

Date: December 10, 1997
To: Membership
From: Competition Task Force
Re: Collusion, Harassment and Intimidation

The Securities and Exchange Commission's ("SEC or Commission") 1996 investigation and report concerning the operations and activities of the NASD, paid considerable attention to conduct by NASD members described as involving collusion, harassment and intimidation for the purpose of limiting competition in the Nasdaq market. Specifically, the so-called pricing convention and size convention on Nasdaq (which had as their objectives maintaining artificially wide spreads between the bid and ask for Nasdaq stocks) were allegedly created by collusion among Nasdaq market makers, and were enforced by harassing and intimidating those market makers who did not adhere to these conventions. These practices were characterized by the SEC as inconsistent with the "free and open" market contemplated by the Securities Exchange Act of 1934, and were found to be suggestive of other significant underlying problems in the Nasdaq market. In the context of the NASD investigation and report, it was clear that collusion, harassment and intimidation had as their goal the reduction of competition in the Nasdaq market, and the subordination of the interests of investors to the self interest of the market makers who engaged in this anti-competitive behavior.

Following the publication of the SEC's NASD report, CBOE's Office of the Chairman designated a special Competition Task Force, consisting of senior members of the Exchange, to consider the extent of competition on the CBOE and to make recommendations for enhancing that competition. Among other things, the Task Force focused on collusion, harassment and intimidation, with the goal of eradicating any such anti-competitive behavior that might occur on CBOE.

Having completed its review, the Task Force has determined to issue this circular as a reminder to all members that *collusion, intimidation and harassment are strictly prohibited on CBOE and cannot be permitted to take place*. Such activities are considered to be conduct inconsistent with just and equitable principles of trade in violation of Exchange Rule 4.1, subjecting persons engaging in such activities to disciplinary action by the Business Conduct Committee. Among the prohibited activities are agreements or understandings among members not expressly provided for in the Rules that have as their intended purpose or effect the lessening of

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competition on the Exchange, as well as any expressions or other acts intended to discourage a

member from making competitive markets in a manner permitted by the Rules. Although it is not possible to describe each type of conduct that constitutes impermissible collusion, intimidation or harassment, a few examples might help to illustrate the kind of conduct that is prohibited.

1. In ordinary circumstances, market makers in a trading crowd may not attempt to agree among themselves what the market for a particular series of options “ought to be” and should not otherwise discuss how each market maker intends to fulfill his/her individual obligation as a market maker. This does not preclude market makers from coordinating a response to a request emanating from outside the trading crowd for a market “in size” that cannot reasonably be filled promptly and efficiently in the absence of such coordination.
2. More experienced market makers may not attempt through intimidation to limit the ability of less experienced market makers to improve the quoted market, so long as the less experienced market makers enter bids and offers in a manner consistent with the requirements of the Rules. Thus, a market maker must be permitted to enter a quote in the minimum size allowed under the Rules, even if the trading crowd has committed to honor the quoted market for more than the minimum size.
3. Floor members may not harass other members or threaten reprisals in order to discourage a member from asserting the right to participate in a transaction in accordance with the rules of time and price priority that govern such participation.
4. Members may not refuse to deal with other members, or threaten such refusal, as a means of discouraging the other members from making competitive markets.
5. Members may not harass other members by asking them for their markets more frequently than can be justified by the legitimate trading interest of the requesting member.

Persons who are aware of anti-competitive collusion or who believe they have been subjected to anti-competitive harassment or intimidation should promptly report their concern to appropriate Floor Officials, TFL personnel or the Department of Market Regulation. The Exchange must be advised immediately of any instance of alleged improper behavior in order to act promptly and decisively to prevent the abusive behavior from continuing.

Questions concerning the issues raised in this memorandum may be directed to Edward L. Provost, Operations Planning Division, at (312) 786-7717.