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VIA ELECTRONIC FILING

Ms. Nancy M. Morris
Secretary, Securities and Exchange Commission
100 F. Street, NE
Washington, DC 20549-1090

Re: File No. SR-CBOE-2007-107

Dear Ms. Morris:

The Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange) hereby responds to the comment letter (the "CME Comment Letter") submitted on behalf of CME Group Inc. ("CME Group") and its wholly-owned subsidiary, the Board of Trade of the City of Chicago, Inc. ("CBOT" and, collectively with CME Group, the "CME Commenters"), and to the comment letter ("Richards Letter") submitted by Paul Richards ("Richards" and, collectively with the CME Commenters, the "Commenters"), regarding Interpretation and Policy .02 of CBOE Rule 3.19, as set forth in SR-CBOE-2007-107 (the "Transition Rule Filing").

The Commenters fail to state any valid objection to the Transition Rule Filing, which is substantially the same as SR-CBOE-2007-77 (the "Continued Membership Rule Filing"). (*See* CBOE Interpretation and Policy .01 of Rule 3.19, which has been in effect since July 2, 2007). The Commenters repeat many of the same arguments they made about the Continued Membership Rule Filing, none of which led the Commission to abrogate that rule filing and similarly should not lead the Commission to abrogate the Transition Rule Filing.

On a separate point, it is time to correct the record concerning the baseless charges, repeated once more by the Commenters, that CBOE and its directors are engaged in a campaign to harm CBOT's "members." It is also time to point out that former CBOT full members made a conscious decision to risk losing their exercise right eligibility in return for receiving substantial financial remuneration and value when they decided to sell CBOT.

The Transition Rule Filing Addresses Important Exchange Act Mandates

The Transition Rule Filing addresses a key mandate of the Exchange Act – that exchanges preserve fair and orderly markets. The Transition Rule Filing serves this critical interest by addressing the need for a transitional trading access plan to avoid market disruption if and after the Commission approves the rule interpretation contained in SR-CBOE-2006-106 (the "Eligibility Rule Filing"). The Eligibility Rule Filing contains CBOE's interpretation of Article Fifth(b) of CBOE's Certificate of Incorporation ("Article Fifth(b)"), under which each "member" of CBOT is granted the right (the "Exercise Right") to become an "Exerciser Member" of CBOE

for so long as that person remains a CBOT member. Under that interpretation, which duly considered prior agreements with CBOT about the proper interpretation of Article Fifth(b) related to prior actions initiated by CBOT, the acquisition of CBOT (the "CME Acquisition") by CME Group's predecessor ("CME") eliminated the concept of CBOT membership contemplated in Article Fifth(b), with the result that no one is eligible to become or remain an Exerciser Member after that transaction. Pursuant to the Continued Membership Rule Filing, the membership status of persons who were Exerciser Members as of a date shortly before the closing of the CME Acquisition has been temporarily continued, but that status automatically ends when the Commission approves the Eligibility Rule Filing. Approximately 225 persons currently are trading on CBOE in this continued membership capacity,[1] and, absent the effectiveness of the Transition Rule Filing, all would immediately and automatically lose their right to trade once the Commission approves the Eligibility Rule Filing.

The Transition Rule Filing puts into effect a transition plan that avoids the potentially disruptive and destabilizing effect on CBOE's markets from such a sudden loss of traders. It does so by building on the rationale underlying the Continued Membership Rule Filing and by extending the continued membership status into the period following the approval of the Eligibility Rule Filing, when that status otherwise would end. In particular, if and when the Commission approves the Eligibility Rule Filing, the Transition Rule Filing will temporarily extend the continued membership status of anyone who was trading in that capacity immediately before the Commission's action. Accordingly, there will be no interruption in trading access as an immediate result of the Commission's approval of the Eligibility Rule Filing. This continuation of membership status will be temporary – until CBOE is able, on the basis of facts then existing, to fashion a more permanent system of trading permits or some other form of substitute trading access rights for persons who are trading in this continued membership status. (*See* Transition Rule Filing at 9).

Commenters' Opposition to the Eligibility Rule Filing

The Transition Rule Filing derives from the Continued Membership Rule Filing and temporarily extends the membership structure recognized by that rule filing. The Commission did not abrogate the Continued Membership Rule Filing, and there similarly is no valid reason to abrogate the Transition Rule Filing. The Commenters do not dispute that the Transition Rule Filing furthers a critical Exchange Act mandate, by avoiding the chaotic effects of suddenly losing approximately 225 market participants. Instead, the CME Commenters argue that the market disruption that the Transition Rule Filing will avoid is the result of the Eligibility Rule Filing, which they in turn oppose. (*See* CME Comment Letter at 1-2). They argue that the "legal validity of the [Transition Rule Filing] depends squarely on the legal sufficiency of the

[1] The number of persons trading in the continued membership capacity was 229 at the time the Transition Rule Filing was filed, but is 225 as of October 23, 2007.

