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96 CIV. 5313

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UNITED STATES DISTRICT COURT FOR  
THE SOUTHERN DISTRICT OF NEW YORK

MAR 17 1956

UNITED STATES OF AMERICA,  
  
PLAINTIFF,

USDC SDNY

v.

Civil Action No.

ALEX. BROWN & SONS INC.;  
BEAR, STEARNS & CO. INC.; CS  
FIRST BOSTON CORP.; DEAN  
WITTER REYNOLDS INC.;  
DONALDSON, LUFKIN & JENRETTE  
SECURITIES CORP.; FURMAN SELZ  
LLC; GOLDMAN, SACHS & CO.;  
HAMBRECHT & QUIST LLC; HERZOG,  
HEINE, GEDULD, INC.; J.P.  
MORGAN SECURITIES, INC.;  
LEHMAN BROTHERS, INC.; MAYER  
& SCHWEITZER, INC.; MERRILL  
LYNCH, PIERCE, FENNER & SMITH,  
INC.; MORGAN STANLEY & CO.,  
INC.; NASH, WEISS & CO.; OLDE  
DISCOUNT CORP.; PAINWEBBER  
INC.; PIPER JAFFRAY INC.;  
PRUDENTIAL SECURITIES INC.;  
SALOMON BROTHERS INC.;  
SHERWOOD SECURITIES CORP.;  
SMITH BARNEY INC.; SPEAR,  
LEEDS & KELLOGG, LP; and  
UBS SECURITIES LLC,

COMPLAINT FOR EQUITABLE  
RELIEF FOR VIOLATION OF  
15 U.S.C. § 1

DEFENDANTS.

COMPLAINT

The United States of America, acting under the direction of  
the Attorney General, brings this civil action pursuant to

Section 4 of the Sherman Act, as amended, 15 U.S.C. § 4, to obtain equitable and other relief to prevent and restrain violations of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. For its Complaint, the United States alleges:

I.

JURISDICTION AND VENUE

1. This Court has jurisdiction of this action and jurisdiction over the parties pursuant to 15 U.S.C. § 4 and 28 U.S.C. §§ 1331 and 1337.

2. Each of the defendants resides, or is licensed to transact business, or is transacting business in this District. Venue is proper in this District under 15 U.S.C. § 22 and 28 U.S.C. § 1391(c).

II.

DEFENDANTS

3. Defendant ALEX. BROWN & SONS INC. is a corporation organized and existing under the laws of the State of Maryland, with its principal place of business in Baltimore, Maryland.

4. Defendant BEAR, STEARNS & CO., INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

5. Defendant CS FIRST BOSTON CORP. is a corporation organized and existing under the laws of the Commonwealth of

Massachusetts, with its principal place of business in New York, New York.

6. Defendant DEAN WITTER REYNOLDS, INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

7. Defendant DONALDSON, LUFKIN & JENRETTE SECURITIES CORP. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

8. Defendant FURMAN SELZ LLC is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

9. Defendant GOLDMAN, SACHS & CO. is a partnership organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

10. Defendant HAMBRECHT & QUIST LLC is a corporation organized and existing under the laws of the State of California, with its principal place of business in San Francisco, California.

11. Defendant HERZOG, HEINE, GEDULD, INC. is a corporation organized and existing under the laws of the State of New York, with its principal place of business in New York, New York.

12. Defendant J.P. MORGAN SECURITIES, INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

13. Defendant LEHMAN BROTHERS, INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

14. Defendant MAYER & SCHWEITZER, INC. is a corporation organized and existing under the laws of the State of New Jersey, with its principal place of business in Jersey City, New Jersey.

15. Defendant MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

16. Defendant MORGAN STANLEY & CO., INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

17. Defendant NASH, WEISS & CO. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Jersey City, New Jersey.

18. Defendant OLDE DISCOUNT CORP. is a corporation organized and existing under the laws of the State of Michigan, with its principal place of business in Detroit, Michigan.

19. Defendant PAINWEBBER INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

20. Defendant PIPER JAFFRAY INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in Minneapolis, Minnesota.

21. Defendant PRUDENTIAL SECURITIES INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

22. Defendant SALOMON BROTHERS INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

23. Defendant SHERWOOD SECURITIES CORP. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

24. Defendant SMITH BARNEY INC. is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business in New York, New York.

25. Defendant SPEAR, LEEDS & KELLOGG, LP, is a limited partnership organized and existing under the laws of the State of New York, with its principal place of business in Jersey City, New Jersey. TROSTER SINGER is a division of Spear, Leeds & Kellogg, LP.

26. Defendant UBS SECURITIES LLC is a corporation organized and existing under the laws of the State of New York, with its principal place of business in New York, New York.

