

floors which would not be available to all, they would have tremendous communications and informational advantages over market-makers on other exchanges. 449/

With respect to these communications and informational advantages,

AMEX has observed:

It is not necessary for a market maker or floor trader to simultaneously observe both markets personally (although that most likely would be possible on the NYSE floor to the extent that options are traded in its equity trading area) in order to achieve such trading advantages. By being physically present in the trading crowd for an underlying stock, a individual can gain valuable market information which he can promptly use in making decisions concerning his trading activities in the related option, and he can implement those decisions prior to the public dissemination, if any, of the market information he has obtained.

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[Moreover,] individual members need not act alone in order to take advantage of market information gained on the floor of an exchange which conducts both options and equities

(footnote continued)

have to utilize more space on its equity trading floor or expand such trading floor by incorporating additional space adjacent thereto. Moreover, even though most of the original twenty-five options are to be traded in a separate, adjacent room, it is our understanding that the NYSE contemplates that all specialists, market makers, floor traders and floor brokers will have equal and unlimited access to both the equity trading area, the "option room" and any other room or area in which either equities or options may be traded in the future. The "ceiling-high solid wall" will apparently be quite permeable, or else readily avoidable by some easily accessible detour.

AMEX Letter, supra, n.90, at 27-29.

449/ Id., at 40 (footnote omitted).

trading. Through cooperation between partners in the same firm, or between independent members who find it convenient and profitable to engage in joint trading efforts, the market intelligence gained from observing the trading crowd in an underlying stock can be transmitted speedily and effectively to a floor trader or market maker standing by at the option post, and vice-versa. Direct oral communications, use of hand signals, sending messages via clerks--these and other means of intra-floor communications will assure that market information which can be of value in making trading decisions is speeded from one partner to another, or from one participant in a joint trading venture to another such participant, so that it can be acted upon before the information is disseminated publicly or its impact has been dissipated in the market. 450/

6. NYSE Ability to Attract Talent

In view of NYSE's predominant position in the securities markets generally and the resulting competitive advantages that it may enjoy if permitted to initiate an options trading program, NYSE may be able to attract marketmaking and other talent from other options exchanges. In fact, since the number of individuals with knowledge of options marketmaking and exchange operations may be limited, and since training new personnel may be costly and time-consuming, NYSE may be compelled to recruit experienced personnel from the other options exchanges when building the foundation for its options marketplace. With regard to this possibility, AMEX stated:

A matter of major concern for other exchanges is the fact that it would be possible for the NYSE and its floor members, through offering high salaries,

450/ AMEX Letter, supra, n.90, at 29-32.

bonuses, offers of partnership and other inducements, to lure away the most knowledgeable and experienced options personnel from other exchanges. This would not necessarily be confined to lower echelon employees, but most likely would be concentrated in the area of experienced market making talent. As the best market makers were induced to transfer to the floor of the NYSE, either as a result of attractive offers to join existing firms or through arrangements by clearing firms to provide large amounts of financing, the options markets on other exchanges would deteriorate, thus further impacting adversely on their ability to compete. There would be practically no way in which such "pirating" could be combatted when all of the other advantages that could be offered by the NYSE and its floor members are considered.

Another factor which could have a substantial impact on the shifting of financial resources and personnel is the fact that many firms which are engaged in market making activities on existing options exchanges are also members of the NYSE. For example, 17 Amex specialist firms are members of the NYSE and several of them already engage in marketmaking activities on that floor. If any significant number of these firms determined it was more advantageous to trade options on the NYSE floor because it is the primary market for all of the underlying stocks, they could very easily shift the bulk of their capital and any needed personnel to that floor, and the result could spell virtual disaster for the Amex options program. 451/

While the scope and effect of NYSE's ability to attract experienced options marketmakers and other personnel are, at best, difficult to project, it may be relevant to consider that the six NYSE's specialist

451/ AMEX Letter, supra, n.90, at 23-24. See also n.439, supra, and accompanying text.