[Eligibility Rule Filing]." But that argument provides no basis to abrogate the Transition Rule Filing. By its own terms, the Transition Rule Filing becomes operative only after the Eligibility Rule Filing has been approved by the Commission. Accordingly, if and when the Transition Rule Filing becomes operative, the Commission necessarily will have already accepted the "legal sufficiency" of the Eligibility Rule Filing, thereby resolving the supposedly linked concerns about the "legal validity" of the Transition Rule Filing.

The Commenters similarly miss the point when they quarrel with whether the Eligibility Rule Filing should be approved. CBOE has answered all of their objections to the Eligibility Rule Filing,[2] and the Commission will resolve those issues when it decides whether to approve that rule filing. The question now before the Commission is whether to abrogate the Transition Rule Filing's transitional plan in the event that the Eligibility Rule Filing *is* approved. However, the Commenters fail to offer any valid objection to the salutary substance and effect of the Transition Rule Filing.

Misrepresentations about CBOE's Intentions

Although the focus should be on the Transition Rule Filing, CBOE cannot leave unaddressed the reckless and unsubstantiated accusations by the Commenters that the Transition Rule Filing is part of an "ongoing campaign to deprive Exerciser Members of valuable rights" under the Exercise Right (*see* CME Comment Letter at 2) or is an "attempt to confiscate the property [of Exerciser Members]" (*see* Richards Letter). The Commenters conveniently avoid mentioning that CBOE initiated no action concerning the Exercise Right, but rather was required to *respond* to the unilateral actions of CBOT and CME when they decided to enter into the CME Acquisition. It was obvious from the announced terms of the transaction that it would result in substantial changes to the structure and ownership of CBOT, changes to the rights represented by CBOT "membership," and would not satisfy required conditions for the exercise right eligibility to survive the CME Acquisition. As in the past, CBOE could not ignore those changed circumstances, but rather had to assess whether those changes affected the eligibility to be an Exerciser Member. In short, the cloud on the Exercise Right was created by CBOT itself, when it agreed to enter into the CME Acquisition. CBOT and its former members should recognize and accept responsibility for their own actions and the resulting consequences.

CBOE took great pains to ensure that its interpretation of the effect of the CME Acquisition was untainted by any self-interest, whether from CBOE seat owners or Exerciser Members. CBOE's Eligibility Rule Filing first was considered and approved – unanimously – in a separate meeting of just CBOE's voting public directors. By Exchange rule, those public directors were free of any self-interest, because they had no membership interest in CBOE, no

[2] CBOE rebutted all of the Commenters' objections about the Eligibility Rule Filing in the letter from one of CBOE's attorneys, Michael L. Meyer, dated June 15, 2007.

right to acquire such a membership interest and no affiliation with any entity that owned any CBOE membership. The Eligibility Rule Filing then was approved unanimously by all voting CBOE directors, with the disinterested public directors constituting a majority of the voting directors.[3] It stretches credulity to suggest that eminent, disinterested public directors would participate in a "campaign" to deprive one set of CBOE members of their rights. Instead, those disinterested directors dispassionately interpreted Article Fifth(b), which created the Exercise Right, and concluded that the CME Acquisition would eliminate Exercise Right eligibility.

Not only was CBOE's Board scrupulously fair in its deliberations over the Eligibility Rule Filing, CBOE gave ample notice to CBOT members of the Board's interpretation – so that they could decide whether they were prepared to put Exercise Right eligibility at risk. The Eligibility Rule Filing was published for comment in December 2006, and CBOT members had seven months to evaluate that interpretation before they voted on the CME Acquisition in July 2007. When they voted on the CME Acquisition, CBOT members were fully aware that the consummation of the transaction could extinguish their Exercise Right eligibility. Indeed, the risk disclosures made by *CME* relating to the CME Acquisition explicitly warned CBOT members that the Eligibility Rule Filing, if approved, would mean that "CBOT members would no longer have the right to be or become members of CBOE pursuant to Article Fifth(b)," that they would not "be entitled to any distributions made to or rights conferred upon CBOE members in connection with CBOE's proposed demutualization" and that "the exercise right likely would no longer have any value."[4] Accordingly, when CBOT members overwhelmingly voted for the CME Acquisition, they did so with their eyes open to the risk to Exercise Right eligibility – and made the financial calculation that the benefits of the CME Acquisition outweighed the detriment associated with the possible loss of Exercise Right eligibility.