27. During a part or all of the time period covered by this Complaint, each of the defendants identified above served as a market maker on Nasdaq and purchased and sold stock on Nasdaq.

28. The acts, deeds or transactions charged in this Complaint have been done by the defendants and were ordered and

performed by their officers, directors, agents, employees or representatives while actively engaged in the management, direction, control or transaction of defendants' business or affairs.

### III.

#### CO-CONSPIRATORS

29. Various partnerships, corporations and associations, including other Nasdaq market makers, not named as defendants in this Complaint, have participated with defendants in the violation alleged in this Complaint.

### IV.

#### TRADE AND COMMERCE

30. The Nasdaq Stock Market, Inc. ("Nasdaq") is the second largest securities market (measured by dollar value of trading) in the United States.

31. Nasdaq market makers, including the defendants, have offices in various states. Their market-making activities, and the violation alleged in this Complaint, affect investors located throughout the United States.

32. During the time period covered by this Complaint, defendants have traded substantial numbers of shares of Nasdaq stock across state lines in a continuous and uninterrupted flow of interstate trade and commerce. The activities of each

defendant as described in this Complaint have been within the flow of, and have substantially affected, interstate commerce.

V.

CLAIM FOR RELIEF

33. Defendants are major "market makers" in Nasdaq stocks.

34. Market makers establish their Nasdaq quotes in a particular stock by simultaneously quoting prices at which they are willing to buy and sell particular Nasdaq stocks. The quote at which an individual market maker is willing to buy a particular stock is known as its "bid"; the quote at which it is willing to sell is known as its "ask." A market maker's bid is always lower than its ask, and the difference between the two is known as its "dealer spread."

35. There are at least two market makers in each Nasdaq stock. These market makers are purportedly independent and purportedly compete against other market makers, by, among other ways, quoting bid and ask prices on Nasdaq for particular stocks.

36. The market makers' bid and ask prices are organized and displayed on Nasdaq's computerized quotation system. The market makers use this computer system to change and update their respective bid and ask prices and to continuously communicate their prices to the other market makers in particular stocks.

37. At any given time, one or more than one market maker may have the best bid or ask price in a particular stock on

Nasdaq. The highest bid price is known as the "inside bid"; the lowest ask price is known as the "inside ask." The difference between the "inside bid" (the highest price offered by any market maker to buy that stock) and the "inside ask" (the lowest price offered by any market maker to sell that same stock) is referred to as the "inside spread."

38. Market makers earn money from the difference between the bid and the ask, or the inside spread. Market makers therefore have an incentive to maintain wider inside spreads in Nasdaq stocks than would exist in a competitive market.

39. The width of the inside spread in a stock has a direct impact on investors in Nasdaq stocks. The wider the inside spread, the greater the transaction costs for buying and selling Nasdaq stocks.

40. Beginning at least as early as 1989, and continuing to the date of this Complaint, a common understanding arose among the defendants and other Nasdaq market makers concerning, among other things, the manner in which bids and asks would be displayed on Nasdaq (the "quoting convention"). Under the quoting convention, stocks with a dealer spread of  $3/4$  point or greater are quoted in even-eighths (quarters). Under the quoting convention, market makers use odd-eighth fractions in their bid and ask prices only if they first narrow their dealer spread in the stock in question to less than  $3/4$  of a point.



41. Defendants and other market makers have reached a common understanding to adhere to the quoting convention. This understanding is evidenced by, among other things, the following facts:

a. For a significant number of major stocks traded on Nasdaq, all of which have prevailing dealer spreads of  $3/4$ s of a point or greater, there has been an almost complete absence of bid or ask price quotes in odd-eighths;

b. Defendants and other market makers have used and continue to use peer pressure to ensure compliance with the common understanding by making it known throughout the industry that it is "unethical" or "unprofessional" for a market maker to "break the spread" by using odd-eighth quotes in stocks with dealer spreads of  $3/4$ s of a point or greater and by accusing market makers who do so of "making a Chinese market";

c. Defendants and other market makers have taken actions to enforce compliance with the common understanding and to coerce non-complying market makers to adhere to the common understanding by, among other things, making telephone calls to market makers who have violated the quoting convention or narrowed the inside spread;

d. Defendants and other market makers have threatened to refuse, and refused, to deal with traders and firms that have violated the quoting convention;

e. Absent a common understanding, it would not have been in the economic self-interest of defendants and other market makers to narrow their dealer spreads below  $3/4$ s of a point as a condition of being able to adjust their bid and ask prices in odd-eighths, as a narrower dealer spread imposes a greater economic risk to market makers;