firms who are also members of OCC clear and finance the accounts of 132 options marketmakers, some of whom are specialists. In fact, the largest NYSE stock specialist presently clears the options transactions for 88 options marketmakers. 452/

C. Conclusions

1. The Predominant Position of the New York Stock Exchange

In 1977, NYSE attracted more than 85 per cent of the consolidated share volume for all stocks listed on NYSE. 453/ During the first half of 1978, it captured a median of more than 85 per cent of the consolidated share volume of stocks on which listed options were traded. 454/ In addition, "NYSE's total revenues, pre-tax income and net worth [in 1977] were as great as or greater than the comparable amounts for all options exchanges and the NASD combined, and were three to five times as great as any other exchange's." 455/ NYSE also has marketmaking resources which substantially exceed those available to the options exchanges. 456/

452/ Data supplied in response to Options Study Questionnaire. See Chapter VII.

453/ Securities and Exchange Commission Statistical Bulletin, supra, n.403.

454/ Letter to Richard Weingarten from James W. Fuller, supra, n.293.

455/ CBOE Letter, supra, n.87, at 31 (footnotes omitted) (emphasis in original).

456/ See discussion at 212-213, supra.

When evaluating NYSE proposals that contemplate NYSE participation in the multiple trading of standardized options or the integration of trading of options and their underlying securities on the NYSE floor or in connection with NYSE stock marketmaking, the predominant position of NYSE in the stock markets should be considered. To the extent that an NYSE options market, capitalizing on NYSE's financial, marketmaking, facilities, and other resources, as well as NYSE's primary stock market designation and public image as the nation's premier securities market, may attract options order flow and marketmaking talent from the other options exchanges, it may (i) enhance the market fragmentation concerns associated with the multiple trading of standardized options, 457/ (ii) seriously jeopardize the financial viability of the secondary stock exchanges and their ability to participate in the implementation of the Commission's recently announced national market system initiatives, 458/ and (iii) eventually extend NYSE's dominance of the securities markets to options trading and "overwhelm weaker competitors in that market." 459/ Similarly, market information and competitive advantages, opportunities to engage in manipulative and other improper trading practices, potential conflicts in marketmaking obligations,

457/ See discussion at 71-86, supra.

458/ See discussion at 86-92, supra.

459/ CBOE Letter, supra, n.87, at 38. See also n.478 and 479, and accompanying text, infra.

and market surveillance difficulties may be most significant if the integration of stock and options trading is permitted on NYSE because NYSE captures such a large percentage of the volume in underlying securities and uses a unitary specialist stock marketmaking system. 460/

NYSE's predominance in the stock markets, however, is not the only factor that should be considered when evaluating an NYSE proposal to initiate options trading or to integrate the trading of options and their underlying securities. Most significantly, it should be kept in mind that the 1975 Amendments embodied a clear legislative mandate encouraging competition among market centers and marketmakers 461/ and charged the Commission with the primary responsibility "to remove burdens on competition which would unjustifiably hinder the market's natural economic evolution" 462/ and "to refrain from imposing * * * any new regulatory burden on competition 'not necessary or appropriate in furtherance of the purposes' of the Exchange Act." 463/ In addition,

460/ See discussion at 125-138, supra.

461/ See discussion at 8-12, 65-67, supra, and Section 11A(a)(1) of the Exchange Act [15 U.S.C. 78k-1(a)(1)].

462/ Senate Report, supra, n.17, at 12. See also Conference Report, supra, n.18, at 49-51 and House Report, supra, n.21, at 49-51.

463/ Conference Report, supra, n.18, at 94.

Congress sought to assure "economically efficient execution of securities transactions" and "the practicability of brokers executing investors' orders in the best market." 464/

Accordingly, the potential that an NYSE options program or integration proposal may hold for increasing competition among options exchanges and among options marketmakers and for generally improving the quality of the markets for options and their underlying securities should be given serious consideration. NYSE, for instance, maintains:

[I]nstead of focusing on how NYSE entry into the options markets might be prevented or minimized, it is much more relevant to examine why the NYSE should be permitted to compete fairly and equally — and without the burden of anticompetitive restrictions which would apply to it alone.

