IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *Plaintiff,*	CASE NUMBER 1:00CV02174 JUDGE: Emmet G. Sullivan
v.	DECK TYPE: Antitrust
AMERICAN STOCK EXCHANGE, LLC; CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED; PACIFIC EXCHANGE, INC.; and PHILADELPHIA STOCK EXCHANGE, INC.	DATE STAMP: 09/11/2000
Defendants.	

COMPETITIVE IMPACT STATEMENT

The United States, pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act ("APPA"), 15 U.S.C. § 16(b)-(h), files this Competitive Impact Statement relating to the proposed Final Judgment submitted for entry in this civil antitrust proceeding.

I.

NATURE AND PURPOSE OF THE PROCEEDING

On September 11, 2000, the United States filed a civil antitrust Complaint alleging that the defendants had violated Section 1 of the Sherman Act, 15 U.S.C. § 1. Defendants are option exchanges that provide a forum on which their members

trade options. An option is the right either to buy or to sell a specified amount or value of a particular underlying interest (equity security, stock indices, government debt securities or foreign currencies) at a fixed exercise price by exercising the option before its specified expiration date. An equity option is one in which the underlying interest is an equity security. Since the early 1990s, exchanges have been permitted to list options on any equity security that meets certain listing criteria. The Complaint alleges that, beginning in the early 1990's, an agreement arose among the defendants to limit competition among themselves by not listing options that were already listed on another exchange.

On September 11, 2000, the United States and the defendants filed a Stipulation in which they consented to the entry of a proposed Final Judgment that requires defendants to eliminate the anticompetitive conduct identified in the Complaint. Specifically, the proposed Final Judgment prevents the defendants from allocating equity options between or among exchanges or from agreeing that an equity option will be traded exclusively on any one exchange. The proposed Final Judgment also prohibits an exchange from maintaining any rule, policy, practice, or interpretation that directly prohibits, or that has the purpose

and an effect of indirectly prohibiting, the multiple listing of equity options. Further, the Final Judgment enjoins defendants from retaliating, harassing or intimidating any exchange or member of an exchange for listing an equity option or introducing a new equity option product.

The United States and the defendants have agreed that the proposed Final Judgment may be entered after compliance with the APPA. Entry of the Final Judgment would terminate the action except that the Court would retain jurisdiction to construe, modify, or enforce its provisions and to punish violations thereof.

Defendants have also reached an agreement with the Securities and Exchange Commission ("SEC" or "Commission") to resolve issues raised by that agency's investigation of the options industry. The SEC's investigation has been resolved through the SEC's issuance of an Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions against the defendants ("SEC Order"). SEC Release No. 43268, September 11, 2000. The SEC Order was issued essentially simultaneously with the filing of the Department's Complaint in this matter. The Department and the Commission

cooperated in their investigations and coordinated the settlements of them. The SEC Order includes significant provisions that require changes in the ways exchanges interact and conduct business, which will correct some of the past practices of the exchanges that facilitated the multi-listing agreement and will ensure additional competition in these markets going forward.

II.

DESCRIPTION OF THE EVENTS GIVING RISE TO THE ALLEGED VIOLATION

A. Background on options trading.

Each defendant is independent and competes against the other defendants in listing options. Defendants provide a forum (commonly known as a "floor") on which their members trade options. Exchanges compete for orders by, among other things, offering lower transaction fees and higher quality services, including quicker execution and greater liquidity, than their competitors. In addition, exchange members making a market in a particular option compete with other market makers, on that exchange and on other exchanges on which the option is listed, in the prices they offer to buy and sell options.

An exchange's quoted prices to buy and sell a given option are the best prices available from the multiple market makers on

a floor of the exchange (referred to as a "crowd"). An exchange's quoted price to buy an option (its "bid") and price to sell (its "ask") are transmitted to the Options Price Reporting Authority ("OPRA"), which transmits the information, combined with information from the other options exchanges, to third parties for processing and distribution. This information is used by market makers in setting prices and by the public in making investment decisions. At any given time, any exchange may have the best bid or ask in a particular option.

One of the ways market makers seek to profit from their market making activities is from the difference between their bid and ask, i.e., the difference between their price to buy and sell the same option, which is referred to as the spread. A wider spread in an option generally results in less favorable prices to investors. Competition between exchanges for the business of investors has the effect of narrowing spreads.

Prior to January 20, 1990, SEC rules prohibited, with few exceptions, equity options from being traded on more than one exchange. The SEC subsequently rescinded these rules and adopted Rule 19c-5. This action was taken in part based on the SEC belief that investors would benefit from options being multiply listed. From January 20, 1990, going forward, the SEC

contemplated that each exchange would be permitted to list any equity option as long as its underlying security met specific criteria, such as having a trading history and sufficient activity, to make it eligible for listing as an option.

Equity options were opened to multiple listing over a period of time. Exchanges were permitted to multiply list "new" options, i.e., options whose underlying security interest had not previously been listed on any exchange, without limitation. Approximately 700 options that had been allocated to specific exchanges prior to January 20, 1990, were opened to multiple listing in phases over a period from late 1992 to late 1994. When the last phase ended in late 1994, all equity options could be listed and traded by any of the defendants.

B. Illegal Agreement to Allocate Options.

In the early 1990s defendants, and others not named in this Complaint, agreed to limit competition among themselves by not listing options that were already listed on another exchange. The Department's investigation determined that from the early 1990s until at least the summer of 1999 a significant number of the industry's most actively-traded options were listed on a single exchange. During this period, there was tremendous growth in options trading which should have made multiple listing more

attractive. Absent an agreement, it would have sometimes been in the economic self-interest of an exchange, freely competing with other exchanges, or in the interests of its members, to list options traded on another exchange. The Department's investigation uncovered significant evidence that the exchanges reached an agreement that no exchange would list an option already listed elsewhere.

The Joint Exchange Options Plan

Following the adoption of Rule 19c-5, the defendants adopted procedures for listing new equity options. These procedures were contained in the "Joint-Exchange Options Plan" ("Options Plan"). The Options Plan required each exchange to pre-announce its intention to list a new equity option class, established a twenty-four hour time frame for other exchanges to announce their intention to list the same option, and provided waiting periods before any exchange could start trading. The Options Plan also provided that if an exchange was not the first exchange to announce an intent to list or did not submit a notice of intent to list within the twenty-four hour period following the initial notice (referred to as the "initial listing window" herein), it had to wait until at least the eighth business day after the date of the initial notice before it could list and begin trading the

option.

The Options Plan was central to the agreement among the exchanges. Although the language of the Options Plan provided that an exchange could list and begin trading previously listed options after waiting eight days, defendants undertook to develop additional procedures to govern the multiple listing of equity options already listed on an exchange. Beginning in 1992, defendants engaged in protracted discussions regarding the development of such procedures.

