

JOINT SUBMISSION OF
CHICAGO BOARD OPTIONS EXCHANGE
AND
MIDWEST STOCK EXCHANGE

October 27, 1978

The Honorable Harold M. Williams
Chairman
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

RE: Proposed combination of Midwest's
options program with that of CBOE

Dear Chairman Williams:

At the time (July 13, 1978) that the Midwest Stock Exchange, Incorporated ("Midwest") and the Chicago Board Options Exchange, Inc. ("CBOE") each informed you of its consent to a continuation of the Commission's voluntary moratorium on expansion of options trading, each also apprised you of a proposed combination of Midwest's options program with that of CBOE and of the two exchanges' intention to ask the Commission to consider the matter prior to the lifting of the moratorium. Subsequently, on July 14, 1978, representatives of both exchanges met with members of the Commission's staff to discuss the general terms of and reasons for the combination. On August 15, 1978, the two exchanges entered into a definitive Agreement (a copy of which is attached to this letter), and on October 4, 1978, all necessary action by the respective Boards and memberships with respect to the Agreement was completed.

The Agreement contemplates that the combination will occur in two stages: first, a relocation of Midwest's options market so as to be physically adjacent to CBOE's options market, on terms and conditions set forth in Article II, pp. 3 to 12, of the Agreement (the "Relocation"); and second, a full combination of the two options markets such that CBOE commences trading in the Midwest options and Midwest ceases to have responsibility for or connection with an options market, on terms and conditions set forth in Article III, pp. 13 to 19, of the Agreement (the "Combination"). The two-stage approach was agreed to in recognition of the fact that formal procedures for approval of necessary rule

changes in connection with the Combination may require a number of months, whereas it should be possible to obtain the benefits of the Relocation without the need for any rule changes and therefore very promptly.

This letter is written to request a determination by the Commission that--

(1) the options moratorium does not prevent the Commission's acceptance and processing in regular course of filings under Rule 19b-4 of the rule changes needed for accomplishment of the Combination and

(2) in any case, the Relocation is not expansionary within the meaning of the moratorium and may be accomplished immediately.

Our reasons in support of this request are discussed below under captions IV and V respectively, preceded by a summary of the basic terms of the Agreement, a summary of the business reasons for the transactions contemplated therein, and a summary of our views as to the public benefits to be gained from combining the two markets, captions I, II and III respectively.

This is a joint submission by Midwest and CBOE, both of which are in full accord with the basic arguments and conclusions expressed below. It should be understood, however, that statements specifically relating to Midwest's past experience, expectations, reasons, etc., are those of Midwest, and that statements specifically relating to CBOE's plans, reasons, etc., are those of CBOE.

I. SUMMARY OF AGREEMENT

The following discussion is a general summary of the basic terms of the Agreement; numerous details are not discussed because they do not bear directly on the determination we are asking the Commission to make.

The Relocation will simply involve a physical move of Midwest's options market to a separate space on CBOE's trading floor. CBOE will be, in effect, acting as a facilities manager for Midwest, and nothing more. CBOE will provide trading post and book processing facilities, will collect and transmit to OPRA last sale reports and quotations and will produce Midwest versions of existing CBOE surveillance reports using CBOE's sophisticated on-line surveillance system. As is the case at present, CBOE will also provide trade match services to Midwest.

During the Relocation stage, CBOE will assume financial responsibility for the basic floor operation of the Midwest options program. All of Midwest's options revenues (dues, transaction fees, OPRA revenues, etc.) will be paid to CBOE monthly, after deducting amounts for contributions to Midwest's Error Fund, compensation to Midwest's Order Book Officials, Midwest's basic costs for regulation, administration and operation of its options market, and an amount (to be credited against payments to be made by CBOE to Midwest at the time of the Combination) to cover Midwest's contingent and unforeseen expenses incurred in the operation of its options market during the Relocation stage. CBOE will also assume Midwest's contractual obligations for specified news services and option valuation and other systems equipment. The assumption of these financial obligations by CBOE is designed to reduce the danger of a further serious drain on Midwest's financial resources from Midwest's options market.

During this first stage, trading in the options classes listed on Midwest will continue to be conducted on a legally separate national securities exchange, i.e., the Midwest Stock Exchange, Incorporated. Midwest will continue to have ultimate regulatory responsibility for such trading, and all trading activity in Midwest options classes will be conducted pursuant to Midwest's rules and subject to its enforcement. Midwest's Order Book Officials will continue to be Midwest employees. Midwest options members will continue to be Midwest members, without any change in their rights or obligations. These members will pay dues and fees only to Midwest, be subject only to Midwest's rules and regulations and be entitled to trade only Midwest-listed options classes. CBOE members will likewise experience no change in their rights and obligations. As is the case at present, unless they are also Midwest members, CBOE members will not be permitted to trade Midwest options. Upon the effective date of the Relocation, CBOE will use reasonable efforts to employ those Midwest employees directly involved in the operation and administration of Midwest's options program (other than Order Book Officials).

The full Combination will take place thirty days after approval by the Commission of all necessary rule changes. Options classes traded in Midwest's options market at the start of the Combination, including any classes approved for trading during the Relocation ("Midwest Options"), will become CBOE listed options. Put classes with respect to the securities underlying the Midwest Options will also be deemed to be Midwest Options, regardless of whether the

particular put class is added before or after the Combination. Midwest will cease to provide a market for trading standardized options and therefore cease to have any responsibilities under the Act for such a market. At the same time, CBOE will offer to employ Midwest's Order Book Officials. In addition, installment payments will be made by CBOE to Midwest pursuant to a formula set forth in the Agreement.

All Midwest options members (including Midwest equity members who have exercised their right to options privileges prior to the Combination) will become "Special Members" of CBOE. Special Members will have the right to trade on the CBOE in Midwest Options which continue to be open for trading on CBOE, and only in those Midwest Options. They will have the same eligibility as present CBOE members may have from time to time for election to the Board of Directors of CBOE and for election or appointment to the standing or special committees maintained by CBOE. Special Members will also have the right to vote or petition on all matters upon which CBOE members may vote or petition under applicable provisions of law or under CBOE's Certificate of Incorporation, Constitution and Rules, as they may be amended from time to time.* They will have no right, however, to participate in any distribution of the assets of CBOE pursuant to dissolution, winding-up, or otherwise.

A Special Member will be able to transfer his special membership, provided that the transferee meets the requirements for membership then imposed by CBOE. He will be able to lease his special membership, however, only to a lessee to whom he had continuously leased his Midwest options membership since July 18, 1978. Each special membership will terminate ten years after the effective date of the Combination.

* Except as otherwise provided by law, the vote or petition signature of a Special Member will count as one-sixth the vote or petition signature of a regular member of CBOE. A majority vote of the Special Members as a separate class will be required to amend specified portions of CBOE's Constitution setting forth the rights of Special Members.

II. BUSINESS REASONS

A. Midwest's decision to combine its options program with that of the CBOE is based on valid and compelling business reasons. Midwest began its options program in December 1976, making it the latest exchange entrant into the options business. As Midwest has informed the Commission on several occasions, its decision to establish an options program was made primarily to enhance and support its stock market, not because an options market per se appeared to present an attractive business prospect. The Commission had given a "green light" to the NASD's proposal for combined stock-options market making in the over-the-counter market. Midwest believed -- and still believes -- that it could bring substantial expertise and resources to a "side-by-side" market. In any event, it seemed to Midwest in 1976 that, with the imminent prospect of side-by-side trading, an options capability was a necessary adjunct to its operation as a competitive stock exchange.

Because of the lead time needed to register Midwest's options division with the Commission, there was a substantial time gap between Midwest's announcement of its decision to enter the options business and its being permitted to pick its first options classes. During this period other exchanges were listing new classes of options, with the result that the options classes available to Midwest when it began its options program (other than those classes already traded on other exchanges) were, for the most part, less attractive than those then being traded on the other options exchanges. However, the Commission appeared to Midwest -- at that time -- to be committed to permitting each successive exchange's entry into the options business on a programmed and economically sound basis. Midwest assumed, therefore, that it would be allowed, as others had been, the opportunity to develop an economically and competitively viable options program by (1) expanding substantially the size of its initial operation, which involved only 11 classes, and (2) making changes in the rules governing the operation of its options market as appropriate in light of the prices and trading characteristics of its options classes.

