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January 12, 2007

Ms. Elizabeth K. King
Associate Director
Division of Market Regulation
Securities and Exchange Commission
100 F Street, N.E.
Mail Stop Room 6628
Washington, D.C. 20549

Re: SR-CBOE-2006-106

Dear Ms. King:

We are writing on behalf of the Chicago Board Options Exchange, Incorporated ("CBOE") in response to two letters, dated December 22, 2006, that were sent to the Commission on behalf of CBOT Holdings, Inc. ("CBOT Holdings") and The Board of Trade of the City of Chicago, Inc. ("CBOT"), and on behalf of a putative class in CBOT Holdings, Inc. et al. v. Chicago Board Options Exchange, Inc., et al. (the "Delaware Action"), a lawsuit currently pending in the Delaware Court of Chancery. Both letters ask the Commission to defer consideration of the referenced proposed rule change (the "Proposed Rule Change") and to continue such deferral until the court has ruled in the Delaware Action.

CBOE strongly objects to this request. As explained below, there is no authority under the Securities Exchange Act of 1934 (the "Act") for the Commission to defer its consideration of a properly filed proposed rule change in favor of proceedings in state court. For the Commission to do so would stand on its head the jurisdictional mandate of the Act, which gives the Commission exclusive jurisdiction to approve or disapprove proposed rule changes (including interpretations of rules) of self-regulatory organizations, subject only to the review of the United States Court of Appeals. See 15 U.S.C. §§ 78s(b)(1), 78s(b)(2) and 78y(a).

New Issues Raised by the Proposed CME Holdings Acquisition

In a misleading attempt to suggest that the issues raised in the Proposed Rule Change were being litigated before that rule filing was made, CBOT Holdings and the putative class misstate the sequence of material events. For instance, CBOT Holding's letter states that the "subject matter of the Proposed Rule Change is a dispute between CBOT and CBOE" and then goes on to say,

incorrectly, that "*[t]his* dispute currently is the subject of a case pending in the Delaware Court of Chancery" (emphasis added), as if the subject matter of the Proposed Rule Change already was in litigation when the Proposed Rule Change was submitted to the Commission. Similarly, the letter from the putative class members misleadingly implies that the lawsuit as originally filed involved a claim that the Proposed Rule Change violated CBOT members' contractual rights.

The original Delaware Action instead involved CBOE's announced intention to demutualize and the amount of stock of a new holding company and perhaps other consideration that would be provided in exchange for CBOE memberships. In contrast, the Proposed Rule Change has nothing to do with these valuation issues and was submitted in response to an event that occurred months *after* plaintiffs filed the Delaware Action – namely, the announcement of the proposed merger (the "CME Holdings Acquisition") between Chicago Mercantile Exchange Holdings, Inc. ("CME Holdings") and CBOT Holdings. When the Delaware Action was filed, CBOT therefore did not raise, and could not have raised, any of the issues addressed by the Proposed Rule Change. Plaintiffs did not inject issues about the Proposed Rule Change into the Delaware Action until they filed an amended complaint on January 4, 2007, several weeks after CBOE had filed its Proposed Rule Change.

The need for the Proposed Rule Change flows from the fundamental changes in CBOT membership that will result from CME Holdings' proposed acquisition of CBOT. If that transaction closes, persons who formerly were full members of CBOT no longer will have an ownership interest in CBOT and will be stripped of most of the other rights associated with CBOT membership, except for certain trading rights. In other words, following the CME Holdings Acquisition, former full members of CBOT will simply be holders of trading permits, and will not possess any of the other rights commonly associated with membership in an exchange.

Article Fifth(b) of CBOE's Certificate of Incorporation ("Article Fifth(b)") grants every "member of . . . [the] Board of Trade" the right to be a member of CBOE ("exercise member") without acquiring a CBOE membership. The fundamental changes associated with CME Holdings' acquisition of CBOT made it necessary for CBOE to determine whether, upon consummation of that transaction, there would continue to be "members" of CBOT within the meaning of Article Fifth(b). The answer to this question has significance beyond the proposed demutualization of CBOE, because it involves whether anyone will be eligible to be an exerciser member of CBOE for any purpose – not just for the purpose of participating in CBOE's demutualization – once CBOT is acquired by CME Holdings.

