

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51189; File No. SR-CBOE-2005-12)

February 10, 2005

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. to Amend its Obvious Error Rule

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 26, 2005, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The proposed rule change has been filed by CBOE as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder.⁴ On February 9, 2005, CBOE submitted Amendment No. 1 to the proposed rule change.⁵ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to amend its obvious error rule, CBOE Rule 6.25 (Nullification and Adjustment of Equity Options Transactions) to adopt an erroneous quote provision. The Exchange also proposes to make two minor grammatical changes to CBOE Rule 24.16

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ Amendment No. 1 made technical corrections to the proposed rule text.

(Nullification and Adjustment of Index Option Transactions). Additions are italicized.

Deletions are bracketed.

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Rule 6.25 Nullification and Adjustment of Equity Options Transactions

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(a) Trades Subject to Review

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(1) – (4) No Change.

(5) Erroneous Quote in Underlying: Electronic trades (this provision has no applicability to trades executed in open outcry) resulting from an erroneous quote in the underlying security may be adjusted or nullified as set forth in paragraph (a)(1) above. An erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying security on the primary market (as defined in Rule 1.1(v)) during the time period encompassing two minutes before and after the dissemination of such quote. For purposes of this Rule, the average quote width shall be determined by adding the quote widths of each separate quote during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).

(b) – (e) No Change.

Interpretations and Policies...

No change.

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Rule 24.16 Nullification and Adjustment of Index Option Transactions

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(a) Trades Subject to Review

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(1) – (7) No Change.

(b) Procedures for Reviewing Transactions

(1) Notification: Any member or person associated with a member that believes it participated in a transaction that may be adjusted or nullified in accordance with paragraph (a) must notify any Trading Official promptly but not later than fifteen (15) minutes after the execution in question. For transactions occurring after 2:45 p.m. (CT[CST]), notification must be provided promptly but not later than fifteen (15) minutes after the close of trading of that security on CBOE. Absent unusual circumstances, Trading Officials shall not grant relief under this Rule unless notification is made within the prescribed time periods. In the absence of unusual circumstances, Trading Officials (either on their own motion or upon request of a member) must initiate action pursuant to paragraph (a)(3) above within sixty (60) minutes of the occurrence of the verifiable disruption or malfunction. When Trading Officials take action pursuant to paragraph (a)(3), the members involved in the transaction(s) shall receive verbal notification as soon as is practicable.

(2) No Change

(c) Adjustments

Unless otherwise specified in Rule 24.16(a)(1)-(6), transactions will be adjusted provided the adjusted price does not violate the customer's limit price. Otherwise, the transaction will be nullified. With respect to Rule 24.16(a)(1)-(5), the price to which a transaction shall be adjusted

shall be the National Best Bid (Offer) immediately following the erroneous transaction with respect to a sell (buy) order entered on the Exchange. For ROS or HOSS transactions, the price to which a transaction shall be adjusted shall be based on the first non-erroneous quote after the erroneous transaction on CBOE. With respect to Rule 24.16(a)(6), the transaction shall be adjusted to a price that is \$0.10 under parity.

(d) - (e) No Change

Interpretations and Policies.....

.01 -.02 No Change

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange's obvious error rule, CBOE Rule 6.25,⁶ establishes guidelines for the adjustment and nullification of transactions in equity options.⁷ Under the Rule, four types of transactions may qualify as obvious errors and hence be adjusted or nullified: (1) obvious price

⁶ See Securities Exchange Act Release No. 50880 (December 17, 2004), 69 FR 77790 (December 28, 2004) (File No. SR-CBOE-2004-83).

⁷ CBOE Rule 24.16 governs obvious errors for transactions in index options and options on

errors; (2) transactions in series quoted no bid at a nickel; (3) transactions resulting from verifiable disruptions of Exchange systems; and (4) transactions resulting from an erroneous print in the underlying market. The purpose of this proposed rule change is to re-insert in CBOE Rule 6.25 a fifth type of qualifying transaction: transactions resulting from erroneous quotes in the underlying security. This provision previously existed in CBOE Rule 6.25.⁸ In SR-CBOE-2004-83, the Exchange proposed to delete the "erroneous quote in the underlying" provision from CBOE Rule 6.25. However, since the implementation of the changes set forth in SR-CBOE-2004-83, the Exchange has experienced several instances involving erroneous quotes in the underlying security, and therefore, believes that it is necessary to amend CBOE Rule 6.25 to again provide for this objective obvious error provision for erroneous quotes in the underlying security.

In this regard, electronic trades resulting from an erroneous quote in the underlying security may be adjusted or nullified.⁹ An erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying security on the primary market, as defined in CBOE Rule 1.1(v), during the time period encompassing two minutes before and after the dissemination of such quote. For purposes of this proposed rule provision, the average quote width shall be determined by adding the quote widths of each separate quote during the four-minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time

ETFs.

⁸ See Securities Exchange Act Release No. 48827 (November 24, 2003), 68 FR 67498 (December 2, 2003) (approving File No. SR-CBOE-2001-04).

⁹ Transactions qualifying for price adjustment (i.e., transactions between two CBOE Market-Makers) will be adjusted in accordance with CBOE Rule 6.25(a)(1). Transactions not qualifying for price adjustment (i.e., transactions involving a non-CBOE Market-Maker) will be nullified.

period (excluding the quote in question). CBOE notes that this provision operates in the same manner as provisions contained in CBOE Rules 24.16 and 43.5(b)(4).

The Exchange also proposes to make two grammatical changes to CBOE Rule 24.16. The first would clarify the reference to Central Time as (CT), rather than (CST) in paragraph (b)(1) of CBOE Rule 24.16. The second grammatical change would add the word "rule" to paragraph (c) of CBOE Rule 24.16.

2. Statutory Basis

CBOE represents that the filing provides an objective guideline for the nullification or adjustment of transactions executed at clearly erroneous prices. For this reason, the Exchange believes the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.¹⁰ Specifically, the Exchange believes the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act¹¹ that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices and, in general, to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

CBOE does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received.

¹⁰ 15 U.S.C. 78(f)(b).

¹¹ 15 U.S.C. 78(f)(b)(5).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms, does not become operative until 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. Furthermore, the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change. Consequently, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³

The Exchange has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. The Commission notes that the proposal to amend CBOE Rule 6.25 by adding a provision relating to erroneous quotes in the underlying market is substantially similar to provisions contained in CBOE Rules 24.16(a)(5) and 43.5 and to a provision that was previously contained in CBOE Rule 6.25. Thus, the Commission does not believe that the proposed rule change raises any new issues. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.¹⁴

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

At any time within 60 days of the filing of this proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2005-12 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2005-12. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2005-12 and should be submitted on or before [insert date 21 days from publication in the Federal Register]

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).