Unfortunately, Midwest's assumption has proved to be incorrect, for it has been precluded from doing either. Shortly after Midwest made its decision to establish an options program, the regulatory direction, as previously understood by Midwest, appeared to shift significantly. Rather than allowing a prompt movement toward side-by-side trading of options and stock, the Commission acted to pre-

vent movement or experimentation in that -- or any other new -- direction. Furthermore, the Commission apparently decided that it would not act on proposed rule changes submitted by Midwest despite Midwest's repeated statements that these rule changes were essential to its building an economically and competitively viable options program.*

Midwest's purpose here is not to debate the merits of the Commission's actions in connection with options trading, but to present candidly and fairly the business situation in which Midwest now finds itself. Because the Commission was unwilling to allow Midwest to expand significantly or make what it considered appropriate changes in its rules after it began operations, when the moratorium was declared in July 1977 Midwest's options program was still a long way from achieving the "critical mass" necessary to be self-sustaining. Midwest simply had not been able to create a trading environment that could attract enough capital or acquire adequate market position or generate sufficient investor recognition to make possible effective competition against the other options exchanges. As a result, through the end of 1977, Midwest incurred severe losses in the operation of its options market. To date during 1978, despite record volumes, Midwest's options market has barely broken even.

Midwest has thus been forced -- because of the adverse economic results of its options program and the recognition that the assumption underlying its commencement of an options program has proved to be incorrect -- to decide what should be done with its options program in light of its responsibility to its members generally and to its options members in particular. The responsible business choices available to Midwest appear to be limited. Midwest does not see the prospect of being able to expand its options program meaningfully in the near future, which means an indefinite continuation of the unsatisfactory position in which it has found itself for the past 22 months. At the same time, Midwest recognizes that if expansion were permitted with an increase in the multiple trading of options, Midwest would be extremely vulnerable to competition from the larger options exchanges.

* The following proposed rule changes were filed by Midwest over a six-month period beginning in February 1977 and ending in July 1977: File Nos. SR-MSE-77-2 (narrowing strike price intervals), SR-MSE-77-6 (increasing authorized number of calls from 20 to 40), SR-MSE-77-28 (eliminating prohibition on individual equity market maker being market maker in related option) and SR-MSE-77-29 (changing method for determining eligibility for listing).

On the other hand, Midwest believes that if expansion were permitted without an increase in multiple trading and Midwest obtained additional high volume options classes and Midwest obtained more puts and options volumes generally remained high, Midwest could, in all likelihood, operate a successful options program. But this combination of assumptions can by no means be taken for granted, and for Midwest to continue to operate its options program based on it would be a highly risky business judgment. Furthermore, even if all the assumptions prove to be correct, Midwest's small size relative to the other options exchanges and the long delay in its ability to expand make it difficult for Midwest to feel confident that it should, as a responsible business entity, take the risk of now attempting to build the volume and capital base necessary to be a strong intermarket competitor in options. On the other hand and notwithstanding an extremely uncertain outlook for the future, Midwest feels a strong commitment (even though it has no legal obligation) to provide, so long as reasonably possible, an economic opportunity in the options business for those people who invested in Midwest's options program and who have worked to make it a success.

After wrestling with these considerations for many months, Midwest's Board of Governors decided that Midwest should terminate its options program -- provided that that could be done in a manner that provided its options members with a realistic opportunity to realize their expectations in joining Midwest in the first place and did not lead to more adverse financial consequences for the Midwest complex as a whole. The combination with CBOE, in accordance with the terms of the August 15 Agreement, satisfies these conditions and would in Midwest's view, based on its present understanding of regulatory policies and its expectation of likely economic and regulatory developments, be in the best interest of the Midwest complex, Midwest's members, the securities industry, and the investing public.

It is important to emphasize that Midwest has not decided to terminate its options program regardless of the terms on which that can be done. Rather, its decision is that the termination of the program in accordance with the August 15 Agreement makes valid, indeed compelling, business sense. Under the Agreement, Midwest members active on the options floor will be able to continue to trade options -- and in an environment that has reached "critical mass" for a viable program -- without having to make an additional capital investment or move their businesses and families to another city. Similarly, Midwest employees operating in the options program will have employment oppor-

tunities using their considerable expertise without having to move out of the Chicago area. These opportunities for Midwest's options members and options employees are major factors in Midwest's decision to enter into the Agreement with CBOE. Without these factors Midwest would have to rethink entirely the already difficult question of the future of its options program.

Fortunately, the arrangement with CBOE offers Midwest an appropriate and justified business and self-regulatory response to a very difficult and potentially untenable situation. The Agreement takes Midwest out of the options business without disruption of trading, loss of continuity of surveillance, or disappointment of the legitimate expectation of Midwest's members. At the same time, it ends the danger of a further serious financial drain on the Midwest complex. In Midwest's view, the Combination not only makes good business sense, but it is also fair to the individuals now involved in that program and fully consistent with Midwest's responsibilities under the Act. The Combination, therefore, represents the opportunity to turn a serious and, under adverse volume conditions, deteriorating situation into a very positive one.

Having made the decision to combine its options program with that of CBOE, Midwest believes the Commission can appreciate how important it is that the transaction be consummated at the earliest possible time. As soon as its plans were announced, Midwest became in effect a "lame duck" options market. Midwest may now be perceived by the industry and the investing public as an options market place that will shortly cease to operate and therefore as one that may not be doing all it can to maintain operational and trading standards. While this perception is most certainly wrong -- Midwest's options market continues to operate at the highest possible level of performance -- the perception nevertheless may not be uncommon.

The longer the period of time between the announcement of the arrangement with CBOE and its consummation, the more likely it is that a mistaken perception of Midwest's options program will spread, with a growing adverse impact on Midwest as a whole and its members. Delay would certainly be hurtful to Midwest's ability to hold and attract options members and operating personnel. Both groups have their own concerns about security and future opportunities; obviously the longer the delay in starting to implement the Agreement, the more uncertain consummation will appear and, hence, the more uncertain will appear the long range future in working on the Midwest options floor. If it grows more

difficult for Midwest to hold and attract members and trained operating personnel, it will also grow more difficult for Midwest to continue to provide high quality trading and regulatory services.

Because of the necessity for speed in consummating the transaction with CBOE, Midwest and CBOE agreed to structure the arrangement in two stages, the first of which could be achieved very quickly, with minimal regulatory process. From Midwest's perspective, that first stage must be moved to promptly if the opportunities presented by the Agreement are not to be lost and the possibility of further economic and competitive injury to the entire Midwest complex is to be avoided.

B. Likewise, CBOE has valid business reasons for acquiring Midwest's options program. Under the terms of the Agreement, the economic risk for the operation of Midwest's options program is being shifted from Midwest to CBOE. CBOE's willingness to take over that economic risk reflects a basic business judgment by CBOE; exactly what the shift will mean for CBOE in terms of enhanced or reduced profitability will be determined by a number of factors not presently measurable, including future regulatory and competitive developments and the future level of trading activity, both in the securities markets generally and in the Midwest Options in particular.*

Apart from that basic result, CBOE expects to realize additional benefits from combining the two markets. For example, at the time of the Relocation CBOE will use reasonable efforts to employ all persons then employed by Midwest on its options floor, with the exception of Midwest's Order Book Officials. The availability of this pool of trained and experienced employees constitutes a valuable asset to CBOE in the operation of its market as well as

* The shifting of economic risk would begin to take place during the Relocation stage of the Agreement, when all of Midwest's revenues, less specified amounts being retained by Midwest for the operation and regulation of its market, will be paid to CBOE. Upon the effective date of the Combination, CBOE will take over Midwest's remaining obligations with respect to its options program, subject to certain indemnification provisions of the Agreement relating to past operations, and Midwest will cease to have responsibility for such program altogether.

Midwest's options market. Because of their training and experience, CBOE will be able to assign them to active trading locations in either market as they are needed, and will not be faced with its usual expense of training new employees.

In addition, CBOE is now performing trade comparison services for Midwest; to do so, it must use two separate programs and two sets of computer runs, one for CBOE and one for Midwest. The Relocation will produce some minor efficiencies in the handling of data, and the Combination will permit a much simpler and more efficient trade comparison process because all trades will then be handled as a single system.