One crucial consideration is that some portion of the significant aggregate capital resources and pool of market-making and other professional talent now represented on the NYSE trading floor could be made available to help assure that an NYSE options market would be characterized by the highest standards of depth, liquidity and price continuity, and the most effective and efficient execution of the investing public's options orders.

A second consideration is that brokerage firm customers would benefit from the substantial efficiencies that would result from a firm's ability to route customers' combined stock/option orders to a single market center that maintains high-quality markets for both types of securities. From the public investors' standpoint,

464/ Section 11A(a)(1) of the Exchange Act [15 U.S.C. 78k-1(a)(1)].

brokers would be able to handle stock/option contingency orders — i.e., where execution of the options portion of the order is contingent upon the broker's ability to execute the stock portion, or vice versa — more easily and efficiently, with less chance of error, * * *.

[A third consideration is that] if concurrent trading were permitted, specialists * * * and other market makers would be able to use options to hedge stock positions acquired in fulfilling their obligations to the marketplace in the underlying stock. * * * Allowing specialists to use options to hedge stock positions would increase their ability and willingness to commit capital to marketmaking in the underlying stocks. Thus, the end result would be to improve specialist performance and enhance the depth and liquidity of NYSE markets in listed securities. Similar market benefits could be expected to accrue from the ability of competitive traders and registered competitive market-makers to engage in options trading.

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Another important factor as to why the NYSE should be permitted to trade options is the NYSE's experience in developing trading mechanisms designed to maximize the efficient use of available resources. * * * [T]he NYSE has begun developing an improved options routing capability and an automated "book" that, hopefully, would be ready for implementation concurrently with the start-up of the NYSE options program. The NYSE is also looking into other possible computer-supported services which might be introduced to enhance the effectiveness of an NYSE options market at some time after it has gained essential experience in trading standardized options. 465/

As a practical matter, as the national market system for stocks evolves, NYSE's predominant position in the stock markets may not continue, or may continue only to a lesser degree. 466/ As NYSE has stated:

In the rapidly changing environment of the emerging national market system for stocks — an environment that encourages free and open competition among market centers and among their market-makers — there obviously can be no assurance that the historic predominance of the NYSE will continue. In fact, the NYSE's share of the market for listed stocks will be continually and increasingly vulnerable to any competing market center that can achieve higher standards of market-making performance. In terms of the present inquiry, the NYSE will retain its present share of the market for listed stocks — including those which underlie standardized options — only to the extent that it continues to provide the best markets and deserves to retain that share. 467/

Furthermore, while NYSE has financial resources that are considerably greater than those of the options exchanges, it also has considerably greater expenses and financial commitments. Consequently, it may not be able to use these resources, or may only be able to use a portion of them, to gain a competitive advantage in a multiple exchange option

466/ See NYSE Letter, supra, n.85, at 12.

467/ Id., at 13.

trading environment. In this regard, NYSE has noted "a number of extremely relevant considerations:"

First, the NYSE's primary "product" is, always has been, and will continue to be, listed stocks. * * * [Accordingly,] 1977 NYSE expenditures relating to the principal function of maintaining the primary marketplace for listed stocks (and the NYSE market for listed bonds) -- not options -- absorbed almost 90% of total revenues. Thus, while the NYSE's financial position will indeed be an important factor in its ability to risk entering competition in options, and in providing the type of options trading environment that will be most beneficial to public investors, that position does not translate into anything resembling the competitive advantage [that might be] implied * * *.

Second, * * * the NYSE has made a substantial commitment of funds and other resources to the ongoing development of a national market system for stocks. Added to this is the possibility that the NYSE Board of Directors may be asked to authorize a further commitment * * * of some \$9.5 million for modernization of NYSE stock trading facilities. All of these innovations have the same goal: To provide order-routing and operational efficiencies that will reduce costs to NYSE member organizations while enabling them to improve service to public customers. At the same time, it must be noted that the supply of funds for these purposes and, prospectively, for development and maintenance of an NYSE options market, is not * * * unlimited.