By the end of 1994, when the last most actively-traded options were about to become available for multiple listing,[1/] the proposed procedures for listing existing options had become complex and highly restrictive. The exchanges could not agree on ground rules for multiple listing and active discussion of multiple listing ceased. The interpretation of the Options Plan adopted by the exchanges and the absence of an agreed-upon procedure meant that no exchange would engage in multiple listing, other than listing new options in the initial listing

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[1]The exchanges were allowed to choose the order in which their exclusives would become available for multiple trading in the phase out period. The exchanges uniformly chose to open their exclusives to the possibility of multiple listing based on trading volume, with the most actively traded, and therefore most vulnerable to multiple listing, made available last, in late 1994.

window.

During the course of defendants' discussions about the Options Plan, an agreement between and among defendants developed that each defendant would refrain from listing equity options classes that were already listed on another exchange. Pursuant to this agreement, each defendant exchange would refrain from listing equity option classes that were already listed on another exchange. The exchanges were able to preserve the agreement by, among other things, the actions set forth below.

Listing Committee Procedures

Beginning in the early 1990's, exchange employees uniformly avoided considering option classes already traded elsewhere for listing on their exchange. The internal procedures for assessing listing opportunities at the several exchanges excluded consideration of options already listed on another exchange. In addition, employees responsible for listings at each of the exchanges did not consider listing an option already listed on another exchange. Rather, these employees limited themselves to considering options that (1) were becoming eligible for listing or (2) for which they had received notice that another exchange was going to list and for which they had a one-day opportunity to join in listing, or challenge the listing of, under the terms of

the Options Plan.

In addition, exchange members who wished to have their exchange begin to list an option that was already traded elsewhere had no formal means to bring their requests to exchange listing committees for consideration. Nevertheless, on a few occasions, market makers or broker/dealers sought to induce an exchange to list an option listed on another exchange. These requests were always rejected.

Corporate Mergers

A recurring threat to the agreement was a situation in which a company whose options were exclusively traded on one exchange merged with a company whose options were traded exclusively on another. To deal with such situations, the exchanges adhered to a protocol for determining which exchange would assume responsibility for the options of the merged company.

Generally, the protocol provided that, in stock transactions, when the acquiring and acquired companies were of different sizes, the exchange on which options of the larger company were listed would continue to trade the option and the exchange on which the options of the smaller company were listed would not. As a result, in many cases, an exchange would not trade options on a merging company even though it was in a good

position to compete for such trades. On occasion, exchanges would utilize the Options Clearing Corporation ("OCC") to act as an arbiter of which exchange would list an option following a merger.

Coordination, Threats, Intimidation and Harassment

Changes in market conditions sometimes strained the agreement. As option markets evolved, each exchange's incentives changed and, at one time or another, one of the exchanges considered taking action that would threaten the agreement. In one instance, an exchange considered multiple listing in an effort to increase the volume of options traded on its floor. Other threats to the agreement, during the course of the decade, were posed by exchanges that considered violating the merger protocol or considered listing new option products that might substitute for exclusives on other exchanges.

In each instance identified during the Department's investigation, the exchange about to take action that might have contravened the agreement did not do so. In many instances, there was some form of communication between the exchange about to take the step and another exchange. Generally, employees of one exchange would contact employees of a second exchange and ensure that the second exchange did not encroach on listings

allocated to the first by the agreement.

Further, in other instances, one exchange would pressure another, or the market makers on that exchange, in some way in order to stop a threat to the agreement. Generally, the threats involved the promise of retaliatory listing of valuable exclusives or some other form of economic harm to the exchange or market maker. In sum, threats, intimidation and harassment helped preserve the agreement.

Use of OPRA to Preserve the Agreement

The defendant exchanges also relied on their joint participation in OPRA to reduce threats to the agreement. OPRA is jointly controlled by the four defendant exchanges. It contracts with the Securities Industry Automation Corporation to consolidate and transmit information on quotes and transactions from the exchanges to third parties, who send it to investors, brokerage houses and back to the exchanges. In this process, OPRA acts as the exchanges' agent to acquire the message capacity needed to accept and forward the quote and transaction information generated by the exchanges. Decisions on the amount of message capacity OPRA will acquire and how it is allocated among exchanges are reached jointly by the defendant exchanges.

Historically, this structure gave exchanges the ability to

jointly control the amount of message capacity available to each exchange. Because of the operation of OPRA, the exchanges were collectively able to limit capacity, which discouraged multiple listing.

Break Down of the Agreement

In November 1998, the Department opened an investigation into allegations of collusion among the four existing options exchanges. The SEC also opened an investigation of the options markets. In the summer of 1999, all the defendants began to list many options that were already listed on another exchange. The exchanges' change in behavior cannot be explained by concurrent changes in the market or the fundamentals of the underlying stocks.

Effects of the Agreement

The purpose and effect of the agreement was to limit competition among exchanges in the purchase and sale of options. As a result of the agreement, price competition among the defendants and co-conspirators in the purchase and sale of some options was unreasonably restrained. In addition, consumers were denied the benefits of lower transaction fees and higher quality executions, including quicker executions and greater liquidity that would have occurred had the exchanges competed by multiply

listing equity options. In sum, investors who have purchased or sold options that would have been multiply listed were deprived of the benefits of free and open competition in the purchase and sale of options.

III.

EXPLANATION OF THE PROPOSED FINAL JUDGMENT

Agreements

The proposed Final Judgment (Section IV.A) ensures that defendants do not enter into, continue or reinstate agreements among themselves relating to whether, or the circumstances under which, options will be listed on a particular exchange. To this end, it enjoins each defendant from agreeing with another exchange, directly or indirectly, to trade an option class exclusively on one exchange, to allocate any option class between or among exchanges or to require, prevent or limit the listing or delisting of any option class. This provision would also preclude agreements like the protocol governing corporate mergers and covers agreements with all existing and future exchanges.

Rules, Practices and Procedures

The proposed Final Judgment (Section IV.B) also prohibits any defendant from maintaining any rule, policy, practice or interpretation that directly prohibits or that has the purpose

and effect of indirectly prohibiting it from listing an option class because the option class is listed on another exchange. This provision is meant to preclude the development of internal exchange procedures, like those uncovered in the investigation, that effectively prevented exchange employees and members from having an option already listed elsewhere be listed on an exchange. Having such procedures in place helped preserve the agreement among the exchanges.

Threats, Harassment and Intimidation

The proposed Final Judgment (Section IV.C) bars each of the defendants from threatening to retaliate, retaliating against, harassing or intimidating any exchange or any exchange member because it begins to list or trade an option class. It also forbids such conduct in response to an exchange seeking to increase OPRA capacity or an exchange or exchange member seeking to introduce a new options product. This provision will ensure that the exchanges cannot use such tactics in the future to discourage competitive behavior or enforce anticompetitive agreements.

Exceptions

The proposed Final Judgment includes a section designed to ensure that the Final Judgment is not construed to prohibit

certain conduct. Specifically, Section V.A states that the proposed Final Judgment shall not be construed to prohibit conduct expressly permitted by statute, SEC rule, SEC order, exchange rule or authorized by SEC personnel. Authorized by SEC personnel means, for purposes of the decree, that the conduct has been explicitly described to the SEC in writing, and about which the SEC has stated, in a writing signed by a person at the Director level or higher, that it has no objection to such conduct or otherwise approves it. Conduct is also "authorized by SEC personnel" if it has been expressly requested to be undertaken in a writing signed by a person at the Director level or higher.