CBOE should also be able to make more efficient use of its other existing and planned facilities by combining its options market with that of Midwest. The average daily contract volume on Midwest amounts to approximately 5% of that on CBOE. The addition of that incremental volume is not itself sufficient to require that CBOE develop additional capacity, but having that additional volume should make for more efficient and economic use of CBOE's trading floor, data processing equipment, and operational and regulatory personnel -- both now and in the future.

III. PUBLIC BENEFITS

Apart from the sound business reasons that led Midwest and CBOE to enter into the Agreement, the transactions contemplated by the Agreement will result in important benefits for the options professionals operating on the Midwest options floor, the securities industry generally, and the investing public. The achievement of these benefits is possible, however, only if the parties are permitted promptly to commence the Relocation stage of the Agreement and to file the rule changes necessary to accomplish the full Combination, and the Commission undertakes a timely review of those rule changes.

The benefits of the Agreement for the options members on Midwest have already been mentioned -- e.g., the Agreement assures those members who have invested their capital and business careers in the Midwest options program that they will be able to continue to do business in Chicago on essentially the same terms. The opposite side of this coin is that the Agreement assures the securities industry and the investing public that the talent and resources of these options professionals will not be lost. The impor-

tance of attracting and holding competent and well trained professionals in the business should be obvious from both a regulatory and an operational standpoint. The Agreement will contribute to this objective by removing the uncertainty about the future of Midwest's options program and providing a defined and meaningful business opportunity for Midwest's options members and staff in a stronger options market center.

In addition, the arrangement will mean that the Midwest options program, beginning upon the Relocation, will operate with the same reporting and floor surveillance facilities now used by CBOE. This will result in an immediate upgrading of Midwest's surveillance capabilities, which will be of benefit to it in carrying out its self-regulatory responsibilities, as well as to the Commission in performing its general oversight role. Of course, Midwest might, on its own, make the changes needed to bring its technical and surveillance procedures up to the standard of CBOE -- indeed, there are present plans for Midwest to do so. However, a major public advantage of the Agreement is that Midwest will achieve these regulatory improvements faster, at substantially less cost, and without risk to the industry and the Midwest complex that the monies involved will be lost because of an ultimate shutdown of the Midwest options program.

A further public benefit of combining the two markets will be the significant economies and efficiencies the financial community will achieve through having all options facilities and personnel in Chicago in a single location. For example, brokerage firms' back offices for options will be able to consolidate their operations and make more efficient use of their personnel, and the same will be true of clearing firms carrying options market makers' accounts. In addition, for most firms the incremental cost of accommodating an additional 5% of business on the CBOE floor will be minor in comparison to the fixed costs of maintaining a duplicate facility on the Midwest options floor.

Another major benefit to member firms is that following the Combination CBOE's Order Support System ("OSS") will include the Midwest Options as well as those listed on CBOE.* Thus the member firms will gain access to an

* OSS is being implemented gradually, with full implementation scheduled for January 1980; both parties expect to complete the Combination prior to that time.

electronic order routing and automated book facility with respect to Midwest Options that they otherwise would not have.

Obviously, the achievement of efficiencies in the securities industry through the consolidation of facilities or the elimination of duplicative facilities must be carefully scrutinized in terms of the other objectives of the Act and the importance of preserving fair competition. In this case, however, combining the two options markets is fully consistent with all objectives of the Act and will not impose any burden on competition not necessary or appropriate in furtherance of those objectives, as discussed in IV below. Thus, the significant economies and efficiencies that will result are available to the industry without offsetting negative consequences.

IV. PROPOSED RULE CHANGES BY CBOE AND MIDWEST TO ACCOMPLISH THE COMBINATION SHOULD BE ACCEPTED AND PROCESSED IN REGULAR COURSE DURING THE MORATORIUM, SO THAT THE REVIEW PROCESS CAN BE COMPLETED AS PROMPTLY AS POSSIBLE.

A. The proposed Combination should not be deemed expansionary within the meaning of the moratorium. Even when fully consummated, the Combination will not expand options trading in the aggregate, will not expand combined options-stock trading in the same market, and will not involve any new product or new form of options trading. Nor will it present any moratorium-related issues; the only relevant issue is market surveillance and regulation and, as seen above, these will clearly be enhanced, not impaired, by the Combination.

The completed transaction will, of course, result in a modest expansion of CBOE's market. Even if this end result were to be deemed expansionary within the meaning of the moratorium, it presumably will not occur until after the end of the moratorium even if the process of reviewing necessary rule changes begins promptly. Allowing that process to begin promptly, notwithstanding the moratorium, is fully justified by Midwest's compelling need to act as expeditiously as possible in disposing of an uneconomic situation as discussed under II above and by the public interest in promptly accomplishing the benefits summarized under III above.

B. CBOE expects its Rule 19b-4 filing to show full compliance with applicable standards of the 1934 Act, particularly as to competition and regulatory capability. CBOE's explanation and justification of the Combination under the standards of the Act will, of course, be fully spelled out in its formal rule filings and in its answers to whatever questions or objections may be raised in regard thereto. The following is a summary of the principal data and arguments that we expect to present as to compliance with the standards of the Act (in addition to the data and arguments as to business purposes and public benefits summarized in II and III above):

(1) Competition. When the Commission reviews the proposed rule changes with respect to the Combination, one of the questions to be considered is whether those proposed rule changes impose any burden on competition not necessary or appropriate in furtherance of the purposes of the 1934 Act. That question may be considered either on the assumption that the Commission will, or that it will not, permit expansion of multiple trading in the foreseeable future.

On the former assumption, it is clear that the Combination will not significantly affect competition as it exists today, since (i) Midwest and CBOE do not, with one nominal exception, presently trade the same classes of options* and (ii) Midwest has come to the conclusion that it would have a difficult time surviving as an options market with unrestricted multiple trading. On the same assumption, even if the Combination were accomplished before general expansion of multiple trading were permitted, CBOE would not gain any significant advantage vis-a-vis other options exchanges, since experience has shown that being the first exchange to trade a class of options does not assure primacy in the trading of that class. This has been true even in the absence of national market system facilities designed to enhance competition; a fortiori it would be true if, as CBOE has recommended elsewhere, expanded multiple trading were to occur only in an appropriate national market system framework.

* The exception is American Express options, in which CBOE's and Midwest's contract volumes for the first nine months of 1978 were 29,170 and 50, respectively. Midwest will cease trading in American Express options at or prior to the effective date of the Relocation.

On the opposite assumption, that the Commission will not permit expansion of multiple trading in the foreseeable future even after there is a lifting of the general moratorium, the basic regulatory policy should and presumably will be, as formerly, that each exchange is permitted to expand in accordance with its own capability as a market and as a self-regulator. Stated another way, it would be anti-competitive rather than pro-competitive for the Commission to limit the expansion of all options exchanges, whatever their stage of development, to the same absolute or relative rate.

We recognize that, on the latter assumption, circumstances may arise in which it may be appropriate to have a method of random selection among exchanges with regard to new classes of options. However, the Midwest situation is quite exceptional in that regard. In the first place, the options classes in question are already traded in an existing market in Chicago and, of course, that market has its floor members and staff located in Chicago. Thus the geographical factor discussed in II above comes into play: It makes good business sense and, we believe, regulatory sense for Midwest's ongoing options market to be combined in toto with another market in the same city, so that there will be minimum loss to Midwest (in terms of recoupment of its development costs, reduction of ongoing costs of space, and avoidance of termination costs that might otherwise be incurred) and minimum hardship on the individuals who have been directly involved in its options market.*

Moreover, the Midwest options classes are by no means a uniquely desirable group. They were chosen by Midwest, the last of the five options exchanges to get started, as being the most desirable then available for exclusive trading in a new market in Chicago; but any of them might have been selected by another exchange for exclusive trading at an earlier date, or might have been (and some were) selected by another exchange for dual trading after the inception of Midwest's market and before the start of the moratorium. In these circumstances, no exchange can claim that serious competitive disadvantage will result to it from moving the Midwest options program to CBOE, certainly not any that outweighs Midwest's valid business reasons, dis-

* This geographical factor takes on added significance in view of the very slight impact of the Combination on the market shares of the remaining options exchanges, as discussed below.

cussed in II above, for seeking to keep its options market intact in Chicago.

