CBOE
CHICAGO BOARD OPTIONS EXCHANGE

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April 13, 2012

Via Electronic Mail
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
comments@sec.gov

Re: Comment Letter on File No. SR-ISE-2012-22

Dear Ms. Murphy:

Chicago Board Options Exchange, Incorporated ("CBOE") hereby submits comments on the proposed rule change of International Securities Exchange, LLC ("ISE"), rule filing number SR-ISE-2012-22.[1] In its filing, ISE proposes to establish a pilot program under which ISE would list and trade options overlying a benchmark that ISE refers to as the "ISE Max SPY index" or the "ISE Max SPY."[2]

Introduction

The ISE filing seeks authority to trade options that would violate an existing Illinois state court injunction, contains misleading characterizations of the Proposed Options, and raises other significant issues that warrant either disapproval of the proposal by the U.S. Securities and Exchange Commission ("SEC" or "Commission") or substantial alteration of the filing to address these issues. First, the ISE filing itself is a violation of an existing injunction issued by the Illinois state court, and the Proposed Options are currently the subject of a pending motion that seeks to enjoin the listing and trading of the Proposed Options. Second, the ISE proposal should not be approved in its current form because the description of the Proposed Options is inaccurate and misleading. Third, the ISE proposal contains significant ambiguities that must be addressed before it is possible to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the requirements of the Securities Exchange Act of 1934 (the "Act").[3] In addition, the Options Disclosure Document

[1] See Securities Exchange Act Release No. 66614 (March 16, 2012), 77 FR 16883 (March 22, 2012) (noticing SR-ISE-2012-22).

[2] These proposed options are sometimes referred to in this letter as the "Proposed Options" or the "Options," and the underlying benchmark proposed by ISE is sometimes referred to in this letter as the "Proposed Benchmark."

[3] See Section B. of the "General Instructions for Form 19b-4" ("This form, including the exhibits, is intended to elicit information necessary for the public to provide meaningful comment on the proposed rule change and for the Commission to determine whether the proposed rule change is consistent with the requirements of the Act ....").

(the "ODD") would require supplementation before the Proposed Options could be listed and traded. These points are discussed in further detail below.

The Proposed Options Violate An Existing Injunction

On March 23, 2012, CBOE and The McGraw-Hill Companies, Inc. filed a "Motion to Enforce Permanent Injunction" against ISE in Illinois state court. See Attachment 1. The core point of the Motion is that the Proposed Options are in fact options on the S&P 500 Index and therefore would violate a permanent injunction entered by the Illinois state court on July 8, 2010 (the "Injunction"). See Attachment 1, Exhibit 1. ISE's violation of the Injunction is evidenced by the express acknowledgement in ISE's rule filing that, "the proposed rule change would provide Members and investors with additional opportunities to trade S&P 500® options with a p.m.-settlement feature in an exchange environment..."[4] Additionally, the ISE rule filing itself violates the Injunction because the Injunction prohibits ISE from listing options on the S&P 500 Index and the submission and notification of the rule filing commences the process of listing such options.

For the reasons set forth below in more detail, the Commission should disapprove ISE's filing. In any event, the Commission at least should exercise restraint and not take any action to approve ISE's proposed rule change until the litigation is resolved. Significant market disruption and harm to investors could occur if the SEC were to approve the proposed rule change prior to the Illinois state court ruling on whether the Proposed Options violate the existing injunction or are otherwise unlawful. Specifically, ISE could then commence trading the Proposed Options and the Illinois state court thereafter could find that such trading is unlawful. Investors then would have no readily available means to trade out of or exercise their positions in these options. It is far more prudent for the Commission either to disapprove the rule filing or at least to not take any action to approve the filing until litigation over the Proposed Options is concluded.

If the Commission proceeds to consider the ISE proposed rule change prior to judicial action on the pending Motion, the Commission should make clear that any approval is solely concerned with whether the ISE proposed rule change is consistent with the requirements of the Act, and that the Illinois state court has full and independent authority to resolve the issues that arise under state law.[5] Otherwise, the Illinois state court might incorrectly interpret the SEC order as a federal grant of approval to trade the Proposed Options that trumps the Illinois state court's consideration of the state law issues that bar trading of those options.

