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November 17, 2005

Via Facsimile and Federal Express

Mr. Jonathan G. Katz, Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
450 5th St., N.W.
Washington, D.C. 20549

Re: Chicago Board Options Exchange, Incorporated – Request for Exemption Under Rule 608(e) of Regulation NMS Under the Securities Exchange Act of 1934 from Certain Provisions of the “Plan for the Purpose of Creating and Operating an Intermarket Option Linkage” Relating to the Representation of Principal Acting as Agent Orders

Dear Mr. Katz:

Chicago Board Options Exchange, Incorporated (“CBOE”) respectfully requests that the Commission grant CBOE a partial exemption from Rule 608(c) of Regulation NMS under the Securities Exchange Act of 1934 (the “Exchange Act”), which requires CBOE to comply with and enforce compliance by its members with the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (the “Plan”). As more fully set forth below, CBOE seeks an exemption that would allow CBOE employees or independent contractors, when acting in the capacity of “PAR Officials” under CBOE rules as described below, to utilize the principal account of CBOE designated primary market makers (“DPMs”) in order to send a Principal Acting as Agent Order (“P/A Order”) through the Intermarket Option Linkage (the “Linkage”) established by the Plan, even though the DPM is not acting as the agent for that order.

Commission’s Exemptive Authority

Rule 608(e) of Regulation NMS under the Exchange Act authorizes the Commission to issue exemptions from the provisions of Rule 608. In particular, Rule 608(e) provides:

The Commission may exempt from the provisions of this rule, either unconditionally or on specific terms and conditions, any self-regulatory organization . . . if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system.

17 CFR 242.608(e). The Plan is an effective national market system plan pursuant to Rule 608, and CBOE is a Participant in the Plan. Rule 608(e) authorizes the Commission to issue an

exemption to CBOE from Rule 608(c), which requires CBOE to comply with and to enforce compliance by CBOE's members with the terms of the Plan.¹

Background

CBOE seeks this exemption in order to facilitate a rule change that eliminates the possibility of priority rule violations by DPMs.² CBOE has determined that the most effective way to accomplish this goal is to eliminate a DPM's duty or authority to represent unexecuted customer orders as an agent. Under the PAR Official Proposal, the duty to execute customer orders on the PAR workstation would be assumed by Exchange employees or independent contractors that would be known as "PAR Officials."

In executing customer orders on the PAR workstation, the PAR Officials will need a mechanism to obtain an execution for customer orders when the best available price exists on another exchange. Under the current CBOE Rules, a DPM acts as agent for unexecuted customer orders on the PAR workstation and can route a P/A Order through Linkage to the exchange that is disseminating the national best bid or offer ("NBBO"). When the DPM receives an execution of a P/A Order, it then executes a corresponding transaction in favor of the customer at the price obtained for the P/A Order, thereby effectively transferring the trade to the customer.

After PAR Officials assume responsibility for unexecuted customer orders received on the PAR workstation, PAR Officials need a comparable means to ensure that customer orders receive an execution on another exchange when the bid or offer on that exchange is superior to CBOE's market. Only P/A Orders are guaranteed an execution under the Plan for a size applicable to customer orders.³ Under Section 2(16)(a) of the Plan, however, a P/A Order may be routed to another exchange only through the principal account of a Market Maker that is authorized to represent customer orders. The PAR Official Proposal would require a DPM to allow the DPM's principal account to be used by PAR Officials to place P/A Orders related to unexecuted customer orders on the PAR workstation when another exchange is disseminating a superior price. This mechanism would enable PAR Officials to obtain for customers the same quality of execution that DPM agents now are able to obtain for customer orders on the PAR workstation.

¹ Rule 608(c) requires each self-regulatory organization to "comply with the terms of any effective national market system plan of which it is a sponsor or a participant [, and] absent reasonable justification or excuse, enforce compliance with any such plan by its members." 17 CFR 242.608(c).

² See Securities Exchange Act Release No. 34-52017 (July 12, 2005), 70 FR 41453 (July 19, 2005) (SR-CBOE-2005-46) ("PAR Official Proposal").

³ Compare Section 7(a)(ii)(A) and (B) of the Plan with Section 7(a)(ii)(C) of the Plan.

Provisions of the Plan Requiring Exemption

Section 7(a)(ii) of the Plan provides that a member of a Participant who wishes to buy or sell contracts of a series of an Eligible Option Class, as defined in the Plan, by sending an order through Linkage may do so by using one of three defined order types. Section 2(16)(a) of the Plan defines a P/A Order as an order for the “principal account of a Market Maker that is *authorized to represent* Customer orders, reflecting the terms of a related unexecuted Customer order *for which the Market Maker is acting as agent.*”⁴ (Emphasis added.) Under CBOE’s proposed approach, the P/A Order would be placed through the DPM’s principal account, and the P/A Order would reflect the “terms of a related unexecuted Customer order.” However, the PAR Official, not the DPM, would have custody of, and be responsible for executing, the related customer order. Accordingly, although the DPM qualifies as a “Market Maker,” the Customer order would *not* be one for which the DPM would be “acting as agent” or one that the DPM would be “authorized to represent” in the sense that an agent represents a Customer’s order. Accordingly, CBOE requests an exemption from the requirement in Rule 608(c) that CBOE enforce compliance by its members with the requirement in Section 7(a)(ii)(A) and (B) of the Plan that P/A Orders be for the account of a market maker that is authorized to represent Customer orders and that is acting as agent for a related unexecuted Customer order. Absent an exemption, Rule 608(c) would require CBOE to enforce compliance by its members with these aspects of the definition of an allowable P/A Order and thereby would prevent DPMs from sending through Linkage a P/A Order that reflects the terms of a related unexecuted Customer order held by the PAR Official.