The question of impact on competition may also be looked at in terms of market shares. For the first nine months of 1978 the market shares of the five existing options exchanges, expressed as percentages of aggregate contract volume of all exchanges in all options classes, were: CBOE 59.6%, AMEX 25.5%, PHLX 5.9%, PSE 5.7%, and MSE 3.2%.* On a pro forma basis after the Combination, CBOE's market share would thus become 62.8% (59.6% plus 3.2%). Considering that CBOE, as the pioneer and innovator in standardized options trading, started with 100% in 1973 but was called on by the Commission as early as 1974 to share some of the basic concepts and facilities created by it in order to facilitate competition in options trading on the part of some existing stock exchanges, the fact that CBOE's share had by 1978 been reduced to 59.6% should be regarded as evidence of the vigor of competition that has developed; and the fact that the Combination would bring the percentage back up to 62.8% -- due to Midwest's need to dispose of its options market and its desire to do so in such manner as to take maximum advantage of the geographic factor -- should not give cause for concern as to any danger of dominance, let alone monopoly, on the part of CBOE.

This conclusion is further supported when CBOE is compared with the exchange having the next largest market share, AMEX. For the first nine months of 1978 the ratio of market shares of those two exchanges alone was 70.0% and 30.0%,** which on a pro forma basis after the Combination would become 71.0% and 29.0%.

* The comparable market shares of those five exchanges for earlier periods are as follows:

	CBOE	AMEX	PHLX	PSE	MSE
1975	79.7	19.5	0.8	N/A	N/A
1976	66.4	27.9	3.9	1.7	0.0+
1977	62.7	25.4	5.5	4.9	1.5

** These ratios between the two largest exchanges may be compared with the following ratios for earlier periods:

	<u>CBOE</u>	<u>AMEX</u>
1975	80.3	19.7
1976	70.4	29.6
1977	71.2	28.8

Neither of these two largest exchanges trades stocks underlying the classes of options that it trades.* However, whereas CBOE trades no stocks at all, AMEX was, of course, a stock exchange long before it became an options exchange. As a stock exchange it has accumulated substantial tangible and intangible resources, and it has very significant ongoing sources of revenue, that are in no way matched by CBOE's resources or revenues. As one example, AMEX in 1977 received \$5,027,000 of revenues from listing fees related to its stock market, for which CBOE had and has no counterpart. As another example, AMEX for some years has been a junior partner with NYSE in the joint development, ownership and control of various critical and costly data processing and communications facilities, for which CBOE has only a limited counterpart in its past and proposed sharing of certain facilities with Midwest. Even though CBOE remains the largest options market and will become slightly larger as a result of the Combination, the far greater total resources and revenues of AMEX provide strong assurance that competition in options trading will remain vigorous and that CBOE will not be on the road to dominance as a result of the Combination.

To the extent the Combination may slightly affect the competitive balance, the Commission must also take account of the public benefits -- in the form of enhanced surveillance, greater member firm economies, preservation of the talent and resources of Midwest's options professionals and staff, and the eventual availability of CBOE's OSS for the Midwest options -- to be gained from the Combination. In statutory terms, any slight burden on competition is necessary and appropriate in furtherance of the purposes of the 1934 Act.

(2) CBOE's market and regulatory capability. CBOE presently trades 95 call options classes and 5 put classes; Midwest presently trades 17 call classes** and 5

* The three smaller exchanges all trade, among others, stocks underlying their own options classes, with physical separations between their respective stock and options markets. AMEX trades two classes of stock underlying options classes traded elsewhere but not in its own options market.

** One class will not be moved to CBOE. See n., p. 13.

put classes. CBOE presently has approximately 1,400 to 1,700 persons on its trading floor at any one time during the trading day, depending upon trading conditions. The Relocation of Midwest's options market would add some 125 persons. For the first nine months of 1978, average daily volume has been 135,383 contracts on CBOE and 7,260 on Midwest. CBOE is confident that it now has more than adequate trading capacity and regulatory capability to accommodate the Midwest options market.*

For the longer term, CBOE is involved in discussions with the Chicago Board of Trade, in whose office building it is a tenant, with respect to the proposed construction of a new, larger trading floor in a building that would be constructed immediately adjacent to the present building. Since such a project would probably not be completed until 1981-82, CBOE is also analyzing the potential capacity of its present floor to handle projected volume levels over the next three years. Preliminary studies indicate CBOE's present facilities have sufficient capacity, but since estimates of trading volume have not always proved accurate in the past, CBOE is exploring ways to expand and make better use of its existing trading space during this interim period.

As for systems capacity, since Midwest's on-floor Quotron system is a direct sub-set of the CBOE's Trading Support System, virtually overnight the CBOE system can take over all of the functions presently handled by the Midwest system without placing a strain on its own market. Additionally, CBOE is already providing the trade match service for Midwest, so that the Relocation and Combination will not require any additional trade comparison capacity. Further, as part of the development of CBOE's OSS and, in general, to increase the long-term capacity of the CBOE systems, the CBOE Board of Directors voted in September 1978 to embark on a major upgrade of its central complex of IBM computers that, when completed, should more than double the projected order-handling capacity of OSS.

* CBOE has agreed to provide facilities and services for the trading of those Midwest Options which continue to be open for trading as adequate as the facilities and services then utilized for the trading of the same number of classes of CBOE options having comparable trading volume.

The Commission may wish comments on two possibly relevant developments since the start of the moratorium. First, the Options Study has been giving much attention to the possible need for a general upgrading of market surveillance and regulation, which could raise the question of CBOE's capability to meet new, more demanding expectations of the Commission. Our answer is that CBOE believes it was well ahead of other exchanges in its capability and performance in these areas when the Study was instituted, and it has since taken, or is in the process of taking, various measures to strengthen its facilities and personnel further. It is confident that it will be able to meet whatever requirements or expectations are expressed at the conclusion of the Study.

A different sort of development was the episode in April 1978 when, for a period of six consecutive trading days, volumes of trading shot up well beyond anything previously experienced.* CBOE's average daily volume of 267,600 contracts for the period April 14-21 was more than two and one-half times the average daily volume for the full year 1977 (98,566 contracts) or the first quarter of 1978 (101,128 contracts). On April 17, 1978, CBOE's record breaking volume of 402,440 contracts was 80% greater than the previous record volume of 223,781 contracts recorded on November 11, 1977. This sudden and unpredictable upsurge did put very heavy strains on some of CBOE's facilities, particularly its order handling, trade match and audit trail facilities, and on capacities and facilities of some members and member firms of various types.

However, the CBOE systems did handle the April surge and, as detailed in CBOE's letter dated June 16, 1978, a number of measures were immediately taken and others are currently being taken to prevent a recurrence of similar strains, even in the unlikely event of another dramatic upsurge resembling that of April. For example, CBOE has increased its floor operations staff from 104 to 141. CBOE did in fact experience a volume as high as 329,742 contracts on August 3, 1978, which was handled with virtually no difficulties. In any case, the addition of the Midwest options

* Since April 1978 other stock and options exchanges have had similar episodes of stress relating to unusually high volume.

market, equivalent to about 5% of CBOE's market, would not add any significant new burdens.*

Given the CBOE's present excess capacity and its current and planned programs for expansion, CBOE is confident that its trading facilities can readily accommodate the Midwest options market, in both the short and long run.

(3) Fairness of terms. All terms of the Agreement, including, of course, those specifically applicable to the Relocation as well as those applicable to the Combination, were arrived at by arms' length bargaining.** To accomplish the Relocation, Midwest was willing to give up its options revenues basically in return for CBOE's providing certain facilities and services, relieving it of certain ongoing expenses, and assuming the financial risks of (but not the regulatory responsibility for) Midwest's options market pending accomplishment of the full Combination; and CBOE was willing to accept Midwest's options revenues as appropriate compensation for providing the specified services and facilities and assuming the expenses and risks of the Midwest options program until the Combination could be consummated. After the Combination, when the Midwest options program will be taken over by CBOE, certain amounts will become payable by CBOE to Midwest pursuant to a formula to take account of varying amounts that may have been paid and received prior to the Combination. The ultimate payment (in installments) to be made by CBOE represents an amount that Midwest insisted it was entitled to receive and that CBOE regarded as fair and appropriate to pay.

* As discussed earlier, CBOE has agreed to use reasonable efforts to employ the present Midwest floor operations staff (other than Order Book Officials) at the time Midwest's market is physically transferred.

** As already mentioned, the respective Boards and memberships of the two exchanges (including the Midwest options members as a separate class) have taken all necessary action to approve the transaction.