Section V.B provides that the decree does not prohibit any defendant from making unilateral business decisions, reflecting independent business judgment based upon factors set forth in SEC approved rules, regarding whether to list or delist an option class, whether to introduce a new option product, or whether to increase or decrease capacity to list option classes.

Nor does the proposed Final Judgment (i) address the legality of a merger, or acquisition of another exchange, or a legitimate joint venture between a defendant exchange and a non-defendant (Section V.C); (ii) limit defendants' right to petition

in accordance with the doctrine established in Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127 (1961), and its progeny (Section V.D); or (iii) prohibit an exchange member from engaging in normal business activity such as unilaterally setting the spreads, quantities or prices at which such member will trade any option or communicating terms at which he or she is willing to trade any option, for the purpose of exploring the possibility of a purchase or sale of such option (Sections V.E and V.F). Finally, the Final Judgment does not prohibit defendant exchanges from undertaking surveillance or taking action in conjunction with the Intermarket Surveillance Group (Section V.G).[2/]

Additional Relief

The proposed Final Judgment would further require each defendant to establish and maintain an antitrust compliance program (Section VI). Under the compliance program, an Antitrust Compliance Officer, to be appointed by each defendant, is required to distribute copies of the Final Judgment to certain personnel, including members of a defendant's board of directors or governors, all officers and all employees and members whose

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[2]The Intermarket Surveillance Group is an exchange organization formed to detect illegal activity occurring across the options exchanges.

responsibilities include selecting option classes to be listed, developing new options products or surveillance, enforcement or ensuring compliance with laws and regulations. The Antitrust Compliance Officer must also brief defendant's personnel on the meaning and requirements of the federal antitrust laws and the meaning of the Final Judgment, as well as obtain their certification that they have read and agree to abide by the Final Judgment and understand the penalties for non-compliance.

The Final Judgment further provides that the United States may obtain information from defendants concerning possible violations of the Final Judgment (Section VIII.A and B). Each Antitrust Compliance Officer is required to submit an annual report that details each request made to list an option and what action was taken in response to the request, and to provide information on each allegation of harassment in possible violation of Section IV.C and what efforts were undertaken to investigate it (Section VIII.C). Defendants are required to report semi-annually on each option that has been listed or delisted (Section VIII.D).

In order to facilitate monitoring of regulatory filings that may affect the Final Judgment, the Final Judgment provides that each defendant must submit to the Department copies of any filing

or submission to the SEC that relates to compliance with Section IV of the decree, or Sections IV.B.(a),(b),(c),(h) or (j) of the SEC Order (Section VIII.E). The obligation extends to any request, formal or informal, to the SEC, including any request for extension of time or additional time for compliance. This will allow the Department to consult with the SEC on proposed changes to provisions of the SEC Order that are important to promoting competition.

SEC action

The Department determined that, because of the important role played by the SEC in regulating this industry, various corrective actions needed to prevent the recurrence of the agreement alleged in the Complaint and to promote competition could best be addressed by the SEC. Some activities or changes in activities that were needed required new rules or rule modifications that would need to be filed with and reviewed by the SEC. The Department, therefore, has worked with the SEC to see that needed corrective actions were included in the SEC Order.

For example, the Options Plan needed to be modified to make it less useful as a way to signal the intent of an exchange to multi-list or to allow one exchange to delay another from listing

a particular option. The best way to address this problem was to require defendants to propose revisions to the Options Plan that will eliminate the opportunity to engage in anticompetitive conduct and for the SEC to conduct a rulemaking proceeding to revise the Options Plan. Consequently, in Section IV.B.(a) of the SEC Order, the defendants have committed to submit rules eliminating anticompetitive provisions of the Options Plan no later than 90 days after entry of the SEC Order.

Similarly, the absence of procedures for exchange members to get prompt consideration of multiple listing proposals is best addressed by requiring defendants to formulate procedural rules that would provide for the submission and processing of such requests. Therefore, in Section IV.B.(b) of the SEC Order, defendants have committed to submit rules establishing such procedures no later than 120 days after entry of the SEC Order. The rules to be submitted will require each exchange to specify the criteria it will use to consider such requests and to respond to such requests in writing within a specified time frame.

As noted above, OPRA, as traditionally managed, has served to create a shared industry capacity for the dissemination of quote and trade data in the options markets. This approach has led to a situation where the exchange participants in OPRA have

managed data transmission capacity growth and allocation as a joint endeavor. Thus, each competitor has had knowledge of every other competitor's capacity plans and needs and, by acting jointly, the exchanges can thwart competitors' plans by failing to provide needed capacity.

The Department believes that the option industry must be required to move away from the shared capacity paradigm in order for competition to significantly increase. To that end, defendant exchanges have agreed to move to a system in which each exchange can acquire and manage its own data transmission capacity independently. Significant changes in the rules under which OPRA operates are necessary in order to achieve this result. Specifically, defendants have agreed, as a part of the SEC Order, to modify the structure and operation of OPRA to (i) establish a system for procuring and allocating data transmission capacity that eliminates joint action by the participants in OPRA in determining the amount of total capacity procured and the allocation thereof, and provides that each participant in OPRA will independently determine the amount of capacity it will obtain; (ii) establish a system for gathering and disseminating business information from and to participants of OPRA such that all non-public information specific to a participant in OPRA

shall remain segregated and confidential from other participants; and (iii) set forth a statement of OPRA's functions and objectives and provide for rules and procedures that limit any joint action by the participants in OPRA to circumstances in which such joint action is necessary in order to fulfill the stated functions and objectives. SEC Order Section IV.B.(c). Defendants have committed to submit rules establishing such procedures no later than seven months after entry of the SEC Order.

The defendants have also agreed, as part of the SEC order, to increase transparency on the activities on their trading floors. Specifically, Section IV.B.(j) of the SEC order requires that any practice or procedure, not currently authorized by rule, by which any market makers trading any particular option class determine by agreement the spreads or option prices at which any particular option class, or the allocation of orders in an option class, be filed for approval within six months of the date of the SEC order. The defendants have committed to stop any such practice or procedure that is not submitted to and ultimately approved by the Commission. This obligation will ensure that market maker practices concerning spreads, option prices and order allocations are permitted by the SEC and are publicly

known. This will promote competition between market makers to the benefit of investors.

Other provisions of the SEC Order will also promote competition. In this regard, the SEC Order provides for significant increases in expenditures for surveillance activities by the defendants, particularly with respect to options order handling rules governing best execution, limit order display, priority rules, trade reporting and firm quotes. It also requires exchanges to report trades within 90 seconds and to enhance incentives to quote competitively, particularly in the context of automatic execution systems. Taken together, these actions constitute a major restructuring of the options industry and a dramatic move toward increasing competition in it.

IV.

REMEDIES AVAILABLE TO PRIVATE LITIGANTS

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgment will neither impair nor assist the bringing of such actions. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C.

§ 16(a), the Final Judgment has no *prima facie* effect in any subsequent lawsuits that may be brought against the defendants.