Third, options are fast becoming the most important potential revenue-producing product at many of the other exchanges -- and, in the case of the CBOE, of course, options are the only current product. Thus, it is reasonable to expect that other exchanges will continue to allocate substantial portions of their available assets and revenues to operate and improve their individual options trading facilities and capabilities. If NYSE entry into the options business further stimulates such constructive efforts -- as may be anticipated -- then the resulting alterations

in the "form and substance of competition" in options trading * * * will unquestionably improve the quality of options market-making facilities and services available to the investing public. 468/

2. The New York Stock Exchange and the Statutory Dilemma

The 1975 Amendments directed the Commission to "facilitate the establishment of a national market system for securities * * * in accordance with the findings and to carry out the objective set forth in paragraph (1) of [Section 11A(a) of the Exchange Act]." 469/ Section 11A(a)(1) states the Congressional findings that, among other things,

(C) It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure —

(i) economically efficient execution of securities transactions;

(ii) fair competition among brokers and dealers, [and] among exchange markets, * * * [and]

(iii) the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities;

(iv) the practicability of brokers executing investors' orders in the best market * * *. 470/

468/ Id., at 14-15.

469/ Section 11A(a)(2) of the Exchange Act [15 U.S.C. 78k-1(a)(2)].

470/ Id.

One objective of a national market system is to centralize all buying and selling interest for securities included in the system and to encourage all dealers to make simultaneous markets within the national structure. 471/ The system is to "evolve through the interplay of competitive forces as unnecessary regulatory restrictions are removed" 472/ and the Commission is "to remove burdens on competition which would unjustifiably hinder the market's natural economic evolution and to assure that there is a fair field of competition consistent with investor protection in situations in which natural competitive forces cannot, for whatever reason, be relied upon * * *. 473/ The Commission is also to refrain from imposing burdens on competition that are not necessary or appropriate in furtherance of the purposes of the Exchange Act 474/ and to consider whether exchange rule proposals are consistent with the development of a national market system. 475/

Within this statutory context, an NYSE proposal to establish an options trading program may require the Commission to choose among these

471/ See discussion at 8-12, supra.

472/ Conference Report, supra, n.18, at 92.

473/ Senate Report, supra, n.17, at 12. See also House Report, supra, n.21, at 44.

474/ Conference Report, supra, n.18, at 94. See also Sections 6(b)(8), 19(b), 19(c), and 23(a)(2) of the Exchange Act [15 U.S.C. 78f(b)(8), s(b), s(c), and n(a)(2)].

475/ See, e.g., Sections 6(b)(5) and 19(b) of the Exchange Act [15 U.S.C. 78f(b)(5) and s(b)].

competing statutory considerations. The Commission, for example, might choose to preclude NYSE from engaging in options trading under existing circumstances because, among other possible considerations, (i) NYSE's predominant position in the stock markets may gradually be extended to the options markets and result in a diminishing of competition among exchanges and marketmakers in the options markets, (ii) the multiple trading of standardized options involving NYSE may contribute to further fragmentation of the options markets, (iii) competition among options exchanges and options marketmakers involving NYSE may not be fair due to (a) NYSE's financial and marketmaking resources and primary market designation and order flow in securities underlying NYSE listed options and (b) the absence of market linkages and neutral order routing techniques in the options markets, 476/ and (iv) the loss of options order flow to an NYSE options market may threaten the financial well-being of secondary stock exchanges that permit the trading of standardized options and thus the evolution of a national stock market system composed of competing market centers. 477/ Such a decision, however, should be considered in light of the Congressional intent that a national market system "evolve through the interplay of competitive forces" and that the Commission remove burdens on competition. Similarly, the Commission should consider (i) whether, if NYSE is not allowed to engage in options trading, competition among options

476/ See discussion at 71-86, supra, and 257-268, infra.