In addition, Section 4(b) of the Plan requires CBOE to enforce compliance with the provisions of the Plan by CBOE’s members when they use the Linkage through CBOE’s facilities. Because CBOE is seeking an exemption from the requirement that it enforce compliance with certain provisions of the Plan, it will necessarily need an exemption from Section 4(b) of the Plan as well.

Exemption Request

In connection with the Commission’s approval of CBOE’s PAR Official Proposal, CBOE respectfully requests an exemption, pursuant to Rule 608(e), from the requirement of Rule 608(c) that CBOE enforce compliance by its members with the requirements in Section 7(a)(ii)(A) and (B) of the Plan that P/A Orders be for the account of a market maker that is authorized to represent Customer orders and that is acting as agent for a related unexecuted Customer order, provided that:

- 1) The P/A Order is routed through the Linkage and is for the principal account of the DPM;

⁴ Section 2(5) of the Plan defines a “Customer” order as “an order which, if executed, would result in the purchase or sale for an account in which no Broker/Dealer has an interest.” (Emphasis omitted.)

- 2) The order reflects the terms of a related order of a Customer, as that term is defined under Section 2(5) of the Plan;
- 3) The order is routed to the PAR workstation where the order is in the custody of a PAR Official; and
- 4) The resulting execution is transferred to the Customer by means of an appropriate offsetting transaction.

Lastly, to the same extent and subject to the same limitations, CBOE requests exemptive relief from the requirement in Rule 608(c) of Regulation NMS that CBOE comply with Section 4(b) of the Plan by enforcing compliance by its members with the provisions of Section 7(a)(ii)(A) and (B) of the Plan, as discussed above.

The exemption CBOE requests satisfies the requirements of Rule 608(e) of Regulation NMS, in that the exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system. In particular, the exemption will enable CBOE to implement the PAR Official Proposal, which is intended to eliminate trading ahead violations by DPMs, a result that is in the public interest and will protect investors, while enabling PAR Officials to protect and represent Customer orders by obtaining executions at a superior option price when one is available on another exchange. Moreover, the elimination of the possibility of trading ahead by these DPMs will promote the fairness of CBOE's market and will further an important overall goal of the national market system – namely, ensuring that these DPMs are not in a position to put their own interests above those of Customers and eliminating any public perception that these DPMs may engage in such conduct. These changes thereby will promote investor confidence in the integrity of CBOE's market, which itself will strengthen the overall national market system.

These important goals will be accomplished without sacrificing any of the policy goals that underlie the definition of P/A Orders under Section 2(16)(a) of the Plan. The key purpose behind that definition is to ensure that customer orders have access to the NBBO through the Linkage. The Plan implements that goal by defining a P/A Order as an order that reflects the terms of an underlying "Customer order," which in turn is defined as an order "which, if executed, would result in the purchase or sale for an account in which no Broker/Dealer has an interest."⁵ In contrast, a Principal Order is defined as an order for the DPM's principal account as to which there is no related customer order.⁶

⁵ *Supra at Note 4.*

⁶ Section 2(16)(b) of the Plan defines a "Principal Order" as an "order for the principal account of an Eligible Market Maker and is not a P/A Order." (Emphasis omitted.)

Mr. Jonathan G. Katz

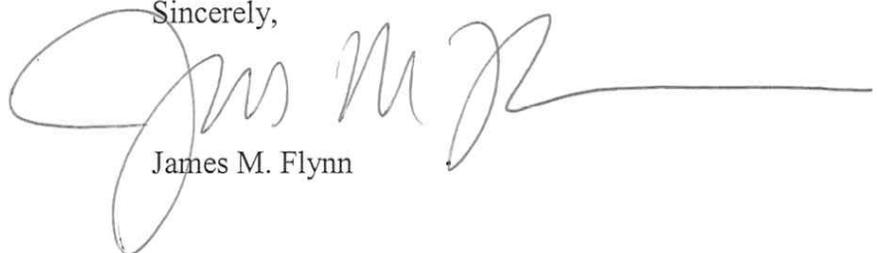
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In other words, the point of the definition of a P/A Order is not that the DPM must be acting as an agent for a Customer with respect to the order in question, but that the DPM must *not* be acting on its *own* behalf as a principal with respect to that order. Although Section 2(16)(a) of the Plan nominally defines a P/A Order in terms of whether the DPM is “acting as agent” with respect to the underlying unexecuted “Customer order,” that language is based on the assumption that the only alternatives are that a DPM must be acting as either an agent or a principal. Based on that assumption, the definition limits P/A Orders to instances when the DPM is acting as an agent – in order to exclude from the definition any instance in which the DPM is acting in its *principal* capacity. However, the present situation involves a third option that the Plan apparently did not contemplate – that the DPM could be acting *neither* as an agent *nor* as a principal, but rather as merely a pass-through intermediary. In particular, the Customer order would be in the custody of, and would be handled exclusively by, the PAR Official, who would simply use the DPM’s account as a vehicle by which to transmit the order through the Linkage system. Because the underlying order would be an order for a non-broker/dealer customer, not for the DPM’s principal account, the requested exemption would be consistent with all of the policy goals that underlie the definition of a P/A Order.

For the foregoing reasons, CBOE respectfully requests that the Commission grant an exemption to CBOE from Rule 608(c), which requires CBOE to comply with, and enforce compliance with, Sections 7(a)(ii)(A) and (B) of the Plan and Section 4(b) of the Plan, under the terms and conditions specified above. Thank you for your consideration of this request. If you have any questions, please feel free to contact me at 312-786-7070.

Sincerely,

A handwritten signature in black ink, appearing to read "James M. Flynn", with a long horizontal line extending to the right.

James M. Flynn

cc: Elizabeth King, SEC’s Division of Market Regulation