V.

PROCEDURES AVAILABLE FOR MODIFICATION OF THE PROPOSED FINAL JUDGMENT

The United States and defendants have stipulated that the proposed Final Judgment may be entered by the Court after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgment is in the public interest. The Department believes that entry of this Final Judgment is in the public interest.

The APPA provides a period of at least sixty days preceding the effective date of the proposed Final Judgment within which any person may submit to the United States written comments regarding the proposed Final Judgment. Any person who wishes to comment should do so within sixty days of publication of this Competitive Impact Statement in the Federal Register. The United States will evaluate and respond to the comments. All comments will be given due consideration by the Department of Justice, which remains free to withdraw its consent to the Final Judgment at any time prior to entry. The comments and the responses of the United States will be filed with the Court and published in

the Federal Register. Written comments should be submitted to:

Nancy M. Goodman, Chief
Computers and Finance Section
Antitrust Division
U.S. Department of Justice
600 E Street, N.W., Suite 9500
Washington, D.C. 20530

The proposed Final Judgment provides that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgment. The proposed Final Judgment would expire ten (10) years from the date of its entry.

VI.

ALTERNATIVES TO THE PROPOSED FINAL JUDGMENT

As an alternative to the proposed Final Judgment, the Department considered litigation on the merits. The Department rejected that alternative for two reasons. First, a trial would involve substantial cost both to the United States and to the defendants, and is not warranted since the proposed Final Judgment provides all the relief the Government would likely obtain following a successful trial. Second, the Department is satisfied that the various compliance procedures to which defendants have agreed will ensure that the anticompetitive practices alleged in the Complaint are unlikely to recur and, if

they do recur, will be punishable by civil or criminal contempt, as appropriate.

VII.

STANDARD OF REVIEW UNDER THE APPA FOR THE PROPOSED FINAL JUDGMENT

The APPA requires that proposed final judgments in antitrust cases brought by the United States be subject to a sixty-day comment period, after which the Court shall determine whether entry of the proposed final judgment "is in the public interest." In making that determination

> the court *may* consider:
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> (1) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration or relief sought, anticipated effects of alternative remedies actually considered, and any other considerations bearing upon the adequacy of such judgment;
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> (2) the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e) (emphasis added). As the Court of Appeals for the District of Columbia Circuit held, the APPA permits a court to consider, among other things, the relationship between the remedy secured and the specific allegations set forth in the

government's complaint, whether the decree is sufficiently clear, whether enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. United States v. Microsoft, 56 F.3d 1448, 1458-62 (D.C. Cir. 1995).

In conducting this inquiry, "the Court is nowhere compelled to go to trial or to engage in extended proceedings which might have the effect of vitiating the benefits of prompt and less costly settlement through the consent decree process."[3/] Rather,

> [a]bsent a showing of corrupt failure of the government to discharge its duty, the Court, in making its public interest finding, should . . . carefully consider the explanations of the government in the competitive impact statement and its responses to comments in order to determine whether those explanations are reasonable under the circumstances.

United States v. Mid-America Dairymen, Inc., 1977-1 Trade Cas. ¶ 61,508, at 71,980 (W.D. Mo. 1977).

Accordingly, with respect to the adequacy of the relief secured by the decree, a court may not "engage in an unrestricted

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[3] 119 Cong. Rec. 24598 (1973). See United States v. Gillette Co., 406 F. Supp. 713, 715 (D. Mass.1975). A "public interest" determination can be made properly on the basis of the Competitive Impact Statement and Response to Comments filed pursuant to the APPA. Although the APPA authorizes the use of additional procedures, 15 U.S.C. § 16(f), those procedures are discretionary. A court need not invoke any of them unless it believes that the comments have raised significant issues and that further proceedings would aid the court in resolving those issues. See H.R. 93-1463, 93rd Cong. 2d Sess. 8-9, reprinted in (1974) U.S. Code Cong. & Ad. News 6535, 6538.

evaluation of what relief would best serve the public." United States v. BNS, Inc., 858 F.2d 456, 462 (9th Cir. 1988) quoting United States v. Bechtel Corp., 648 F.2d 660, 666 (9th Cir.), cert. denied, 454 U.S. 1083 (1981). See also United States v. Microsoft, 56 F.3d 1448 (D.C. Cir.1995). Precedent requires that:

> the balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is "within the reaches of the public interest." More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.[4/]

The proposed Final Judgment, therefore, should not be reviewed under a standard of whether it is certain to eliminate every anticompetitive effect of a particular practice or whether it mandates certainty of free competition in the future. Court approval of a final judgment requires a standard more flexible

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[4] United States v. Bechtel, 648 F.2d at 666 (citations omitted)(emphasis added); see United States v. BNS, Inc., 858 F.2d at 463; United States v. National Broadcasting Co., 449 F. Supp. 1127, 1143 (C.D. Cal. 1978); United States v. Gillette Co., 406 F. Supp. at 716. See also United States v. American Cyanamid Co., 719 F.2d 558, 565 (2d Cir. 1983).

and less strict than the standard required for a finding of liability. "[A] proposed decree must be approved even if it falls short of the remedy the court would impose on its own, as long as it falls within the range of acceptability or is 'within the reaches of public interest.' (citations omitted)." United States v. American Tel. and Tel Co., 552 F. Supp. 131, 150 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983) quoting United States v. Gillette Co., supra, 406 F. Supp. at 716; United States v. Alcan Aluminum, Ltd., 605 F. Supp. 619, 622 (W.D. Ky. 1985).

Moreover, the court's role under the APPA is limited to reviewing the remedy in relationship to the violations that the United States has alleged in the complaint, and does not authorize the court to "construct [its] own hypothetical case and then evaluate the decree against that case." Microsoft, 56 F.3d at 1459. Since "[t]he court's authority to review the decree depends entirely on the government's exercising its prosecutorial discretion by bringing the case in the first place," it follows that the court "is only authorized to review the decree itself," and not to "effectively redraft the complaint" to inquire into other matters that the United States might have but did not pursue. Id.

VIII.

DETERMINATIVE MATERIALS/DOCUMENTS

The Department considers the SEC Order to be a determinative document within the meaning of Section (b) of the APPA, 15 U.S.C.§ 16(b). As noted above, the Department determined that various corrective actions needed to prevent the recurrence of the agreement alleged in the Complaint and to promote competition could best be addressed by the SEC. Absent the SEC Order, the Department would have included additional corrective actions in this settlement. Accordingly, the SEC Order will be filed with this Final Judgment.

Dated: September 11, 2000

Respectfully submitted,

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 43268 / September 11, 2000

Administrative Proceeding
File No. 3-10282

In the Matter of	:	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 19(h)(1) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS
CERTAIN ACTIVITIES OF	:	
OPTIONS EXCHANGES	:	

I.