From the point of view of Midwest's competitive strength as a stock market, the net effect of the Agreement will be substantially to restore Midwest to the financial position that it would have been in if it had not embarked on an options program, and thus enable it to develop, improve, and compete more effectively as a stock market and to engage in other existing or new activities. From CBOE's point of view, it is hoped that the marginal costs of adding Midwest's options program will be covered by revenues to be derived from the Midwest options; depending upon future regulatory and competitive developments and the level of future trading activity in the securities markets in general and the Midwest options in particular, acquisition of the Midwest options program may provide a modest addition to CBOE's market.

- V. THE RELOCATION IS CLEARLY NOT EXPANSION-ARY WITHIN THE MEANING OF THE MORATORIUM AND SHOULD BE PERMITTED TO BE ACCOMPLISHED AS PROMPTLY AS POSSIBLE.

A. The Relocation will amount to no more than the physical relocation of Midwest's options market, with no change in its operation, no diminution of Midwest's regulatory responsibility, and no effect on moratorium issues. Midwest's relocated options market will remain in every sense Midwest's market. The Relocation will not result in any change in its mode of operation, its rules, its membership, or the rights and obligations of its members (or CBOE's members). Midwest's regulatory responsibility for the relocated market will also be unaffected. However, by way of enhancement of Midwest's capacity to carry out both operational and regulatory functions, CBOE will furnish to Midwest (in addition to trading facilities) certain services including the collection and transmission to OPRA of last sale and quotation reports, audit trails and Midwest versions of existing CBOE surveillance reports using CBOE's on-line surveillance system.*

* These are in addition to the trade match service which already is, and will continue to be, performed for Midwest by CBOE.

In addition to the fact that the Relocation will not involve any change in Midwest's rules or mode of operation, we also emphasize that it will not involve any new product, will not add to the options classes presently being traded in any market, will not involve any integrating of stock and options markets and will not alter the protections presently afforded public investors. Thus, the Relocation will not magnify any of the concerns that have been identified in connection with the Options Study or the moratorium. Moreover, the Commission will continue to have all the alternatives that are presently available or that will be available at the end of the moratorium to deal with any such matters. To the extent that one of those concerns relates to self-regulatory surveillance, the Relocation will have a positive impact.

B. The Relocation will permit immediate realization of significant economies, efficiencies and benefits. Although the business purposes outlined under II and the public benefits outlined under III cannot be fully realized short of effecting the full Combination, the Relocation itself will contribute significantly in the directions indicated: The Relocation will remove the risk of a further drain on Midwest's resources that its options program has produced and the moratorium has prolonged. Further, the Relocation will enable Midwest promptly to strengthen its surveillance capability as well as its operational efficiency, without additional capital outlay. At the same time, the Relocation will enable Midwest to begin to devote greater resources and efforts to strengthening its stock market and other present or planned activities. The Relocation should also permit member firms to begin to achieve modest savings through concentration of certain facilities or personnel in a single place instead of two places in Chicago.

C. The Relocation will not give undue competitive advantage to CBOE. We have shown under IV-B(1) above that, whether or not it is assumed that there will be a general expansion of multiple trading in the foreseeable future, even the full Combination will not have undue anti-competitive impacts, i.e., will not impose any burden on competition that is not necessary and appropriate in light of valid business and regulatory considerations. A fortiori this will be true of the mere Relocation prior to the full Combination.

During the Relocation the Midwest options market will merely be adjacent to the CBOE options market. There will be no change in Midwest members' rights and obligations in the Midwest market or CBOE members' rights and obligations in the CBOE market, and neither Midwest nor CBOE members will gain any rights in each others' market. If any members of either exchange wish to have transactions in the other market they will need to become members of the other exchange or gain access through a member.

The most that can happen as a result of the Relocation, therefore, is that some CBOE members will decide to become options members of Midwest for the first time because of the slightly greater convenience of doing business on an adjacent floor rather than a floor two blocks away; and the same may conceivably be true in reverse (Midwest options members becoming CBOE members). It may also be true that, even though there can be no assurance as to the duration of the Relocation or the state of affairs after its termination, some off-floor members may during the Relocation strengthen their communications on other facilities or personnel in Chicago beyond what they might have done with physically separated market places.

All of the above possibilities, even if realized, could not have significant competitive effects in relation to other options markets. And in any event, the geographic factor mentioned at several points above (i.e., the important advantages to Midwest and its options members and staff of relocating in the same city), coupled with other benefits summarized under V-B above, would clearly outweigh any slight competitive impacts that might be claimed by any other options exchange.

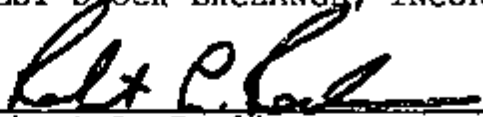
CONCLUSION

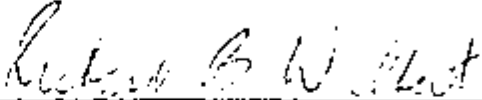
Implementation of the Combination of the Midwest and CBOE options markets will require each exchange to file proposed rule changes pursuant to the provisions of Section 19(b)(2) of the 1934 Act and Rule 19b-4 thereunder; the Relocation will not necessitate rule changes, but only a physical transfer of the location of the Midwest options market. Based upon this submission we request the Commission as promptly as practicable to determine that these joint actions by Midwest and CBOE -- namely, (1) the filing of proposed rule changes to effect the Combination and (2), while the rule changes are pending, accomplishment of the physical transfer constituting the Relocation -- are consistent with

the Points of Agreement supporting the continuation of the voluntary moratorium.

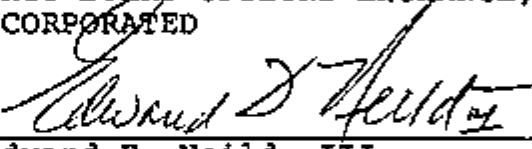
Very truly yours,


MIDWEST STOCK EXCHANGE, INCORPORATED

By 
Robert L. Raclin
Chairman of the Board

And 
Richard B. Walbert
President

CHICAGO BOARD OPTIONS EXCHANGE,
INCORPORATED

By 
Edward F. Neild, III
Chairman of the Board

And 
Joseph W. Sullivan
President

cc: Commissioner John R. Evans
Commissioner Philip A. Loomis, Jr.
Commissioner Irving M. Pollack
Commissioner Roberta S. Karmel
Mr. Andrew M. Klein

AGREEMENT

THIS AGREEMENT is made this 15th day of August, 1978, by and between Midwest Stock Exchange, Incorporated ("MSE"), a non-stock corporation organized under the laws of the State of Delaware, and Chicago Board Options Exchange, Incorporated ("CBOE"), a non-stock corporation organized under the laws of the State of Delaware.

RECITALS

A. MSE and CBOE are each national securities exchanges registered with the Securities and Exchange Commission (the "Commission") pursuant to Section 6 of the Securities Exchange Act of 1934 (the "Act");

B. MSE provides a market (the "MSE Options Market") for trading in classes of standardized options and CBOE also provides a market (the "CBOE Options Market") for trading in classes of standardized options;

C. The present moratorium on expansion of options activities has imposed economic and competitive hardships on MSE;

D. MSE and CBOE desire to effect a combination of all of the activities in the MSE Options Market with those of the CBOE Options Market such that upon the effectiveness of the combination MSE would no longer provide a market for trading in standardized options and CBOE would provide a market for trading in the classes of standardized options then traded in the MSE Options Market; and

E. MSE and CBOE desire to accomplish such combination at the earliest possible date but, recognizing that the obtaining of the requisite regulatory approvals may delay the combination, wish to provide for the prompt relocation of the MSE Options Market in space and with facilities and certain personnel furnished by CBOE in order to achieve cost savings and enhanced regulatory surveillance for MSE.

NOW, THEREFORE, MSE and CBOE agree as follows:

ARTICLE I - DEFINITIONS

1.1. The term "MSE Options" means (i) all classes of call options on the underlying securities listed on Schedule 1 to this Agreement, (ii) all other classes of call options in which MSE commences trading prior to the Combination with approval of the Commission other than classes of call options which, on the day such trading commences, the CBOE is also trading, and (iii) all classes of put options on all securities underlying classes of call options covered by (i) and (ii) in which MSE commences trading prior to the effective date of the Combination with approval of the Commission or in which CBOE commences trading after the effective date of the Combination.