477/ See discussion at 86-92, supra.

markets and options marketmakers may be reduced or limited; (ii) whether execution efficiencies that NYSE may be able to introduce would be lost; and (iii) whether it would become more difficult for brokers to execute customer orders "in the best market."

On the other hand, the Commission, seeking to enhance competition among options exchanges and marketmakers, to improve the quality of the markets for options and their underlying securities, and to allow market forces to determine the form of a national market system, may decide to permit NYSE to implement an options program. Under existing circumstances, such a decision may enable NYSE to strengthen its pre-dominant position in the stock markets and to assume a similar position in the options markets. As AMEX has stated:

Since the number of equity securities suitable for options trading is limited and options on most of these stocks are already listed and traded on one or more options exchanges, NYSE will have to establish its program principally through dual trading. Unquestionably, this would draw options order flow away from present markets. The combination of NYSE's dominant status in the securities markets generally, its unique position as the primary market in practically all equities suitable for options trading, and the unfair advantages gained from operating an integrated market would very likely establish it quickly as the dominant factor in options as well. The resulting decline in options business flowing to existing markets, their probable loss of market making personnel and capital, and the further strengthening of NYSE's supremacy would result in a major and disruptive restructuring of the securities markets. The viability of options markets on many of the existing exchanges trading options would be seriously threatened. The Amex would be particularly vulnerable because the member firm community has demonstrated that it will not support two exchange markets for a single security in the same geographical location.

Several exchanges already facing substantial financial pressure may find the loss of their options market too large a burden to bear, and be forced either to further reduce their activities or else close entirely. In any event, the result will be a further entrenchment of the NYSE's dominant position in equities, the likelihood of its extending that dominance to options, and a significant weakening of the existing market centers, which at present provide a highly competitive environment for options trading and a degree of competition with the NYSE in equities as well. 478/

Thus, enhanced competition among options exchanges and among options marketmakers on various exchanges in the short term may result in (i) diminished competition among options exchange and options marketmakers and (ii) diminished competition among stock exchanges and stock marketmakers in the longer term. In this regard, CBOE has stated:

Superficially, it might be argued that the NYSE's entry into options trading would enhance, rather than decrease, competition. In purely numerical terms this might be true; the immediate effect of the NYSE's entry into options would be to increase the number of competing exchanges from five to six. But in the absence of multiple trading, there would be no increase in direct competition. If and when expansion of multiple trading is permitted, the NYSE would be in a position to compete head-to-head with one or more much smaller and poorer exchanges lacking the benefits of monopoly power, and that competition is likely to be short-lived at best. The inevitable tendency of the NYSE's entry would be to decrease the possibilities of meaningful competition among the existing options exchanges. 479/

478/ AMEX Letter, supra, n.90, at 5-6.

479/ CBOE Letter, supra, n.87, at 42-43.

This longer term "deterioration of competition" 480/ might be deemed an unnecessary and inappropriate burden on competition 481/ and may impair,

480/ Id., at 43.

481/ It should be noted that principles of antitrust law may be useful guides to the Commission in deliberations concerning whether NYSE entry into standardized options trading should be deemed anti-competitive. Section 2 of the Sherman Act [15 U.S.C. 2], for example, provides that it is unlawful for an entity which dominates one market to use that dominance to affect adversely its competitors in another market. See, e.g., United States v. Aluminum Co. of America, 148 F.2d 416 (C.A.2, 1945); United States v. Griffith, 334 U.S. 100 (1948). Section 7 of the Clayton Act also provides that "no corporation engaged in commerce shall acquire * * * any part of the stock * * * of another corporation * * * where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or tend to create a monopoly," 15 U.S.C. 18. Accordingly, it may be unlawful for a new entrant to a market to threaten, by means of a combination, to entrench an existing market participant by giving it the means to dominate the market. See, e.g., FTC v. Proctor & Gamble Co., 386 U.S. 568 (1967); Allis-Chalmers v. White Consolidated Industries, Inc., 414 F.2d 506 (C.A.3, 1969); United States v. Wilson Sporting Goods Co., 288 F.Supp., 543 (N.D. Ill., 1968). Further, mergers extending a firm's product line that may eliminate the acquiring firm's competitors may violate Section 7 of the Clayton Act. See, e.g., Proctor & Gamble, supra; Kennecott Copper Corp. v. FTC, 467 F.2d 67 (C.A. 10, 1972); Bendix Corp. [1970-1973 Transfer Binder] Trade Reg. Rep. ¶ 19,288 (FTC, 1970). Mergers creating the probability of reciprocal dealing may also run afoul of Section 7. See, e.g., FTC v. Consolidated Foods Corp., 380 U.S. 592 (1965).