The Securities and Exchange Commission ("Commission") deems it appropriate, in the public interest, and for the protection of investors that public administrative proceedings be instituted pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934 ("Exchange Act") against respondents American Stock Exchange LLC, Chicago Board Options Exchange, Inc., Pacific Exchange, Inc. and Philadelphia Stock Exchange, Inc. In anticipation of this proceeding, the respondents have submitted Offers of Settlement which the Commission has determined to accept. Solely for the purposes of this proceeding and any other proceeding brought by or on behalf of the Commission or to which the Commission is a party, and prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 et seq., the respondents, by their Offers of Settlement, without admitting or denying the Commission's findings except those contained in Section III. A. below, which are admitted, consent to the entry of this Order Instituting Public Administrative Proceedings, Making Findings and Imposing

Remedial Sanctions.

II.

Accordingly, IT IS HEREBY ORDERED that proceedings pursuant to Section 19(h)(1) of the Exchange Act be, and they hereby are, instituted.

III.

On the basis of this Order and the Offers of Settlement submitted by the respondents, the Commission finds[1] that:

A. RESPONDENTS

1. The American Stock Exchange LLC

The American Stock Exchange LLC ("AMEX") is located in New York, New York. The AMEX is registered with the Commission as an exchange pursuant to Section 6 of the Exchange Act.

2. The Chicago Board Options Exchange, Inc.

The Chicago Board Options Exchange, Inc. ("CBOE") is located in Chicago, Illinois. The CBOE is registered with the Commission as an exchange pursuant to Section 6 of the Exchange Act.

3. The Pacific Exchange, Inc.

The Pacific Exchange, Inc. ("PCX") is located in San Francisco, California and Los Angeles, California. Options trading on the PCX is conducted in its San Francisco facilities. The PCX is registered with the Commission as an exchange pursuant to Section 6 of the Exchange Act.

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[1] The findings herein are made pursuant to the respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding. Moreover, the findings made herein do not affect any respondent's rights in any respect as to parties other than the Commission.

4. The Philadelphia Stock Exchange, Inc.

The Philadelphia Stock Exchange, Inc. ("PHLX") is located in Philadelphia, Pennsylvania. The PHLX is registered with the Commission as an exchange pursuant to Section 6 of the Exchange Act.

B. OVERVIEW

The Commission, in its oversight of the options exchanges, has investigated significant issues relating to the competitiveness of the options market and the fulfillment by the options exchanges of their obligations as self-regulatory organizations. Section 19(g) of the Exchange Act obligates registered exchanges to comply with their own rules and to enforce compliance with their own rules by their members and persons associated with their members. The options exchanges have significantly impaired the operations of the options market by (a) following a course of conduct under which they refrained from multiply listing a large number of options; and (b) inadequately discharging their obligations as self-regulatory organizations by failing adequately to enforce compliance with (i) certain of their rules, including order handling rules, that promote competition as well as investor protection, and (ii) certain of their rules prohibiting anticompetitive conduct, such as harassment, intimidation, refusals to deal and retaliation directed at market participants who sought to act competitively. In addition, the options exchanges each have inadequately discharged their obligations as self-regulatory organizations by failing to enforce compliance with their trade reporting rules, which promote transparency of the market and facilitate surveillance and enforcement of other exchange rules and the federal securities laws. These matters are discussed below.

C. THE RESPONDENT EXCHANGES' IMPEDIMENTS TO MULTIPLE LISTING OF OPTIONS

1. Respondents Followed a Course of Conduct that Limited Multiple Listing

Rule 19c-5 under the Exchange Act[2] incorporates into the rules of all exchanges a prohibition against any "rule, stated policy, practice or interpretation" that prohibits or conditions the listing of any stock option class listed on another exchange.

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[2] 17 C.F.R. § 240.19c-5.

The respondent options exchanges failed to comply with Rule 19c-5 as incorporated into their rules, by following a course of conduct under which they refrained from multiply listing certain options listed on a single exchange that were available for multiple listing.[3] In this connection, the respondents engaged in certain courses of conduct that hindered, discouraged or prevented the multiple listing of these exclusively listed options, including, among other things, the following:

a. The respondents maintained (i) an improper interpretation of procedures for the listing of options that impeded the multiple listing of options, and (ii) improper limitations on the listing of options that hindered the multiple listing of options of merged entities;

b. Certain respondents improperly deterred efforts by their members to have the respondents multiply list options; and

c. Certain respondents utilized their voting power in the Options Price Reporting Authority ("OPRA"), which provides for the transmission of quotations and trade reports from the options market to vendors for dissemination to the public, in an improper effort to limit transmission capacity in order to hinder and discourage multiple listing of an option.

These activities are discussed below.

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[3] For purposes of determining whether the exchanges violated Section 19(g) of the Exchange Act and Rule 19c-5 as incorporated into their rules, the Commission need not determine, and does not in this Order decide, whether or not this course of conduct was pursuant to an agreement among them. The conduct was inconsistent with Rule 19c-5 as incorporated into their rules either way. However, nothing stated herein would be inconsistent with a finding that the exchanges have engaged in collective conduct.

2. Respondents Impeded Competition in Multiple Listing

a. Respondents' Interpretation of the Joint-Exchange Options Plan Inhibited the Multiple Listing of Options

On September 17, 1991, the Commission approved the Joint-Exchange Options Plan (the "Joint Plan"), which set forth procedures governing the listing of new options. The Joint Plan did not restrict the multiple listing of options that were already exclusively listed at the time of the plan's adoption. The respondent exchanges participated in communications with each other about the meaning of the Joint Plan after it was authorized by the Commission, which led to their interpretation that the absence of procedures regarding the exclusively listed options prevented them from multiply listing any of the exclusively listed options. This interpretation of the Joint Plan improperly created a barrier to the multiple listing of options.

b. Respondents' Course of Conduct Impaired the Multiple Listing of Options for Merged Entities

The respondent exchanges followed a course of conduct that impaired the multiple listing of options of merged entities. In general, when a public company acquired another public company, both of which had options for their securities exclusively listed on different exchanges, the respondent exchange on which options for the acquiring company were listed would thereafter list the options for the merged entity. The respondent exchange on which the options for the acquired company had been listed would refrain from listing the options of the merged entity.

When the respondent exchanges listing the options for the acquiring and acquired companies disagreed about which of them should list the options for the merged entity, the exchanges followed a procedure for resolving the disagreement that resulted in only one of the two exchanges listing the option for the merged entity, thereby improperly limiting competition in listings.

c. Respondents Discouraged Competitive Action by Their Members

Member firms of certain of the respondent exchanges made proposals to multiply list options. In order to avoid or defer multiple listing, the respondent exchanges rebuffed or denied these proposals without an adequate basis in their rules and, in some instances, threatened or harassed member firms who made the proposals.

d. Certain Respondents Acted Through OPRA to Limit Transmission Capacity

OPRA provides for the transmission of quotation and trade data from the options exchanges to vendors that disseminate such data to public subscribers. OPRA historically has contracted with a third party for transmission capacity. The transmission capacity is quantitatively limited at any given point in time. In June 1998, the options exchanges met at OPRA to discuss the possibility of accelerating the expansion of their transmission capacity. Certain of the respondents voted against the acceleration in order to prevent the multiple listing of an option. This resulted in a tie vote and the planned capacity expansion was not accelerated. The results of the vote in this instance allowed the facilities of OPRA to be used improperly to discourage multiple listing of an option.

e. In August 1999, the Respondent Exchanges Began to Multiple List Options

In August 1999, and soon thereafter, the respondent exchanges initiated multiple listing of a number of formerly exclusively listed options.