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[4] 77 FR at 16888; also SR-ISE-2012-22, p. 15.

[5] See Securities Exchange Act Release No. 57159 (January 15, 2008), 73 FR 3769 (January 22, 2008) (order approving SR-CBOE-2006-106) at 3773-3774 (in the face of concurrent state court proceedings, the Commission's role is limited to determining whether the proposed rule change is "consistent with the requirements of the Exchange Act"); see also id at 3783 (in connection with concurrent litigation involving similar issues to those before the Commission, the Commission stated that the Delaware state court remained free to "determine and apply the relevant state law in its normal fashion" notwithstanding the Commission's approval of CBOE's proposed rule change).

Background: Description of the Proposed Options

ISE proposes that the Options be P.M. cash-settled and subject to European-style exercise. ISE proposes that the underlying benchmark for the Options be "a newly-developed, ISE proprietary index" that is "designed to represent 10 times the value of the published share prices in the SPDR® S&P 500® ETF Trust."[6] (The trading symbol for the units or shares of the SPDR® S&P 500® ETF Trust is "SPY.")

ISE states that "[t]he ISE Max SPY is calculated by multiplying the share prices of SPY by a factor of 10 and rounding to the tenths place. For example, if the share price for SPY is 112.35 then the ISE Max SPY value would yield a value of 1123.50 for the ISE Max SPY."[7]

However, ISE proposes to disregard SPY share prices for purposes of calculating settlement values of the Proposed Options. Instead, ISE proposes to settle ISE Max SPY options to an entirely different value that it describes as follows:

> The settlement value of the ISE Max SPY index is determined using the last (closing) reported sales price in the primary market for the portfolio components of SPY on the last business day before the expiration date.[8]

In addition, the ISE further describes how it proposes to calculate the settlement value:

> The settlement value for the ISE Max SPY index is calculated using the Net Asset Value ("NAV") of the fund [that is, the SPDR S&P 500 ETF Trust], as calculated by the Exchange, on a per share basis, times ten.[5] [NB: This superscript "5" represents footnote 5 in the Federal Register of the ISE filing, which is quoted below in the text; it does not represent a footnote in this letter.] The NAV of *an ETF* is the per-share dollar amount of the fund which is calculated by dividing the total value of all the securities in its portfolio, *less any liabilities*, by the number of fund shares outstanding. In general, equity ETFs use the closing prices of each of the fund's holdings to determine the total value of all the securities in its portfolio. *In the case of SPY, the closing prices of the*

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[6] 77 FR at 16883. For background, the SPDR ETF is an exchange-traded fund whose objective is to "provide investment results that, before expenses, generally correspond to the price and yield performance of the S&P 500 Index." (Prospectus for SPDR S&P 500 ETF Trust, dated January 25, 2012, at cover. A copy of the current SPDR ETF prospectus can be accessed at: https://www.spdrs.com/library-content/public/SPY%20Prospectus.pdf. This Prospectus is sometimes referred to in this letter as the "SPDR Prospectus.") The issuer of the SPY ETF has entered into a license agreement "to use the S&P 500 Index as a basis for determining the composition of the Portfolio." (SPDR Prospectus at 52.) "The Trustee [for the SPDR Trust] on a non-discretionary basis adjusts the composition of the Portfolio to conform to changes in the composition and/or weighting structure of Index securities in the S&P 500 Index." (SPDR Prospectus at 46.)

[7] 77 FR at 16883-16884.

[8] See SR-ISE-2012-22, Exhibit 3-2 (Contract Specifications of the ISE Max SPY) at p. 40. The actual filing submitted by the ISE (sometimes referred to in this letter as the "ISE Filing") is available at http://www.ise.com/assets/documents/OptionsExchange/legal/proposed_rule_changes/2012/SR-ISE-2012-22$Proposed_Rule_Change_to_Trade_Options_on_a_Newly-Developed_Proprietary_Index$20120309.pdf

> *portfolio securities are determined by the closing auction processes of the NYSE for each of those securities.*[9] (emphasis added).