Because self-regulatory organization rulemaking proposals are to a large extent immunized from the application of the antitrust laws, the principles of these antitrust cases should be viewed as analytical tools rather than as binding precedent. See Gordon v. New York Stock Exchange, 422 U.S. 659 (1975) and United States v.

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depending on the extent of the deterioration, the Commission's ability to facilitate a national market system for stock or options by reducing the number, resources and capacity of the stock and options market centers and marketmakers to be included in such a system. Moreover, competition among the other options exchanges and NYSE and among options marketmakers on other options exchange and NYSE options marketmakers might be considered unfair under present conditions due to (i) the competitive advantages that NYSE options marketmakers may derive from their preferential access to NYSE's stock market for informational and execution purposes, NYSE's financial and marketmaking resources, and NYSE's order flow and designation as the primary market for underlying stocks, (ii) the absence of communications linkages tying the options markets together and providing options marketmakers on all options exchanges with the opportunity to interact with the order flow for multiply traded classes

(footnote continued)

National Association of Securities Dealers, Inc., 422 U.S. 694 (1975). See also CBOE Letter, supra, n.87, at 42-44; AMEX Letter, supra, n.90, at 66-72; PHLX Letter, supra, n.88, at 10-12; NYSE Letter, supra, n.85, at 16-17; and Letter to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, from James E. Buck, Secretary, NYSE, dated November 29, 1978. A copy of this letter follows the NYSE Letter in Appendix Exhibit 1.

on all exchanges, 482/ and (iii) brokerage firm option order routing practices involving a primary market designation. 483/

3. A Cautious Approach

Should the Commission determine to resolve the statutory dilemma by permitting NYSE to establish an options market, a cautious approach to the initiation of NYSE options trading may alleviate some of the regulatory concerns that such trading may create. Two approaches may be followed. 484/

First, the Commission may take steps to assure that NYSE would begin options trading under circumstances as nearly equal to those prevailing on other exchanges as is practicable. Such steps should be designed to minimize competitive advantages that NYSE may enjoy as a result of its predominant position in the securities markets generally and in underlying securities particularly. For example, when reviewing an NYSE proposal to initiate options trading, the Commission may seek to assure that:

482/ See discussion at 71-74, supra, and 266-268, infra.

483/ See discussion at 52-61, 75-86, supra.

484/ The Commission, of course, would have to approve any NYSE proposal to initiate standardized options trading pursuant to Section 19(b) of the Exchange Act [15 U.S.C. 78s(b)] before such a program could become operational. Notice of the proposed rule change and an opportunity for public comment would also be provided in accordance with that section. During such a proceeding, it may be feasible to explore the viability and ramifications of the alternative approaches set forth above with greater specificity.