D. THE RESPONDENT EXCHANGES' PERFORMANCE AS SELF-REGULATORY ORGANIZATIONS

The Exchange Act requires the respondents, as registered exchanges, to conduct oversight of their members and their markets.[4] In conducting such oversight, the respondents must comply with, and vigorously enforce, in an evenhanded and impartial manner, the provisions of the Exchange Act, the rules and regulations thereunder and their own rules. The respondents have the affirmative obligation to be vigilant in surveilling for and taking effective enforcement action to address violations of such provisions.

The respondents have not satisfied their obligations under the Exchange Act to enforce their rules and the federal securities laws, in that they have inadequately surveilled their markets for potential violations, failed to conduct thorough investigations when needed, and failed adequately to enforce rules applicable to members on their floors. As a result of these regulatory deficiencies, the respondents have violated the Exchange Act. In addition, the respondents have not adequately

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[4] Sections 19(g) and 19(h) of the Exchange Act, 15 U.S.C. §§ 78s(g) and 78s(h).

addressed issues of competition that have arisen in their markets. The respondents' regulatory deficiencies are discussed at greater length below.

1. Respondents Have Engaged in Inadequate Enforcement of Order Handling Rules, Policies or Procedures

The respondents failed effectively to enforce compliance by their members with exchange rules, policies or procedures relating to order handling. More specifically, the respondents have failed effectively to surveil for, or take appropriate action with respect to evidence of, violations of priority rules,[5] firm quote rules,[6] and limit order display rules, policies or procedures[7]. Respondents generally lack automated surveillance systems, and rely too heavily on complaints to detect potential violations. In addition, when violations were uncovered, respondents, in many instances, did not take appropriate enforcement action. In many other instances, if enforcement action was taken, respondents did not impose sanctions adequate to provide reasonable deterrence against future violations. As a result of these deficiencies in surveillance and enforcement, the respondents did not adequately enforce their order handling rules.

2. Respondents Have Permitted Deficiencies in Trade Reporting

The respondents failed effectively to enforce compliance by their members with exchange trade reporting rules. The respondents have conducted either no automated surveillance, or inadequate automated surveillance, of trade reporting. Their existing surveillance processes have been inadequate to ensure compliance with their trade reporting rules. As a consequence, the respondents failed adequately to detect noncompliance by their members.

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[5] With certain exceptions, priority rules generally require that a customer limit order be executed before any other orders if it has the best price (*i.e.*, highest bid or lowest offer). If there is more than one order at the best price, the customer order that arrived at the trading post first has priority.

[6] Firm quote rules require specialists or market makers to trade specified minimum numbers of options at the prices they quote.

[7] The exchanges' limit order display rules, policies or procedures generally require that customer limit orders that are priced better than the highest bid or lowest ask price otherwise quoted on the exchange be displayed in the quotations.

The respondents applied their trade reporting requirements in a manner that often allowed trades not to be reported in a sufficiently prompt manner or they utilized surveillance parameters that were not sufficiently comprehensive to adequately detect noncompliance with the rules. The inadequacies of the respondents' application of their trade reporting rules and surveillance for rule violations have undermined effective enforcement of those rules. Ensuring reliable trade reporting enhances the transparency of the markets and effective surveillance and enforcement with respect to order handling and other rules.

3. Respondents Have Failed Appropriately to Enforce Rules Relating to Harassment and Intimidation of Members

The respondents have failed adequately to surveil for, or take appropriate action with respect to evidence of, harassment and intimidation of members who acted competitively or sought to act competitively. Certain members on the floors of the respondent exchanges who competed or sought to compete on certain occasions have indicated that they have been subjected to harassment, intimidation, refusals to deal and retaliation by other participants on the floors of the respondent exchanges. The indicated harassment, intimidation, refusals to deal and retaliation were, in various instances, verbal, economic or physical conduct, and could violate exchange rules.

The respondents' surveillance for such improper conduct was deficient, in that it relied on complaints and the observations of limited numbers of floor officials. The respondents did not have effective means of surveillance for refusals to deal or economic retaliation. The respondents also responded inadequately to indications of rule violations that were brought to their attention. In some instances, floor officials overlooked indications of rule violations by, or addressed them selectively against, some members, but not others. In a number of instances, the respondent exchanges did not investigate or failed adequately to investigate allegations of harassment, intimidation, refusals to deal and retaliation.

In addition, the respondents have not taken appropriate steps to inquire into quoting activities on their markets. Bid-ask quotations made on respondents' markets have frequently been at the maximum allowable bid-ask spreads.[8] The frequency of maximum spreads may indicate anticompetitive conduct. The respondents have not

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[8] The "bid-ask" spread is the difference between the highest quoted bid price and the lowest quoted ask price. The respondent exchanges have rules prescribing maximum spreads that can be quoted for options.

adequately surveilled or investigated for anticompetitive conduct that may be indicated by the high frequency of maximum spreads.

E. CONCLUSION

Based upon the foregoing, the Commission finds that during the relevant period the AMEX, CBOE, PCX and PHLX failed to comply with certain of their rules, including, among others, Rule 19c-5 promulgated under the Exchange Act, and, without reasonable justification or excuse, failed to enforce compliance with certain of their own rules, in violation of Section 19(g) of the Exchange Act.

IV.

In view of the foregoing, it is appropriate, in the public interest, and for the protection of investors to impose the sanctions specified in the Respondents' Offers of Settlement.

Accordingly, IT IS HEREBY ORDERED THAT:

A. The AMEX, CBOE, PCX and PHLX be, and hereby are, censured.

B. The AMEX, CBOE, PCX and PHLX comply with the following undertakings within the time frames specified below, or such longer times as are (a) provided by further order of the Commission or (b) approved in writing by the Directors of the Commission's Division of Enforcement, Division of Market Regulation and Office of Compliance Inspections and Examinations:

a. No later than four months after the date of this Order, each respondent exchange shall, acting jointly with all other options exchanges, amend the Joint-Exchange Options Plan (the "Joint Plan"), so as to: (i) eliminate advance notice to any other exchange, alternative trading system, or other trading venue that lists options issued by the Options Clearing Corporation (collectively referred to herein as "markets") of the intention to list a new option; (ii) eliminate advance notice to any other market of the intention to list an existing option, except for not more than one business day's notice to any other market that already lists or has applied

to list the option in question; (iii) eliminate any provisions of the Joint Plan (other than any advance notice provision permissible under (ii) of this subsection) that prevent a market from commencing to list or trade any option listed on another market or an option that another market has expressed an intent to list; (iv) eliminate any provisions of the Joint Plan allowing one market to prevent or delay another market from listing an option; and (v) eliminate any provisions of the Joint Plan that allow one market to delay the commencement of trading of an option by another market. Nothing in this subsection shall prohibit any exchange from providing (a) not more than one business day's notice to the Options Clearing Corporation of the exchange's intention to list an existing option, or (b) reasonable advance notice to the Options Clearing Corporation of the exchange's intention to list a new option. As part of its compliance with this undertaking, each respondent exchange shall, acting jointly with all other options exchanges, discuss, develop, and provide to the Commission staff, no later than 60 days after the date of the Order, draft proposed amendments to the Joint Plan that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder and which would be, if approved by the Commission, sufficient to effect the changes required by this undertaking; provided, however, that in the absence of joint agreement after a good faith effort to reach joint agreement, each respondent exchange shall individually provide to the Commission staff, no later than 90 days after the date of the Order, draft proposed amendments reasonably designed to effect the changes required by this undertaking.

