preference is not displayed, exposed or communicated to any other Participant.

Responses and Indications

Participants may submit Responses and Indications to the System, for the purpose of interacting with orders on Primex. Responses and Indications are not communicated to any Participant, except to the extent they result in an execution with an order. Responses and Indications cannot execute against other Responses and Indications. Responses are instructions submitted to the System by Participants to interact with available orders exposed on Primex. Responses may be either a Fixed Price Response (e.g., buy 1,000 at \$20) or a Relative Priced Response (e.g., buy 1,000 at the bid plus 3 cents).

Indications are instructions submitted to the System to interact with future orders exposed on Primex by either the next day or the next five days, as selected by the Participant. An Indication may be a Predefined Relative Indication ("PRI") or a Go-Along Indication. PRIs have no specific fixed price, but are expressed at time of entry in terms relative to the best bid or offer publicly displayed at such time when the System activates the PRI against orders on Primex. PRIs are ranked in relative price/time priority among all other PRIs and any same-side orders currently being exposed. When activated by the System, a PRI will match against orders at a price equal to the best bid (for PRIs to buy) or offer (for PRIs to sell) publicly displayed at that time in the NBBO, plus or minus (respectively) the relative price term associated with that PRI; provided that such price also satisfies any applicable condition associated with the order to which it is responding. All PRIs must be for at least 100 shares. The System will only accept PRIs that meet the required amounts of price improvement (set forth in proposed NASD Rule 5018(c)(1)(C)). Participants may associate a Per Auction Maximum size with a PRI, which will provide the Participant with an opportunity to withdraw the PRI once the Per Auction Maximum is exhausted.

Go-Along Indications also have no specific fixed price, and are also expressed at time of entry in terms relative to the best bid or offer publicly

displayed at such time when the System activates the PRI against orders on Primex. Go-Along Indications are only activated when there has been at least one other contemporaneous Crowd execution at the NBBO, provided there are no PRIs available or orders being exposed. Each Go-Along Indication is required to be for at least 10,000 shares.

All orders submitted to the System are identified as either a Public Order (in general, an order for the account of a customer) or a Professional Order (in general, an order for the proprietary account of a broker-dealer). This status is not communicated to any other Participant, but is used to determine whether an order is available to interact with the Response or Indication of a Crowd Participant. A Participant that responds to orders on Primex can choose whether its Responses and Indications interact with both Public and Professional Orders, or just Public Orders. However, a Participant entering an order does not have the ability to select or control whether public or professional interest may interact with the order.

IV. NYSE Comment Letter and Nasdaq Response

In the NYSE Comment Letter, the NYSE argued against the Commission granting permanent approval to Primex. The NYSE argued that the Commission must evaluate whether Primex complies with Nasdaq's regulatory obligations as an exchange pursuant to Section 6 of the Act,¹⁷ even though Nasdaq's exchange application is pending with the Commission. The NYSE argued, among other things, that Primex's true character is not that of an auction, but rather, an anti-competitive dealer internalization system. For example, the NYSE argued that Primex's "match mechanism" for dealer guarantees allows dealers to jump ahead of pre-existing customer orders.

In the Nasdaq Response Letter, Nasdaq stated that it would respond to all of the comments raised by the NYSE Comment Letter, even though it is only required to comply with the requirements of Section 15A of the Act¹⁸ because of its current status as a registered securities association. Nasdaq further stated that Primex is fully consistent with these statutory obligations.

The NYSE argued that the requirement that PAMMs submit 80% of their order flow is anti-competitive and compromises the ability of broker-dealers to comply with their best

execution obligations. The NYSE further stated that the 80% requirement is an off-board trading restriction which conditions the ability of any member to effect any transaction otherwise than on Primex. The NYSE also believes the requirement unfairly discriminates against members with high volume of order flow.

Nasdaq responded that the 80% delivery requirement applies only to those dealers who wish to take advantage of the benefits of certain rebates and features available to PAMMs. Nasdaq stated that the only penalty for not meeting the 80% delivery requirement is to be ineligible for PAMM status; there are no disciplinary sanctions for failing to meet the 80% requirement, and such dealers will still have access to the other features of Primex. Nasdaq contended that the requirement does not place participant in a position where it must choose between violating a NASD rule and its duty of best execution; rather, each participant is free to execute its orders in whichever manner it believes can obtain best execution. Finally, Nasdaq stated that all orders that are exposed in Primex are eligible for the 80% test, even if they are executed elsewhere.

Nasdaq further argued that the 80% requirement is designed to encourage dealers with customer order flow to expose customer's orders to the public. It asserted that, without the 80% requirement, the market would believe that dealers were only posting unwanted orders.

NYSE argued that Primex allows participating dealers to provide customers with trade prices no better than if their orders had been internalized, and therefore should not claim to offer an auction-type execution. NYSE contended that there are no true market makers on Primex because no participant has an affirmative obligation to provide the liquidity of continuous two-sided quotations. NYSE further argued that Primex does not display quotes or even the existence of any trading interest in the "virtual" trading crowds that Nasdaq claims exists as a source of liquidity, nor does it display most orders entered onto the system to interact with the putative trading crowd. NYSE stated that customer orders may be entered for immediate auction, which it argued would not provide any opportunity for participants to respond.

Nasdaq responded that Primex is designed to expose to a broader audience orders that might otherwise be internalized. Moreover, Nasdaq stated that even if such orders are internalized, federal securities laws do not prohibit

¹⁷ 15 U.S.C. 78f.

¹⁸ 15 U.S.C. 78o-3.