1.2. The term "CBOE Options" means all classes of options traded from time to time on CBOE other than MSE Options.

1.3. The term "Relocation" means the physical relocation of the trading activities in the MSE Options Market to facilities provided to MSE by CBOE in accordance with Article II of this Agreement. The Relocation will not change MSE's responsibilities under the Act for the MSE Options Market or expand the CBOE Options Market to include any activities with respect to MSE Options.

1.4. The term "Combination" means the combination of all aspects of the MSE Options Market with the CBOE Options Market in accordance with Article III of this Agreement.

1.5. The term "Interim Period" means the period commencing at the effective date of the Relocation and ending at the effective date of the Combination.

1.6. The term "MSE Options Members" means all persons who, from time to time, own a Midwest Stock Exchange Membership With Options Privileges or a Midwest Options Membership (as those terms are defined in Article II, Section 1(b) and 1(c) of the MSE Constitution).

ARTICLE II - RELOCATION AND INTERIM PERIOD.

2.1. MSE and CBOE shall use their best efforts to accomplish the Relocation at the earliest possible date, subject to the provisions of this Agreement.

2.2. Upon the effective date of the Relocation (which shall be the sixtieth day following the satisfaction

of the conditions set forth in Paragraph 2.10, unless MSE and CBOE agree in writing to another date), CBOE will make available to MSE reasonably contiguous facilities located adjacent to the CBOE trading floor reasonable for the conduct of the MSE Options Market, and MSE will relocate the MSE Options Market to those facilities; provided, however, that nothing in this Agreement shall be construed to give MSE any rights in CBOE's leasehold interest at 141 West Jackson Boulevard, Chicago, Illinois. CBOE may, from time to time, make reasonable changes in the location of the facilities provided for the MSE Options Market; provided, however, that during the Interim Period such facilities shall be reasonably contiguous and shall be as adequate for the trading of MSE Options as are the facilities then utilized for the trading of the same number of classes of CBOE Options having comparable trading volume. CBOE will use its best efforts to provide adequate booth space (under the same terms and conditions as booth space is provided to CBOE members) and access (of the same type provided to CBOE members) to communications facilities for allocation by MSE among MSE Options Members.

2.3. Prior to or concurrently with the Relocation, MSE will terminate trading in options with respect to the common stock of American Express Company.

2.4. During the Interim Period, trading in MSE Options will be conducted by MSE Options Members as members of MSE under the supervision and regulation of MSE and in accordance with the rules (as defined in the Act) of MSE. MSE will enforce dress and decorum policies in the MSE Options Market equivalent to those in effect from time to time in the CBOE Options Market.

2.5. During the Interim Period, the MSE Options Market will be open for trading only when the CBOE Options Market is open for trading. CBOE shall have no responsibility for any failure of the MSE Options Market to open, or to remain open, for trading on any day or at any time the CBOE Options Market is not open for trading for any reason whatever.

2.6. (a) During the Interim Period, CBOE will supply to MSE, in addition to the facilities referred to in Paragraph 2.2, the facilities and services listed below (all such facilities and services being collectively referred to as the "CBOE Services") in connection with the operation of the MSE Options Market:

(1) Collection and transmission of last sale reports and quotations to the Options Price Reporting Authority ("OPRA");

(2) Trade comparison processing performed under the existing Service Agreement dated March

2, 1978, between CBOE and MSE, as the same may be amended from time to time, with the addition of related administrative and clerical functions;

(3) Trading post and book processing facilities, systems, and services, including the supervision of MSE's Order Book Officials, substantially comparable to those now available in the MSE Options Market;

(4) Surveillance reports with respect to trading in the MSE Options Market using CBOE's computerized surveillance systems to generate MSE versions of existing CBOE reports from data contained in the daily Market Data Retrieval, Matched Trade List and The Options Clearing Corporation compliance files; and

(5) A daily transaction file sufficient for MSE to perform billing for transaction fees and book executions.

In carrying out the obligations of this paragraph, CBOE will use reasonable efforts to employ the personnel (other than Order Book Officials, who will remain employees of MSE) now employed by MSE in the operation and administration of the MSE Options Market. MSE will make reasonably available to CBOE the Order Book Officials employed by MSE in the MSE Options Market for the training of and consultation

with any personnel employed by CBOE in the operation of a trading system in the CBOE Options Market using order book officials. MSE will not hire or discharge any Order Book Official nor alter the terms of employment of any Order Book Official without the consent of CBOE, which consent shall not be unreasonably withheld. MSE agrees to assign the Order Book Officials to such classes of MSE Options as CBOE may from time to time request.

(b) CBOE shall have no obligation to provide a particular CBOE Service at any time when it does not, for any reason, provide a similar service or facility in connection with the operation of the CBOE Options Market or at any time when it is unable to do so on account of conditions over which it has no reasonable control. CBOE shall use its good faith efforts to correct such conditions promptly.

(c) To the extent the same are within CBOE's reasonable control, the CBOE Services shall be of the same general quality and timeliness, and delivered or made available to MSE on substantially the same basis, as are the comparable services and facilities CBOE supplies to the CBOE Options Market.

2.7. During the Interim Period, MSE will enforce Article XLVI, Rule 8, of its Rules and will maintain the Error Fund thereunder (the "Error Fund") at a level of not less than \$200,000. MSE will notify CBOE of any claim made

against the Error Fund within two business days after any such claim is asserted.

2.8. During the Interim Period, MSE will pay to CBOE, on or before the fifteenth of each month, a fee equal to all MSE Options Fees (as currently established under the MSE By-Laws and itemized at pages 6029 and 6030 of the CCH Midwest Stock Exchange Guide) and OPRA revenues collected by it with respect to the MSE Options Market for the immediately preceding month and all Options Fees and OPRA revenues then due MSE for more than 90 days and not yet paid, less the sum of (a) any amount paid during such preceding month (or paid during a prior month during the Interim Period and not previously deducted) by MSE into the Error Fund in excess of the amount of interest earned by MSE on the Error Fund during such preceding month (or earned in a prior month during the Interim Period and not previously credited hereunder), plus (b) an amount equal to the compensation and related expenses with respect to MSE's Order Book Officials for such preceding month, plus (c) \$25,600 per month during the Interim Period to be retained by MSE to defer the cost and expenses of its regulation, administration and operation of the MSE Options Market, plus (d) \$8,300 per month during the Interim Period (to a maximum of twelve months); provided, that the foregoing

shall not require MSE to pay to CBOE any MSE Options Fees and OPRA revenues accruing prior to the effective date of the Relocation, and provided further, that the commencement of the Combination shall not extinguish any liability of MSE to CBOE for the payment of such fee based on MSE Options Fees and OPRA revenues collected or due with respect to the MSE Options Market during the Interim Period (which payments shall be made on the fifteenth day of the four calendar months following the effective date of the Combination). The amount retained per month by MSE pursuant to clause (c) above will be reduced thereafter to \$16,800 if the Interim Period should extend beyond December 31, 1980; and to \$16,200 if the Interim Period should extend beyond December 31, 1981. MSE agrees to furnish to CBOE, on or before the fifteenth of each month, a report showing the MSE Options Fees and OPRA revenues due MSE for the preceding month, the amount collected, the amount outstanding and length of time outstanding, and a calculation of the fee for such month due to CBOE pursuant to this Paragraph 2.8. MSE agrees upon request of CBOE to increase a particular MSE Options Fee in proportion to any increase in a comparable fee imposed by CBOE. Unless required by the Commission, MSE will not hereafter decrease any MSE Options Fee, and any decrease in any MSE Options Fee required by the Commission will be equitably

allocated between MSE and CBOE in accordance with the reason stated by the Commission in its order requiring such decrease. MSE agrees to use its best efforts to utilize, assign its rights to, sublease, or otherwise to relieve itself of its obligations with respect to, the space described on Schedule 2 to this Agreement, and the amount that MSE is entitled to retain pursuant to clause (c) of the first sentence or the second sentence of this paragraph in respect of any month shall be reduced by the amount by which MSE is able to utilize or obtain such relief for such month.

2.9. On the effective date of the Relocation, MSE will assign to CBOE (in form satisfactory to CBOE), all of MSE's rights in the equipment, leases and agreements listed on Schedule 3 hereof, and CBOE will pay MSE \$23,500 therefor and assume MSE's obligations thereunder. CBOE will also purchase from MSE, at MSE's cost (not to exceed \$12,000), any remaining inventory of MSE market-maker trading forms.