b. No later than six months after the date of this Order, each respondent exchange shall adopt new, or amend existing, rules that establish formal procedures for exchange members (whether specialists, Designated Primary Market Makers, Lead Market Makers, or others) to submit proposals for such respondent exchange to list particular options classes (whether or not such options are already traded on any other exchange), which shall (i) specify the criteria to be considered by such respondent exchange in deciding whether or not to approve such proposals, or in placing

conditions or limitations, if any, on the approval of such proposals; (ii) provide for a reasonable time frame in which such proposals will be reviewed and decisions thereon made; (iii) require such respondent exchange to respond in writing to any proposal that is denied or which is subject to conditions or limitations, and specify in such written response the bases for the denial or the conditions or limitations; and (iv) in such new or amended rules, or in code of conduct provisions approved by the Commission, prohibit any member, officer, director, governor, employee, committee member or agent of such respondent exchange, or any other person or entity subject to its jurisdiction, from threatening, harassing or retaliating against any person or entity in any way because (aa) of a listing proposal made by such person or entity to any exchange or other market; (bb) of such person's or entity's advocacy or proposals concerning listing or trading on any exchange or other market; or (cc) such person or entity commences to make markets in or trade any option on any exchange or other market.[9] Actions taken by the respondent exchanges in accordance with rules filed with and approved by the Commission pursuant to Section 19 of the Exchange Act shall not be deemed to be threats, harassment or retaliation for the purposes of this undertaking. As part of its compliance with this undertaking, each respondent exchange shall provide to the Commission staff, no later than 120 days after the date of the Order, draft proposed rules, rule amendments, and/or code of conduct provisions, that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder and which would be, if approved by the Commission, sufficient to effect the changes required by this undertaking.

c. Each respondent exchange shall act jointly with all other options exchanges to amend the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information ("Plan") no later than one year after the date of

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[9] The AMEX and the CBOE have adopted new, or amended existing, rules required by this undertaking IV.B.b.(iv).

this Order, so as to modify the structure and operation of the Options Price Reporting Authority ("OPRA") in a manner that (i) establishes a system for procuring and allocating options market data transmission capacity ("capacity") that eliminates joint action by the participants in OPRA in determining the amount of total capacity procured and the allocation thereof, and provides that each participant in OPRA will independently determine the amount of capacity it will obtain; (ii) establishes a system for gathering and disseminating business information from and to participants of OPRA such that all nonpublic information specific to a participant in OPRA shall remain segregated and confidential from other participants (except for information that may be shared in connection with activities permitted under Section 3.c.(iii) hereof); and (iii) sets forth a statement of OPRA's functions and objectives, as permitted under the Exchange Act, and provides for rules and procedures that limit any joint action with respect to OPRA by the participants in OPRA to circumstances in which such joint action is necessary in order to fulfill the stated functions and objectives. As part of its compliance with this undertaking, each respondent exchange shall, acting jointly with all other options exchanges, discuss, develop, and provide to the Commission staff, no later than six months after the date of the Order, draft proposed amendments to the Plan, pursuant to and in compliance with Section 11A of the Exchange Act, which would be, if approved by the Commission, sufficient to effect the changes detailed above in this undertaking no later than one year from the date of this Order; provided, however, that in the absence of joint agreement after a good faith effort to reach joint agreement, each respondent exchange shall individually provide to the Commission staff, no later than seven months after the date of the Order, draft proposals reasonably designed to effect the changes required by this undertaking.

d. Pursuant to Section 17(b) of the Exchange Act and Rule 17a-1(c) promulgated thereunder, each respondent exchange shall simultaneously provide to the Directors of the Divisions of Enforcement and Market Regulation, and of the Office of Compliance Inspections and Examinations, all

reports and documents provided by such respondent exchange to the Antitrust Division of the U.S. Department of Justice ("D.O.J.") pursuant to such respondent exchange's settlement of a civil action instituted by D.O.J. substantially contemporaneously with the institution of this proceeding.

e. Each respondent exchange shall, acting jointly with all other options exchanges, design and implement a consolidated options audit trail system ("COATS"), as specified below, that will enable the options exchanges to reconstruct markets promptly, effectively surveil them and enforce order handling, firm quote, trade reporting and other rules. Specifically, each respondent exchange, acting jointly with all other options exchanges, shall: (i) no later than six months after the date of the Order, synchronize its trading and supporting systems time clocks with all other options exchanges; (ii) no later than nine months after the date of the Order, design and implement a method to merge all options exchanges' reported and matched transaction data on a daily basis and disseminate this merged data among all options exchanges using a uniform computer-readable format (the "common computer format"); (iii) no later than twelve months after the date of the Order, incorporate its own quotes and the National Best Bid and Offer as displayed in its market with the merged transaction data ("merged transactions and quotations data") in such a manner that it could be promptly retrieved and readily merged in the common computer format with other options exchanges' merged transactions and quotations data; (iv) no later than eighteen months after the date of the Order, design and implement an audit trail that provides an accurate, time-sequenced record of electronic orders, quotations, and transactions on such respondent exchange, beginning with the receipt of an electronic order by such respondent exchange, and further documenting the life of the order through the process of execution, partial execution, or cancellation of that order, which audit trail shall be readily retrievable in the common computer format; and (v) no later than twenty-four months after the date of the Order, incorporate into the audit trail all non-electronic orders (such that the audit trail provides an accurate, time-

sequenced record of electronic and other orders, quotations and transactions on such respondent exchange, beginning with the receipt of an order by such respondent exchange and further documenting the life of the order through the process of execution, partial execution, or cancellation of that order, which audit trail shall be readily retrievable in the common computer format. Concurrently with the design of each part of COATS, each respondent exchange shall also design effective surveillance systems, or effectively enhance existing surveillance systems, to use the newly available COATS data to enforce the federal securities laws and such exchange's rules, and shall promptly implement such surveillance systems after implementing the corresponding part of COATS. As part of its compliance with this undertaking, each respondent exchange shall, acting jointly with all other options exchanges, discuss, develop and provide to the Commission staff, at least 90 days before the respective deadlines for items (i) through (v) above, a draft proposed plan, or draft proposed rules or rule amendments relating to the item that is the subject of the deadline which comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder, and which would be, if approved by the Commission, sufficient to effect the changes required by each of these items; provided, however, that in the absence of joint agreement after a good faith effort to reach joint agreement, each respondent exchange shall individually provide to the Commission staff, at least 60 days before the deadlines above, a draft proposed plan, or draft proposed rules or rule amendments reasonably designed to effect the changes required by each of those items of this undertaking.