This situation was not contemplated when Article Fifth(b) was adopted as part of CBOE's Certificate of Incorporation, nor was it addressed in any of CBOE's subsequent interpretations of Article Fifth(b) that the Commission approved pursuant to Section 19(b) of the Act.

Accordingly, as has happened on a number of prior occasions when changes in the structure and ownership of CBOT potentially affected CBOT members in ways not contemplated in Article Fifth(b), CBOE is once again confronted with the need to interpret the term CBOT "member" in Article Fifth(b) in light of the new and unanticipated circumstances arising out of CME Holdings' acquisition of CBOT. To that end, CBOE filed the Proposed Rule Change with the Commission on December 12, 2006.

The only relationship between the subject matter of the Proposed Rule Change and the issues that originally were before the court in the Delaware Action is that approval of the Proposed Rule Change will moot the allocation issue that was the original focus of the Delaware Action, as long as the CME Holdings Acquisition takes place prior to CBOE's demutualization. In that event, the CME Holdings Acquisition will result in no person any longer qualifying as a CBOT "member" within the meaning of Article Fifth(b) and therefore will eliminate the class of persons who are eligible to be exerciser members of CBOE. Because CBOE believes it is important for all parties to know with certainty the effect of the CME Holdings Acquisition on the exercise right well before the vote on that transaction, CBOE decided that it should address this question of interpretation at this time, by filing its interpretation under Section 19(b).

Of course, if for some reason the CME Holdings Acquisition is not consummated by the time CBOE demutualizes, then the Proposed Rule Change will have no impact on the demutualization, CBOE will still have exerciser members, and it will again be necessary to determine how to allocate among the two types of CBOE members the shares of stock and other consideration into which CBOE memberships will be converted. It is for that reason that, contrary to the assertions in CBOT's letter, CBOE has not disbanded the Special Committee of independent directors that CBOE earlier formed to decide these allocation issues. The activities of the Special Committee have only been suspended because it appears that the CME Holdings Acquisition will be completed before CBOE's demutualization. If it should become apparent that the CME Holdings Acquisition will not be completed before CBOE's demutualization, the Special Committee will need to resume its activities and once again will address these allocation issues.

The Commission's Jurisdiction to Consider Interpretations of Article Fifth(b)

Just as CBOE must interpret what it means to be a "member" of CBOT for purposes of Article Fifth(b) under the new circumstances arising out of the CME Holdings Acquisition, so too does the Commission have the authority and responsibility to review and decide whether to approve that interpretation pursuant to Section 19(b) of the Act and Commission Rule 19b-4. In deciding whether to approve the interpretation, Section 19(b) requires the Commission to consider whether the interpretation is "consistent with the requirements of [the Act] and the rules and regulations thereunder applicable to such organization." Because one of the requirements of the Act is that a securities exchange comply with its own rules, the Commission's review of a

proposed rule interpretation necessarily includes a review of whether that interpretation is consistent with the language of the exchange rule being interpreted – here, Article Fifth(b). Accordingly, in affirming its jurisdiction to consider a previous interpretation of Article Fifth(b) notwithstanding allegations that there were competing issues under state law, the Commission declared:

> "Among other things, national securities exchanges are required under section 6(b)(1) of the Exchange Act to comply with their own rules. Thus, if CBOE has failed to comply with its own Certificate of Incorporation, which is a rule of the exchange, the Commission believes that this may not only violate state corporation law, but it would also be inconsistent with the Exchange Act and, thus, the Commission could not approve the proposed rule change under section 19."

See Securities Exchange Act Release No. 51252, 70 Fed. Reg. 10442, 10444 (Mar. 3, 2005). In that instance, the Commission concluded that it was a "federal matter under the Exchange Act" whether CBOE "complied with its own Certificate of Incorporation." Id. So too, it is a "federal matter under the Exchange Act" whether CBOE has appropriately interpreted what it means to be a CBOT "member" for purposes of Article Fifth(b) in light of the circumstances arising from the CME Holdings Acquisition.