f. Absent a common understanding, there are numerous instances in which it would have been in the economic self-interest of market makers freely competing with one another to maintain a dealer spread of  $3/4$ s of a point or greater and yet have improved their bid or ask prices by  $1/8$  of a point, rather than by  $1/4$  of a point;

g. Confronted by (1) widespread news reports of an academic study that indicated collusion in the Nasdaq market, and (2) a major and continuing investigation by the Antitrust Division of the Department of Justice, the defendants and other market makers have altered their quoting practices by using odd-eighth increments for bid and ask quotes in some stocks where such increments were previously avoided. This abrupt change in behavior cannot be explained by any reduction in the defendants'

costs of doing business, nor by any change in market structure, trading strategy, or the fundamentals of the underlying stocks; and

h. Market makers, including defendants and others, frequently have used and continue to use an electronic trade system known as Instinet on which to buy and sell, at odd-eighth prices, the same Nasdaq stock that they have quoted and continue to quote only in even-eighth prices on Nasdaq. The fact that defendants and other market makers have used and continue to enter orders to buy and sell Nasdaq stocks at prices quoted in odd-eighths on a proprietary trading system that is comparable to Nasdaq shows that the absence of odd-eighth quotes on Nasdaq is not the result of any fundamental attributes of those stocks and is evidence that the quoting convention has operated and continues to operate on Nasdaq to keep the inside spread in numerous Nasdaq stocks at 1/4 point or greater.

42. The purpose and effect of the quoting convention has been to raise, fix, and stabilize the inside spread on a substantial number of Nasdaq stocks at a minimum of 1/4 point. The quoting convention has had the following effects, among others:

- a. price competition among the defendants and co-conspirators in the purchase and sale of Nasdaq securities has been restrained;
- b. investors who have purchased or sold Nasdaq securities have been deprived of the benefits of free and open competition in the purchase and sale of Nasdaq securities; and
- c. the inside spread on a substantial number of Nasdaq stocks has been wider than it would have been in a competitive market, resulting in higher transaction costs for buying and selling Nasdaq stocks.

43. Unless permanently restrained and enjoined, defendants and other market makers will continue to agree and adhere to the quoting convention, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.

## VI.

### PRAYER FOR RELIEF

WHEREFORE, plaintiff prays:

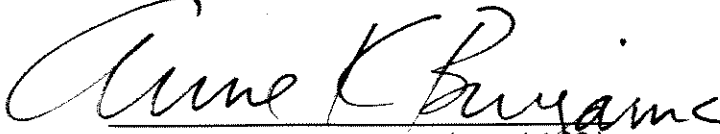
1. That the Court adjudge and decree that the defendants have combined and conspired to restrain interstate trade and commerce in violation of Section 1 of the Sherman Act.
2. That the defendants, their officers, directors, agents, employees, and successors and all other persons acting or claiming to act on their behalf be enjoined and restrained from,

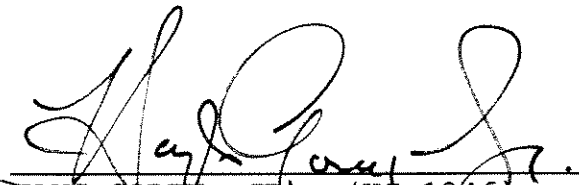
in any manner, directly or indirectly, continuing, maintaining, or renewing the combination and conspiracy hereinbefore alleged, or from engaging in any other combination, conspiracy, contract, agreement, understanding or concert of action having a similar purpose or effect, and from adopting or following any practice, plan, program, or device having a similar purpose or effect.


3. That plaintiff have such other relief as the Court may deem just and proper.

4. That plaintiff recover the costs of this action.

Dated: JULY 17, 1996

  
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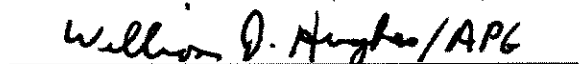
  
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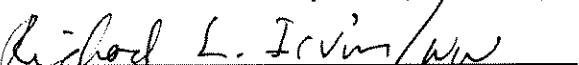
  
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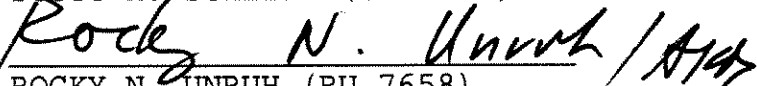
  
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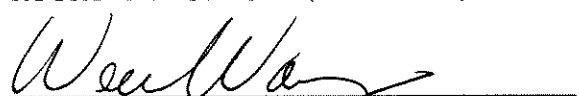
  
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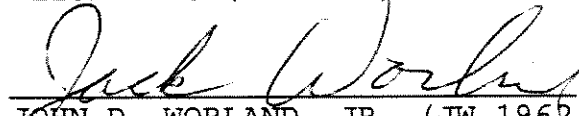
  
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