f. Each respondent exchange shall promptly enhance and improve its surveillance, investigative and enforcement processes and activities with respect to options order handling rules, including, the duty of best execution with respect to the handling of orders after the broker-dealer routes the order to such respondent exchange, compliance with limit order display rules, priority rules, trade reporting and firm quote rules.

g. No later than six months after the date of this Order, each respondent exchange shall adopt new, or amend existing, rules that require trades to be reported within 90 seconds, or less, of the time of execution of the trade. As part of its compliance with this undertaking, each respondent exchange shall provide to the Commission staff, no later than 120 days after the date of the Order, draft proposed rules or rule amendments that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder and that would be, if approved by the Commission, sufficient to effect the changes required by this undertaking.[10]

h. Each respondent exchange shall:

(i) no later than one year after the date of this Order, adopt new, or amend existing, rules concerning its automated quotation and execution systems which (aa) substantially enhance incentives to quote competitively and substantially reduce disincentives for market participants to act competitively; and (bb) specify the circumstances, if any, under which automated execution systems can be disengaged or operated in any manner other than the normal manner set forth in the exchange's rules and require the documentation of the reasons for each decision to disengage an automated execution system or operate it in any manner other than the normal manner. As part of its compliance with this undertaking, each respondent exchange shall provide to the Commission staff, no later than six months after the date of the Order, draft proposed rules or rule amendments that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder and that would be, if approved by the Commission, sufficient to effect the changes required by this undertaking.

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[10] The AMEX, the CBOE and the PHLX have adopted new, or amended existing, rules required by this undertaking IV.B.g.

(ii) no later than six months after the date of this Order, adopt rules, rule amendments or interpretations, or code of conduct provisions approved by the Commission, that expressly prohibit harassment, intimidation, refusals to deal and retaliation by exchange members, or by officers, directors, governors, employees, committee members, and other officials and agents of such exchange, against exchange members or other market participants for acting, or seeking to act, competitively. As part of its compliance with this undertaking, each respondent exchange shall provide to the Commission staff, no later than 120 days after the date of the Order, draft proposed rules, rule amendments or interpretations, and/or code of conduct provisions, that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder and that would be, if approved by the Commission, sufficient to effect the changes required by this undertaking.[11]

(iii) promptly enhance and improve its surveillance, investigative and enforcement processes and activities with a view to preventing and eliminating (aa) harassment, intimidation, refusals to deal and retaliation against market participants for acting competitively, or seeking to act competitively, and (bb) other anticompetitive conduct.

i. No later than one year after the date of this Order, each respondent exchange shall adopt rules establishing, or modifying existing, sanctioning guidelines such that they are reasonably designed to effectively enforce compliance with such exchange's options order handling rules, including, the duty of best execution with respect to the handling of orders after the broker-dealer routes the order to such respondent exchange, limit order display, priority, firm quote, and trade reporting rules. As part of its

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[11] The AMEX and the CBOE have adopted new, or amended existing, rules required by this undertaking IV.B.h.(ii).

compliance with this undertaking, each respondent exchange shall provide to the Commission staff, no later than nine months after the date of the Order, draft proposed rules or rule amendments that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder and that would be, if approved by the Commission, sufficient to effect the changes required by this undertaking.

j. No later than twelve months after the date of this Order, each respondent exchange shall adopt new, or amend existing, rules to include any practice or procedure, not currently authorized by rule, whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class, or the allocation of orders in that option class. As part of its compliance with this undertaking, each respondent exchange shall provide to the Commission staff, no later than six months after the date of the Order, draft proposed rules or rule amendments that comply with Section 19 of the Exchange Act and Rule 19b-4 thereunder that would be, if approved by the Commission, sufficient to effect the changes required by this undertaking. Each respondent exchange shall take all reasonable steps within six months after the date of this Order to promptly stop any other such practice or procedure if neither it nor a related practice or procedure that would supersede the existing practice or procedure, has been submitted to the Commission for approval or is not already authorized by rule.

k. The rule changes adopted pursuant to these undertakings shall not preclude a respondent exchange from exercising or enforcing an intellectual property right in an option, or a license of an intellectual property right in an option, if another exchange proposes to list or has listed the option and such respondent exchange has a good faith belief that the intellectual property right or license thereof exists and the action taken is consistent with the federal securities laws and the Commission's rules, regulations and orders.

l. The respondent exchanges shall, for each of calendar 2000 and 2001, expend for options-related surveillance systems and for staffing in the areas of options-related surveillance, investigation and enforcement, an annual amount that equals or exceeds: (a) $11 million, in the case of the AMEX; (b) $17 million, in the case of the CBOE; (c) $6.5 million, in the case of the PCX; and (d) $4 million in the case of the PHLX.[12] This undertaking shall be deemed fulfilled if the average annual amount of a respondent exchange's expenditures in calendar 2000 and 2001 required by this undertaking equals or exceeds such respondent exchange's annual amount specified earlier in this undertaking. The fulfillment of this undertaking will not necessarily be deemed sufficient to satisfy any other undertakings in this Order and the fulfillment of all other undertakings shall be determined independently of the fulfillment of this undertaking.[13]

m. Each respondent exchange shall, on the first three anniversaries after the date of the Order, provide to the Directors of the Divisions of Enforcement and Market Regulation, and of the Office of Compliance Inspections and Examinations, affidavits or affirmations, detailing its progress in implementing undertakings 3.f., 3.h.iii., and 3.l.

n. In evaluating a respondent exchange's compliance with these undertakings, the Commission will consider: (i) any rule proposals filed by such respondent exchange since August 1, 1999, or any rules adopted by such respondent exchange since August 1, 1999, which are relevant to the

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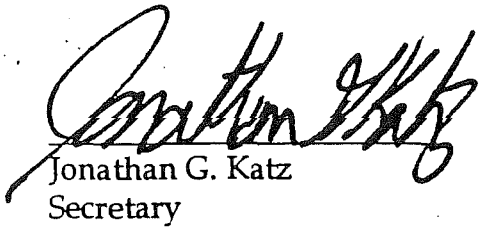
[12] The amounts specified for each respondent do not reflect any determination of a respondent's relative degree of culpability with respect to the conduct alleged in the Order.

[13] If, over the course of calendar 2000 or 2001, the Board of Governors or Directors of a respondent exchange believe that the specified expenditures are not achievable or feasible, or are unwarranted in light of changed circumstances, such respondent exchange may, by application to the Commission, seek modification of this undertaking.

purposes of any of the undertakings; and (ii) any and all steps taken since August 1, 1999 by such respondent exchange to enhance and improve its surveillance, investigative and enforcement processes and activities in any manner relevant to the purposes of any of the undertakings. The Order specifically notes any instances in which the rules previously proposed and adopted by a respondent exchange, or the steps previously taken by a respondent exchange to enhance and improve its surveillance, investigative and enforcement processes and activities, shall be deemed to have fulfilled a particular undertaking.

By the Commission.



Jonathan G. Katz
Secretary