Footnote 5 to that passage states that:

> [5] The settlement value that the Exchange calculates may be different from the NAV published by the trustee of the Trust. According to the prospectus of the Trust, the trustee may deem prices of the Trust's portfolio securities to be inappropriate, and may use the prices of another market other than the NYSE, or may appraise the value of the securities itself. Additionally, the Trust uses the NYSE's closing prices of all the portfolio securities even though several of those securities are not listed on the NYSE (as of the close on February 24, 2012, one hundred components of the SPY portfolio, which represented 20% of the total portfolio count and 21.74% of the weighting, were listed on Nasdaq). In calculating ISE Max SPY, the Exchange uses the published closing prices from the primary market of those securities.[10]

These passages make clear that the settlement value for the Proposed Benchmark will be calculated differently from all other values of the Proposed Benchmark, and that it will be calculated by ISE not by reference to the value of the SPDRs, but by reference to both the securities held in the portfolio of the Trust and the weightings in which these securities are held in the portfolio. That is, the settlement value will be calculated by reference to the stocks in the S&P 500 Index as weighted by S&P in its S&P 500 Index.

<u>The ISE Proposal Should Not Be Approved in Its Current Form Because ISE's Description of the Proposed Options Is Inaccurate and Misleading</u>

The description of the Proposed Options is inaccurate and misleading in two fundamental respects. Although it implies that the benchmark for the Proposed Options would be the "ISE Max SPY Index": first, the benchmark is in fact not based on the SPY ETF, because settlement values of the Proposed Options are not actually settled by reference to the value of the SPY ETF; second, even if the Proposed Benchmark could be said to have reference to SPY ETFs, the benchmark would have only one component security and therefore would simply not be an "index."

With respect to the first of these points, ISE's description of its proposed calculation of the settlement value of the Proposed Options demonstrates that the values with respect to which the Proposed Options will settle will not be values of the Proposed Benchmark (ten times the SPY ETF value, rounded to the tenths place) but rather will be the values of the S&P 500. That is because exercise of the Proposed Options will settle with reference to the value of the recalculated S&P 500, as weighted by S&P, not to any published SPY value or to some multiple of that value. ISE expressly acknowledges this in the filing by stating that, "the proposed rule change would provide Members and investors with additional opportunities to trade S&P 500®

[9] 77 FR at 16884-16885.

[10] 77 FR at 16884.

options with a p.m.-settlement feature in an exchange environment…."[11] This point is further illustrated by ISE's proposal with respect to position limits for the Proposed Options. ISE suggests that the Proposed Options should have no position limits, by reference to the position limits for P.M.-settled S&P 500 Index ("SPXPM") options that trade on C2 Options Exchange, rather than to the position limit levels for other SPY-based products.[12]

With respect to the second of these points, there is no "index" – and certainly no broad-based index – that is calculated with reference to a single underlying security.[13] If the ISE Max SPY index were indeed based on a single reference security, it would not be an index in any meaningful sense, and it certainly would be misleading to characterize it as such. To the extent that the "ISE Max SPY index" is "index-like," it is only because the SPY Trust holds all of the stocks in the S&P 500 Index, weighted as the stocks in the S&P 500 Index are weighted. The "ISE Max SPY index" is an index, in other words, only because it is the S&P 500.

<u>The ISE Proposal Contains Significant Ambiguities with Respect to the Calculation of the Proposed Benchmark</u>

The Proposal should also be disapproved because it contains fundamental ambiguities and omissions.

(a) The ISE Filing is Unclear in Describing the Assets that ISE Would Take Into Account in Calculating Settlement Values.

In the passage quoted above, ISE describes the calculation of the NAV of *an* ETF. But it does not appear to be describing the calculation of the NAV for *this* ETF – that is, the SPY ETF. The SPDR Prospectus states that:

> The NAV of the Trust on a per Unit basis is determined by subtracting all liabilities (including accrued expenses and dividends payable) from the total value of the Portfolio *and other assets* and dividing the result by the total number of outstanding Units.[14] (emphasis added).