1. NYSE stock and options trading floors would be distinct and completely separated by physical barriers; 485/

2. NYSE stock specialist and registered stock market-makers would not be permitted to trade options on their specialty stocks or stocks in which they hold a position except perhaps for the purpose of hedging their stock positions in accordance with a definition of hedging that the Commission has approved; 486/

3. NYSE stock specialists and registered stock market-makers would not have access to the options trading floor, and NYSE options marketmakers would not have access to the NYSE stock trading floor under any circumstances. NYSE stock specialists and registered marketmakers who enter option orders and option marketmakers who enter stock orders would be required to enter such orders in the same manner as other market participants who do not have direct access to the NYSE floor; 487/

4. Quotation and transaction information concerning stock and options trading activity would be transmitted between the NYSE stock and options floors only in the same manner that it is currently disseminated between NYSE and the options exchanges; and

485/ While NYSE does not contemplate side-by-side trading or dual marketmaking at this time, the NYSE Plan clearly expected that option classes would be traded on the main equity floor. See NYSE Letter, supra, n.85, at 1, 19 and discussion at 207, 225-227, supra. See also, e.g., Securities Exchange Act Release No. 11423, supra, n.74.

486/ See discussion at 144-148, supra.

487/ The NYSE Plan did not contain restrictions on the ability of stock and options marketmakers to pass from one trading floor to the other. See discussion at 207, supra.

5. The NYSE options program would be maintained as a separate cost center such that stock revenues and income could not be utilized to subsidize options operations. 488/

Second, NYSE might be permitted to implement an options trading program only at such time as a national market system for options, or certain aspects of such a system are, or are nearly, operational. CBOE, for example, has urged that "further expansion of multiple trading should not be permitted unless and until a national market system or subsystem for options, and the resulting fair field of market competition, have been substantially achieved." 489/ While CBOE admits that "putting off the expansion of multiple trading in options [and thus, NYSE entry into the options markets] until [they] can occur in the context of a national market system suitable for options trading may mean a considerable delay," it also believes that the problems of "not waiting until basic facilities of such a system are operational appear far worse." 490/

488/ NYSE has already stated that its "proposed options market" would be run "as a separate cost center." NYSE Letter, supra, n.85, at 19.

489/ CBOE Letter, supra, n.87, at 10.

490/ Id., at 16. Summarizing these problems, CBOE has stated:

In the absence of a national market system for options, we believe it is clear that multiple trading has had, and if expanded would increasingly have,

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NYSE, on the other hand, has stated:

[T]he NYSE believes there is no reason why the expansion of dual trading of standardized options should be delayed pending further development of a national market system for either stocks or options, or both.

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[T]he Commission has indicated that it expects the national market system to develop in an evolutionary manner, rather than to be established at a predetermined point in time. The NYSE believes this is the correct — indeed, the only possible — approach to a national market system.

The NYSE believes, further, that the public benefits and advantages generally perceived as flowing from a national market system for stocks should be extended to options trading. But whether that objective might be achieved by integrating options trading into a national market system for stocks or by developing a separate national market system for options — or by some other means — is * * * presently unclear.

(footnote continued)

a number of undesirable effects: (1) Multiple trading creates undesirable fragmentation and, at times, disorderliness and confusion in the options markets. (2) Multiple trading confronts brokerage firms doing a public business with very difficult practical and legal problems of "best execution"; these tend to be resolved by the selection of one market as the "primary market" for any given class of options, with a consequent decline in true competition as between that market and all other markets. (3) There does not exist today a fair field of competition among markets, so that multiple trading in the existing circumstances would lead to a long-term decline in competition.

Id., at 10.

What is clear is that public investors should obtain, without unnecessary delay, the benefits and advantages that will result from expanded industry-wide dual trading of standardized options -- including dual trading in an NYSE options market. It is also clear that substantial industry-wide experience with a dual-trading environment must be a prerequisite for meaningful industry-wide participation in decision-making relevant to any future environment that such experience may show to be appropriate for options trading.

Thus it would be distinctly counterproductive to delay expansion of dual trading of standardized options or to prevent the NYSE from participating in dual trading, since any such decision would keep the industry from gaining the knowledge and experience needed to help determine what, if any, national market system-type mechanisms or elements might ultimately best serve the interests of public investors in options. 491/

In sum, deferring NYSE entry into the options markets until elements of a national options market system are in place 492/ and the evolution of a national market system for equity securities is further along may go a long way toward (i) minimizing the effects that NYSE's predominant position in the markets for underlying securities may have upon NYSE's ability to become predominant in the options markets, (ii) assuring that competition among options exchanges and options marketmakers occurs within the fairest regulatory field obtainable under the circumstances, and (iii) improving the likelihood that a national stock market system

491/ NYSE Letter, supra, n.85, at 17-18 (footnote omitted).