2.10. (a) MSE shall have no obligation to effect the Relocation unless and until it has

(1) Obtained any authorization of its membership deemed necessary or advisable by it in order for it to implement the Relocation pursuant to the terms hereof;

(2) Obtained every consent, approval or action of the Commission and of any other gov-

ernmental or regulatory body which in the opinion of its counsel is required in order for it to implement the Relocation pursuant to the terms hereof; and

(3) Received the opinion of Messrs. Schiff Hardin & Waite, counsel for CBOE, to the effect that CBOE has received all authorization of CBOE's membership necessary under the Delaware General Corporation Law and under CBOE's Certificate of Incorporation, Constitution and Rules, and every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of such counsel is required, in order for CBOE to implement the Relocation pursuant to the terms hereof, which opinion shall be satisfactory in form and substance to MSE and its counsel, Messrs. Coffield Ungaretti Harris & Slavin.

(b) CBOE shall have no obligation to effect the Relocation unless and until it has

(1) Obtained any authorization of its membership deemed necessary or advisable by it in order for it to implement the Relocation pursuant to the terms hereof;

(2) Obtained every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of its counsel is required in order for it to implement the Relocation pursuant to the terms hereof; and

(3) Received the opinion of Messrs. Coffield Ungaretti Harris & Slavin, counsel for MSE, to the effect that MSE has received all authorization of MSE's membership necessary under the Delaware General Corporation Law and under MSE's Certificate of Incorporation, Constitution and Rules, and every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of such counsel is required, in order for MSE to implement the Relocation pursuant to the terms hereof, which opinion shall be satisfactory in form and substance to CBOE and its counsel, Messrs. Schiff Hardin & Waite.

(c) Each party shall promptly notify the other of its satisfaction of the conditions imposed by this paragraph, stating the date on which each such condition was satisfied.

ARTICLE III - COMBINATION

3.1. MSE and CBOE will use their best efforts to accomplish the Combination at the earliest possible date, subject to the provisions of this Agreement.

3.2. Upon the effective date of the Combination (which shall be the thirtieth day following the satisfaction of the conditions set forth in Paragraph 3.6, unless MSE and CBOE agree in writing to another date), the following shall occur:

(a) MSE will cease to provide a market for trading in classes of standardized options and will cease to have any responsibilities under the Act for such a market.

(b) CBOE will commence trading in MSE Options.

(c) MSE Options Members in good standing will become "Special Members" of CBOE having the following rights and obligations, all subject to the provisions of CBOE's Certificate of Incorporation, Constitution and Rules and to applicable laws and regulations:

(1) Special Members in good standing shall have the right to effect on CBOE as members of CBOE transactions in MSE Options which continue to be open for trading on CBOE and only in such options.

(2) Special Members in good standing shall have the same eligibility as the holders of present CBOE memberships ("Regular Members") may have from time to time for election to the Board of Directors of CBOE and for election or appointment to the standing or special committees maintained by CBOE.

(3) Special Members in good standing shall have the right to vote or petition on all matters upon which Regular Members may vote or petition under applicable provisions of law or under CBOE's Certificate of Incorporation, Constitution and Rules, as they may be amended from time to time, except that, unless otherwise required by law, the vote or petition signature of each Special Member shall count as one-sixth of the vote or petition signature of a Regular Member and that the presence of each Special Member at any meeting shall count as one-sixth of the presence of a Regular Member in determining whether a quorum exists at such meeting; provided, however, that the rights of Special Members set forth in subparagraphs (c)(1), (c)(2) and (c)(3) hereof shall not

be reduced without the favorable vote of a majority of the Special Members entitled to vote.

(4) Special Members shall have no right to participate in any distribution of the assets of CBOE pursuant to dissolution, winding-up or otherwise.

(5) Special Members shall be subject to all obligations of Regular Members under the Constitution and Rules of CBOE.

(6) Special Members shall pay dues, fees, other charges and assessments ("Fees") at the same rate as the Fees payable at any time and from time to time by Regular Members. A Special Member may at any time surrender his Special Membership to CBOE, provided that such Special Member has paid CBOE all Fees then due. Upon surrender, such Special Membership shall be cancelled and the Special Member's obligations with respect to payment of Fees accruing from and after the date of surrender shall cease.

(7) A Special Member may at any time transfer all his right, title and interest in his Special Membership, provided that

the transferee meets the requirements for membership then imposed by CBOE. An MSE Options Member who has leased his MSE Options Membership continuously since July 18, 1978 to a single lessee may lease his Special Membership, in accordance with CBOE Rules, to that lessee and only to that lessee.

(8) Each Special Membership will terminate ten years after the effective date of the Combination or at such earlier date as such membership may be cancelled pursuant to CBOE's rules for non-payment of Fees.

(d) CBOE will offer to hire all Order Book Officials then employed by MSE on terms no less favorable than those on which they are then being employed by MSE.

(e) Regular Members of CBOE shall have the right to trade in MSE Options on the same terms and conditions upon which they may trade in CBOE Options.

3.3. Prior to or concurrently with the effective date of the Combination, MSE shall transfer to CBOE such membership files and other records theretofore maintained by MSE in connection with the MSE Options Market and the MSE Options Members and their lessees as CBOE shall request.

3.4. Following the effective date of the Combination, CBOE will pay to MSE \$310,800 in three equal annual

installments; provided, however, that the amount so payable shall be reduced by the sum of (a) \$10,300 for each calendar month that the effective date of the Combination occurs after September 30, 1978, plus (b) the amount retained by MSE pursuant to clause (d) of the first sentence of Paragraph 2.8 hereof, plus (c) \$20,000 for each year or part of a year that the effective date of the Combination occurs after November 30, 1978. The first such installment shall be paid within 30 days after the effective date of the Combination, and the second and third installments shall be paid without interest on the first and second anniversaries, respectively, of the effective date of the Combination.

3.5. As at the effective date of the Combination, CBOE shall assume any remaining obligations of MSE with respect to the space described on Schedule 2 to this Agreement. MSE and CBOE will cooperate and use their best efforts to obtain any consents of third parties required to effect such assumption.

3.6. (a) MSE shall have no obligation to effect the Combination unless and until it has

(1) Obtained any authorization of its membership deemed necessary or advisable by it in order for it to implement the Combination pursuant to the terms hereof;

(2) Obtained every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of its counsel is required in order for it to implement the Combination pursuant to the terms hereof; and

(3) Received the opinion of Messrs. Schiff Hardin & Waite, counsel for CBOE, to the effect that CBOE has received all authorization of CBOE's membership necessary under the Delaware General Corporation Law and under CBOE's Certificate of Incorporation, Constitution and Rules, and every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of such counsel is required, in order for CBOE to implement the Combination pursuant to the terms hereof, which opinion shall be satisfactory in form and substance to MSE and its counsel, Messrs. Coffield Ungaretti Harris & Slavin.

(b) CBOE shall have no obligation to effect the Combination unless and until it has

(1) Obtained any authorization of its membership deemed necessary or advisable by it in order for it to implement the Combination pursuant to the terms hereof;

(2) Obtained every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of its counsel is required in order for it to implement the Combination pursuant to the terms hereof; and

(3) Received the opinion of Messrs. Coffield Ungaretti Harris & Slavin, counsel for MSE, to the effect that MSE has received all authorization of MSE's membership necessary under the Delaware General Corporation Law and under MSE's Certificate of Incorporation, Constitution and Rules, and every consent, approval or action of the Commission and of any other governmental or regulatory body which in the opinion of such counsel is required, in order for MSE to implement the Combination pursuant to the terms hereof, which opinion shall be satisfactory in form and substance to CBOE and its counsel, Messrs. Schiff Hardin & Waite.

(c) Each party shall promptly notify the other of its satisfaction of the conditions imposed by this paragraph, stating the date on which each such condition was satisfied.

ARTICLE IV - ADDITIONAL AGREEMENTS

4.1. MSE and CBOE agree to cooperate and to use their best efforts in good faith to secure the authorizations of their respective memberships and any governmental or regulatory consents or approvals necessary in connection with this Agreement, to satisfy the conditions and to consummate the transactions provided for herein, and to implement any changes in their respective Certificates of Incorporation, Constitutions and Rules contemplated or required by this Agreement.