Receipt of Substantial Benefits Tied to Exercise Right

That financial calculation was perfectly logical, because CBOT members were handsomely rewarded in connection with the CME Acquisition, including in ways directly tied to the Exercise Right that they consciously put at risk. Prior to the consummation of the CME Acquisition, a person who wanted to qualify as a CBOT member eligible for the Exercise Right needed to hold, among other things, 27,338 shares of the holding company that owned CBOT ("CBOT Holdings"). That quantity of stock was worth approximately $3.7 million as of the close of trading on October 16, 2006, the day before the CME Acquisition was announced. As part of the CME Acquisition, each person who had retained the required amount of CBOT

[3] *See* letter from one of CBOE's attorneys, Paul E. Dengel, dated August 30, 2007, in respect of SR-CBOE-2007-77 ("Dengel Letter") at 14.

[4] *See* Chicago Mercantile Exch. Holdings, Inc., Registration Statement (Form S-4), at 33-34 (July 6, 2007).

Holdings stock received, in exchange for that stock, CME Group stock that was valued at more than $6 million when the transaction closed – a gain of more than $2.3 million, and more than 62%, in just nine months. In addition, CME and CBOT Holdings matched the $500,000 that CBOT full members would have received as compensation for the extinguishment of Exercise Right eligibility under a competing company's proposal to acquire CBOT. Specifically, as part of the CME Acquisition, each full CBOT member received $500,000 related to that person's Exercise Right, consisting of (1) a choice of receiving $250,000 in cash from CME or a CME guarantee that the person would recover no less than $250,000 in connection with the challenge to the Eligibility Rule Filing, and (2) a CBOT Holdings dividend of $250,000. In short, former CBOT full members have received substantial value for their decision to proceed with the CME Acquisition and thereby to put Exercise Right eligibility at risk. They freely made that choice to enrich themselves, and it is disingenuous for them now to deny that they have received substantial benefits tied to the Exercise Right.

Immediate Effectiveness under Section 19(b)(3)

Stripped of their rhetoric about the Eligibility Rule Filing, the only argument that the Commenters offer against the Transition Rule Filing does not address the merits of that filing at all. Instead, they contend only that the Transition Rule Filing did not qualify for immediate effectiveness under Section 19(b)(3) of the Exchange Act. (*See* CME Comment Letter at 1.) The CME Commenters repeat their mistaken argument that Section 19(b)(3) is reserved for "administrative or housekeeping" rule changes, an argument that CBOE refuted in response to the CME Commenters' earlier, unsuccessful, attempt to convince the Commission to abrogate the Continued Membership Rule Filing.[5] Section 19(b)(3)(A)(i) provides that it may be invoked with respect to a proposed rule change "constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the self-regulatory organization." According to Commission Rule 19b-4(b)(2)(ii), a "stated policy, practice or interpretation" means, among other things, "[a]ny statement made generally available to the membership of, to all participants in, or to persons having or seeking access . . . to the facilities of [the Exchange] . . . with respect to . . . the meaning . . . of an existing rule."

The Transition Rule Filing meets all of these requirements. It is a statement made to the entire membership of CBOE, and to those who are "seeking access" to CBOE, "with respect to the meaning, administration, or enforcement of an existing rule" – namely, CBOE Rule 3.19. Rule 3.19 provides in general for the temporary continuation of a person's membership status when that membership status is lost under "extenuating circumstances." The Transition Rule Filing simply applies those general standards to the present situation. In particular, the Transition Rule Filing interprets, as "extenuating circumstances," the "sudden loss of as many as 229 Temporary Members who then would be providing liquidity to the Exchange's markets," the

[5] *See* Dengel Letter at 8-9.

"strong likelihood that there will be an insufficient number of transferable Exchange memberships available for purchase or lease by Temporary Members" upon the approval of the Eligibility Rule Filing, and CBOE's inability "to formulate prudently" a "well-defined trading access rights plan" that could permanently address those issues of market disruption and trading access because of the "current legal controversy surrounding the effect of that approval on the rights claimed by former exerciser members and by persons who assert the right to become exerciser members." (*See* Transition Rule Filing at 8-10.) Because the Transition Rule Filing in those ways is a stated interpretation of the meaning of an existing rule, it qualifies for immediate effectiveness under Section 19(b)(3) of the Exchange Act.

Conclusion

For these reasons, for the reasons more fully stated in the Transition Rule Filing, and for the reasons that the Commission did not abrogate the Continued Membership Rule Filing, the Commission should not abrogate the interpretation of CBOE Rule 3.19 contained in SR-CBOE-2007-107.

Very truly yours,

Paul E. Dengel

Paul E. Dengel
One of the Attorneys for Chicago Board
Options Exchange, Incorporated

PED:mcb

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Annette L. Nazareth, Commissioner
Erik R. Sirri, Director, Division of Market Regulation
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