492/ See discussion at 71-86, supra, and 257-272, infra.

with competing market centers will evolve successfully. At the same time, such an approach may be deemed inconsistent with the Congressional mandates that a national market system "evolve through the interplay of competitive forces" 493/ and that the Commission refrain from imposing unnecessary or inappropriate burdens on competition. 494/ On the other hand, it should be kept in mind that the 1975 Amendments were designed to provide "maximum flexibility to the Commission * * * in giving specific content to the general concept of the national market system," 495/ and that the Commission is not required to justify its actions as "the least anti-competitive manner of reaching a regulatory objective." 496/

When considering either of these approaches to an NYSE options trading proposal, two additional factors should be taken into account. First, it may be inconsistent with the purposes of the Exchange Act for the Commission "to attempt to protect any market center's share of the market for any security." 497/ As NYSE has observed:

493/ Conference Report, supra, n.18, at 92.

494/ Id., at 94.

495/ Id., at 92.

496/ Senate Report, supra, n.17, at 13-14. See also discussion at 12-14, supra.

497/ NYSE Letter, supra, n.85, at 19. See also Securities Exchange Act Release No. 11942, supra, n.210, at 35 and 40, and discussion at 92, supra.

Clearly, the market center or market-maker that provides the "best" market in a given security should be expected to attract an appropriate share of the order flow in that security. The well-recognized principles which underlie a broker's obligations to his customer demand that result. In adopting the 1975 Amendments, Congress surely endorsed this cardinal principle of competition. And there is no indication anywhere that Congress, in specifically calling upon the Commission to use its authority under the Act to ensure enhancement of competition throughout the securities industry, intended that the Commission would seek out opportunities to suppress fair and open competition under the presumption that one or another market center might lose business if such fair and open competition were permitted to flourish. 498/

In addition, the Exchange Act requires that competition among exchange markets and among marketmakers be "fair." 499/ Clearly, "a dominant firm in one market may not extend its dominance to another market by anticompetitive means." 500/ Accordingly, the Commission should carefully monitor the form and substance of competition among market centers and among marketmakers if an NYSE options plan is approved. In particular, the Commission should discourage the use of NYSE regulatory authority and "intangible resources" to attract options order flow. Further, it may be considered "unfair" to permit NYSE stock specialists and marketmakers

498/ Id.

499/ See, e.g., Section 11A(a)(1) of the Exchange Act [15 U.S.C. 78k-1(a)(1)].

500/ Letter to George A. Fitzsimmons from James E. Buck, supra, n.481.

to subsidize NYSE options marketmaking activities with revenues derived from their stock trading. Similarly, discounting stock brokerage rates or engaging in reciprocal dealings for the purpose of attracting options order flow may be considered unfair, anticompetitive practices. While it may be difficult for the Commission to regulate these areas directly, individual instances in which unfair competitive practices are discovered should be sanctioned severely.

VIII. A NATIONAL MARKET SYSTEM FOR STANDARDIZED OPTIONS

A. Options and the Evolving National Market System

Section 11A(a)(2) of the Exchange Act provides:

The Commission by rule, shall designate the securities or classes of securities qualified for trading in the national market system from among securities other than exempted securities. (Securities or classes of securities so designated hereinafter in this section referred to as "qualified securities".) 501/

The Exchange Act also directs the Commission "to facilitate the establishment of a national market system for securities (which may include subsystems for particular types of securities with unique trading characteristics)." 502/

501/ Section 11A(a)(2) of the Exchange Act [15 U.S.C. 78k-1(a)(2)].

502/ Id.