4.2.(a) CBOE agrees to indemnify and hold harmless MSE, its governors, officers and employees from and against any and all direct or indirect loss, liability, claim, action or expense (including costs of defense and reasonable attorneys' fees) whatsoever arising out of or based upon (1) any claim pending or threatened against CBOE as at the date hereof; (2) any act or omission of CBOE otherwise than in connection with this Agreement or the transactions contemplated hereby; (3) any claim by any past, present or future CBOE member or any person claiming through any CBOE member (including, without limitation, the lessees and customers of CBOE members) arising out of the claimed rights of such a person as or through a CBOE member or arising in connection with this Agreement or any of the transactions contemplated hereby; (4) any failure of CBOE to per-

form those obligations of MSE to third parties which are assigned to and assumed by CBOE pursuant to Paragraphs 2.9 and 3.5 hereof; (5) any failure of CBOE to supply CBOE Services to MSE in breach of Paragraph 2.6 hereof; and (6) any violation by CBOE of any provisions of the Act or of any rule or regulation thereunder, or any failure by CBOE to enforce compliance by its members with its rules, in connection with transactions in MSE Options from and after the effective date of the Combination.

(b) MSE agrees to indemnify and hold harmless CBOE, its directors, officers and employees from and against any and all direct or indirect loss, liability, claim, action or expense (including costs of defense and reasonable attorneys' fees) whatsoever arising out of or based upon (1) any claim pending or threatened against MSE as at the date hereof; (2) any act or omission of MSE otherwise than in connection with this Agreement or the transactions contemplated hereby; (3) any claim by any past, present or future MSE member (whether or not an MSE Options Member) or any person claiming through any such MSE member (including, without limitation, the lessees and customers of MSE members) arising out of any claimed right of any such person as or through an MSE member or arising in connection with this Agreement or any of the transactions contemplated hereby; (4) any violation by MSE of any provisions of the Act

or of any rule or regulation thereunder, or any failure by MSE to enforce compliance by its members with its rules, in connection with transactions in MSE Options prior to the effective date of the Combination; and (5) any acts, errors or omissions of MSE Order Book Officials during any period they are MSE employees.

(c) Promptly after receipt by an indemnified party under this Paragraph 4.2 of notice of the commencement of any action or the assertion of any claim, such indemnified party will, if a claim in respect thereof is to be made against the indemnifying party under this Paragraph, notify the indemnifying party in writing of the commencement thereof. In case any such action is brought or claim asserted against any indemnified party, and it promptly notifies the indemnifying party of the commencement thereof, the indemnifying party will be entitled to participate in, and, to the extent that it may wish, to assume and control the defense thereof, with counsel chosen by it, and after notice from the indemnifying party to the indemnified party of its election so to assume the defense thereof, the indemnifying party will not be liable to such indemnified party hereunder for any legal or other expenses subsequently incurred by the indemnified party in connection with the defense thereof other than reasonable costs of investigation, but the indemnified party may, at its own expense, partici-

pate in such defense by counsel chosen by it, without, however, impairing the indemnifying party's control of the defense. The indemnifying party may negotiate a compromise or settlement of any such action provided that such compromise or settlement does not require a contribution by the indemnified party.

4.3 No assets of MSE shall be sold, transferred or assigned to CBOE, nor shall any liabilities be assumed by CBOE, except as herein otherwise expressly provided.

4.4. Nothing herein shall constitute a limitation on CBOE's right to make future determinations with respect to which classes of options contracts will be approved for trading on CBOE, or with respect to the manner or location on CBOE's floor of such trading; provided, however, that in making any such determination, CBOE will in good faith consider the overall interests of its members (including the interests of Special Members) and will devote to the trading of those MSE Options which continue to be open for trading facilities as adequate as those devoted to the same number of classes of CBOE Options having comparable trading volume.

4.5. MSE agrees that it shall not, from and after the date of this Agreement, increase the number of existing Midwest Stock Exchange Memberships With Options Privileges and Midwest Options Memberships, provided that the foregoing

shall not affect the conversion rights set forth in Article II, Section 1 of the MSE Constitution.

4.6. The Board of Governors of MSE may waive in whole or in part the performance by CBOE of any obligation imposed by this Agreement or the fulfillment by CBOE of any condition precedent to any of the obligations of MSE; and the Board of Directors of CBOE may waive in whole or in part the performance by MSE of any obligation imposed by this Agreement or the fulfillment by MSE of any condition precedent to any of the obligations of CBOE.

4.7. This Agreement shall be binding upon and shall inure to the benefit of the respective successors and assigns of MSE and CBOE, but no assignment by either party of its rights or obligations under this Agreement shall be effective without the prior written consent of the other party.

4.8. This Agreement shall be deemed to be made and entered into pursuant to the laws of the State of Illinois. In the event of any dispute hereunder, this Agreement shall be governed by and shall be construed in accordance with the laws of the State of Illinois.

4.9. This instrument contains the entire agreement between the parties in respect of the subject matter hereof and supersedes all previous agreements, negotiations, commitments and writings in respect of such subject matter.

4.10. All communications, notices and exchanges of information contemplated herein or required or permitted to be given hereunder, shall be in writing and shall be deemed to be given when deposited in the United States mail, certified, postage prepaid, and addressed as follows:

If to CBOE: President
Chicago Board Options Exchange,
Incorporated
141 West Jackson Boulevard
Chicago, Illinois 60604

With a copy to: Schiff Hardin & Waite
7200 Sears Tower
233 South Wacker Drive
Chicago, Illinois 60606

If to MSE: President
Midwest Stock Exchange, Incorporated
120 South LaSalle Street
Chicago, Illinois 60603

With a copy to: Coffield Ungaretti Harris & Slavin
30 North LaSalle Street
Chicago, Illinois 60602

4.11. This Agreement may be executed in any number of counterparts, and each counterpart shall be deemed an original for all purposes.

IN WITNESS WHEREOF, MSE and CBOE have caused this instrument to be executed by their respective duly authorized officers, as of the day and year first above written.

MIDWEST STOCK EXCHANGE, INCORPORATED

By

Robert L. Raclin
Robert L. Raclin
Chairman of the Board

And

Richard B. Walbert
Richard B. Walbert
President

ATTEST:

Dennis A. Bell
Dennis A. Bell
Secretary

CHICAGO BOARD OPTIONS EXCHANGE,
INCORPORATED

By

Edward F. Neild, IV
Edward F. Neild, IV
Chairman of the Board

And

Joseph W. Sullivan
Joseph W. Sullivan
President

ATTEST:

Scott L. Leger
Scott L. Leger
Secretary

Schedule 1 - Securities Underlying MSE Options

Bristol-Meyers Company
Carrier Corporation
Champion International Corporation
Coastal States Gas Corporation
Evans Products Co.
Freeport Minerals Company
Corning Glass Works
Hughes Tool Co.
Litton Industries, Inc.
Middle South Utilities, Inc.
Northwest Industries, Inc.
Owens-Illinois, Inc.
Ralston Purina Co.
Revlon, Inc.
Rockwell International Corp.
Safeway Stores, Incorporated

Schedule 2 - Space at 120 South La Salle Street Relating To
MSE Options Market

1. One-half the space (not to exceed 419 square feet) known as Room 1243, 120 South LaSalle Street, Chicago, Illinois leased by MSE under a sublease dated November 1, 1976, between Pershing & Co., Inc. and MSE.
2. The space now utilized for the MSE options trading floor (not to exceed 3,880 square feet) on the third floor at 120 South LaSalle Street, Chicago, Illinois and leased by MSE under a lease agreement dated June 26, 1957, as amended by agreement dated January 21, 1966, between The Lurie Company and MSE.

Schedule 3 -- MSE Equipment, Leases and Agreements

1. One CCI Terminal, Serial No. 36766
2. The lease of one Trans-Lux Ten Foot Jet now located on the MSE Options Floor and subject to a lease agreement between Trans-Lux Corporation and MSE dated October 4, 1973, as amended November 26, 1976.
3. MWA Option Monitor Services-Subscriber Agreement between Monchik-Weber Associates, Inc., and MSE dated August 1, 1977.
4. Equipment Lease Agreement between Computer Communications, Inc., and MSE dated September 20, 1977.
5. Equipment Installation and Maintenance Agreement between Computer Communications, Inc., and MSE dated September 20, 1977.
6. Letter Agreement among Equivest, Inc., Computer Communications, Inc., and MSE dated September 20, 1977.