prices of each match will be reported. Thus, assuming the dealer quotation is 20–20½, if the file contains two limit orders to buy at 20⅛, each for 1,000 shares, and there are also three 1,000 share limit orders to sell at 20⅛, two 1,000 share limit orders to sell at 20¼, and 4,000 shares to buy at the market, the system will execute as follows: the first two in time priority of the three 1,000 shares sell limit orders at 20⅛ will be matched against the two 20⅛ 1,000 share buy limit orders. The first 3,000 shares to buy at the market will be matched against the remaining limit orders to sell, with the first market order in time receiving an execution of 20⅛ and two 1,000 share market orders next in time receiving executions of 20¼. The remaining 1,000 share market order will be executed against the dealer quote according to the normal post-opening execution algorithm.

3. Rules of Fair Practice

The NASD is also proposing in conjunction with NAqcess three major changes to the Rules of Fair Practice. Under the proposed new rule and Interpretations, the treatment of limit orders will be significantly changed to promote price protection of such orders throughout The Nasdaq Stock Market. These proposed rule changes provide greatly enhanced limit order treatment over current practices. Together with existing limit order protections already in place (*i.e.*, the so-called ''Manning'' rule), the new proposals provide investors placing limit orders with significantly enhanced protections against limit order trade-throughs throughout The Nasdaq Stock Market.

A. *Customer Order Handling.* The NASD is proposing a new Interpretation under Article III, Section 1 of the Rules of Fair Practice. Under the proposal, if a customer requests that his or her order be entered into NAqcess, the member firm must do so. While the Interpretation permits a firm to charge for such services and to recommend the use of its own execution system, the member is not permitted to discriminate against customers that choose NAqcess over an internal system by imposing unfair commissions or charges. The proposed Interpretation covers both market and limit orders.

B. *Price Protection.* The NASD is also proposing a new rule in the Rules of Fair Practice that would prohibit a member firm, whether acting as a principal or as an agent, from executing any order at a price inferior to any limit orders that the firm is able to see in the NAqcess limit order file.[25] An inferior price means an execution price that is lower than a buy limit order or higher than a sell limit order that a member firm is able to see in the NAqcess limit order file. This prohibition means that limit orders in the NAqcess file will not be traded through elsewhere in Nasdaq in most circumstances. A member firm's activity with respect to protecting NAqcess limit orders must be consistent with its best execution obligations to its own customers. When a firm acts as principal in filling a NAqcess limit order when it is in possession of an executable customer market order on the other side of the market, it should pass on the benefit of the NAqcess trade to the customer order. If the firm in receipt of the market order is acting as agent for its own customer's order, its best execution obligation would mean that it should select the appropriate market for execution, which could be NAqcess.

The price protection obligation is related to the ability of the firm to view the orders in the limit order file. Thus, under the proposal's current configuration, limit orders at the top of the file and included in the inside market calculation must be protected by all member firms. Under NAqcess system rules, limit orders ranked below the top of the file are viewable only by market makers in the particular security. Accordingly, market makers in a particular security would be obligated to protect all limit orders in that security in the NAqcess file from inferior executions that they may engage in.[26] Thus, if a market maker in a security sought to execute a 1,000 share trade at 20, when the NAqcess file displayed limit orders to buy at 20⅛ and 20¼, the market maker would be required to either execute the limit orders first or contemporaneously, depending on the size of the limit orders in NAqcess.[27]

The NASD believes it important to explain for the purposes of the price protection rule and the Interpretation regarding equivalent price protection for limit orders held outside of NAqcess, that the protectible price that generates a firm's obligation to provide price protection is the price reported for last sale reporting purposes. Some confusion has occurred regarding limit orders trading at an ''inferior price,'' especially in the context of internal sales credits. If the execution price reported via ACT for Schedule D transaction reporting purposes includes an internal sales credit that will be provided to a sales representative at the firm, the price that triggers the member firm's obligation to protect a limit order is the reported price. The internal sales credit included in the reported price has no effect on the obligation to protect the NAqcess limit order.[28]

C. *Equivalent Price Protection.* As noted earlier, the NASD, to encourage competition and to enhance the liquidity of The Nasdaq Stock Market, has determined that market makers should continue to be permitted to operate their own internal execution systems and to handle limit orders outside of NAqcess. However, the NASD also believes it is important to provide limit orders held outside of NAqcess with price protection substantially equivalent to that which NAqcess orders would have. Accordingly, the NASD has proposed an Interpretation to Article III, Section 1 of the Rules of Fair Practice

[25] It should be noted that placement of a customer limit order in the NAqcess file does not relieve a member firm of its obligation under the Limit Order Protection Interpretation of Article III, Section 1 of the Rules of Fair Practice that prohibits a member firm from trading ahead of a customer limit order it has been entrusted with. Under the so-called ''Manning'' Interpretation, if a member firm holding a customer limit order, whether from its own customer or as a result of a member-to-member order, places that order into NAqcess, the member firm is nevertheless prohibited from trading at the same price or at an inferior price to the customer order. Thus, while the newly proposed price protection rules speak in terms of protecting NAqcess orders from inferior priced transactions, if the NAqcess order is the firm's customer's order or a member-to-member order it placed in NAqcess, the firm may not trade at the same price without protecting that order.

[26] In today's environment, market makers are involved in approximately 83% of all Nasdaq trades. Consequently, it is likely that in a large majority of trades when NAqcess is operational, a market maker will be involved, and thus, orders away from the top of the file typically will be protected as well as the top of the file.

[27] The NASD will interpret the price protection rule to not apply to member firms that operate passively-priced crossing systems, such as POSIT and Instinet's Crossing Network. Generally speaking, such systems execute prices at the dealer quotation spread midpoint and would not likely trade through a NAqcess order. Members that believe that they operate systems that could qualify for this exemption should submit a request for exemption to the NASD.

The proposed rule would apply, however, to ordinary broker-dealer trading systems such as Instinet's regular trading session. Because many such trades could occur at prices that could be inferior to limit orders in NAqcess, the NASD believes it appropriate that such NASD member firms should protect NAqcess customer limit orders as would any other registered broker-dealer member firm. Orders placed in SelectNet that trade through NAqcess are also subject to the price protection rule.

[28] See NASD Special Notices To Members 95–43 (July 27, 1995) and 95–67 (Mar. 21, 1995) for a more detailed discussion of the proper means for protecting customer limit orders when firms are dealing at net prices. The same concepts apply in the context of protecting system limit orders.