Not only does the Commission have jurisdiction to consider the underlying reasonableness of CBOE's interpretation of Article Fifth(b), the Commission's jurisdiction to do so is exclusive, subject only to the right of an aggrieved party to appeal the Commission's determination to the United States Court of Appeals. On January 4, 2007, CBOT and the other plaintiffs amended their complaint in the Delaware Action to seek an injunction to prevent CBOE from implementing the Proposed Rule Change, apparently even if it is approved by the Commission. This effort to undermine the Commission's jurisdiction will fail. State courts consistently have rejected attempts by CBOT and its members to characterize CBOE's interpretations of Article Fifth(b) as involving violations of state law and breaches of contract that displace the Commission's jurisdiction. The leading case is Buckley v. Chicago Board Options Exchange, Inc., 440 N.E.2d 914 (Ill. App. Ct. 1982), in which CBOT and one of its members sought to challenge in state court CBOE's determination that the lessee of a CBOT membership, rather than the lessor of that membership, should be considered the CBOT "member" for purposes of determining who was entitled to the exercise right pursuant to Article Fifth(b). The court concluded that the Commission's jurisdiction over the interpretation of exchange rules, particularly rules like Article Fifth(b) that bear upon the qualifications for membership in an exchange, preempted any state court claims related to such issues. Id. at 919-20; see also Credit Suisse First Boston Corp. v. Grunwald, 400 F.3d 1119, 1131-32 (9th Cir. 2005) (holding that a

rule approved by the Commission "fall[s] under the shadow of the federal umbrella" and therefore preempts state law).

CBOT tried once again in 2000 to use breach of contract claims to subvert the Commission's jurisdiction over interpretations of Article Fifth(b). In that case, CBOT challenged in state court a pending rule interpretation that the then proposed demutualization of CBOT would extinguish the exercise right under the terms of Article Fifth(b). The Illinois state court dismissed the state court claims on the ground of federal preemption, relying on both the rationale articulated in Buckley and "the comprehensive federal statutory scheme regarding exchange membership regulation" established by the Exchange Act.

In short, the propriety of CBOE's interpretations of the terms of Article Fifth(b) raises issues that, contrary to the assertions in the letters of CBOT and its members, arise uniquely under federal, not state, law. This fact does not change simply because prior interpretations may have been reflected in agreements between CBOT and CBOE. To be sure, there are undertakings in those agreements that can be enforced through breach of contract actions under state law – e.g. obligations with respect to such matters as confidentiality and information sharing. However, the interpretations of Article Fifth(b) that are reflected in those agreements are not subject to breach of contract actions under state law. Those interpretations were recited in agreements between CBOE and CBOT in order to reflect the fact that CBOT agreed with CBOE's interpretations, but those interpretations had legal force only because they were approved by the Commission as a matter of federal law. Accordingly, there is no basis to sue for "breach" of an interpretation just because it is reflected in an agreement between CBOE and CBOT. Instead, an interpretation of Article Fifth(b), including any subsequent interpretation of a prior interpretation that was reflected in an agreement between CBOE and CBOT, remains a matter exclusively of federal law for the Commission to resolve.

Deferral Would Be Inappropriate and Unauthorized

For all of these reasons, to the extent plaintiffs attempt to use the Delaware Action to challenge CBOE's interpretation of Article Fifth(b) upon the consummation of the CME Holdings Acquisition, CBOE will move to dismiss the amended Delaware Action on the ground of federal preemption. By granting this motion, the Delaware court will be able to eliminate the potential for conflict that would arise if both the Delaware court and the Commission considered this issue. We expect that the Delaware court will recognize that plaintiffs' state law claims are preempted, as have the Illinois courts that have rejected CBOT's past efforts to challenge the Commission's exclusive jurisdiction over interpretations of Article Fifth(b).

Even if the state court for some reason were not to recognize that state law claims about CBOE's interpretation of Article Fifth(b) are preempted, the answer to this conflict would not be for the Commission to defer to the state court. It would upend the requirements of the Act for the

Commission – whose jurisdiction over the issues in dispute is superior and exclusive – to stay its hand in deference to a state court. Moreover, nothing in the Act gives the Commission the authority to defer to state courts on issues raised in rule filings submitted pursuant to Section 19(b) and Commission Rule 19b-4 – and the letters submitted by CBOT and its members provide no such authority. For the Commission to defer in this manner would seriously undermine its authority over self-regulatory organizations under the Act.

Accordingly, CBOE requests that the Commission deny the request of CBOT and certain of its members to defer consideration of SR-CBOE-2006-106. Instead, CBOE requests that the Commission proceed with its consideration of that filing.

Very truly yours,

Michael L. Meyer

MLM/dcg
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