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[11] 77 FR at 16888; also SR-ISE-2012-22, p. 15.

[12] ISE Rule 4.12.01 provides that the position limit for physically-settled SPY options (which are one-tenth the size of the Proposed Options) is currently 900,000 contracts.

[13] The definition of the term "security" in Section 3(a)(10) of the Act refers to a "put, call, straddle, option or privilege on any … group or index of securities"; that usage of the term "security" clearly does not contemplate an "index" based on a single security. Section 3(a)(55)(B) of the Act provides a definition of the term "narrow-based security index" as an index that, among other things, "has 9 or fewer component securities." We recognize that this definition is used in the Act for purposes of defining the term "security future." Section 3(a)(55)(B) does nonetheless demonstrate that the term "index" is not used with reference to a benchmark with one component security. The ODD defines an index as "a measure of the prices or other attributes of a group of securities or other interests." (March 2011 Supplement to the ODD at 1; an internal footnote is omitted.)

[14] SPDR Prospectus at 67.

ISE's omission of the reference to "other assets" of the Trust in its description of its calculation methodology is not trivial: those "other assets" include cash held by the Trust as a result of dividends payable to the Trust in respect of the Portfolio Securities held in the Trust until the Trust pays those aggregated dividends out to Unit holders on a quarterly basis.[15] The calculation of values of the S&P 500 Index does not take dividends into account.[16] Regardless of whether ISE takes the "other assets" held in the Trust into account in calculating settlement values for the Proposed Options, its calculations will not be based on SPY values. However, if ISE does not take the "other assets" held in the Trust into account in calculating settlement values for the Proposed Options, ISE's method for calculating the settlement values will clearly diverge from the method used by the Trustee for the Trust to calculate NAVs for the Trust. If this is ISE's intent, it needs to be clearly stated in ISE's filing.

(b) The ISE Filing Is Unclear in Describing the Source of the Prices that ISE Would Use in Calculating Settlement Values and Does Not Explain Why Settlement Values Would Be Calculated Differently.

In its filing, ISE states that it will calculate settlement values of the Proposed Benchmark using the closing prices for the stocks held by the Trust "from the primary market of those securities."[17] ISE states that this value may differ from the NAV value published by the trustee of the Trust. ISE represents in its filing that per the SPDR Prospectus, "the Trustee uses the NYSE's closing prices of all the portfolio securities even though several of those securities are not listed on the NYSE." This representation is inconsistent with the SPDR Prospectus. The Prospectus describes that the NAV for the Trust on a given day is calculated using, for each stock in the Trust portfolio, "the closing sale price on that day ... on the exchange which is deemed to be the principal market therefor or, if there is no such appropriate closing sale price on such exchange, at the closing bid price ...."[18] S&P calculates values of the S&P 500 using the prices from the primary market for each security in the Index.

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[15] SPDR Prospectus at 10.

[16] S&P does calculate a "total return" version of the S&P 500 Index – a version that takes dividends paid with respect to the component securities into account and assumes that the dividend are reinvested in the stocks included in the Index. The S&P 500 Index itself, however, is a "price return" index; it does not take dividends into account. See "S&P U.S. Indices Methodology" (available on the S&P website at www.standardandpoors.com by clicking on "S&P 500" and then clicking on "Methodology" under the "Index Information" heading), page 17.

[17] 77 FR at 16884, footnote 5 (quoted above in the text of this letter). See also the ISE Filing at p. 40 ("The settlement value of the ISE Max SPY index is determined using the last (closing) reported sales price in the primary market for the portfolio components of SPY on the last business day before the expiration date.").

[18] SPDR Prospectus at 67. ("The value of the Portfolio is determined by the Trustee in good faith in the following manner. If Portfolio Securities are listed on one or more national securities exchanges, such evaluation is generally based on the closing sale price on that day (unless the Trustee deems such price inappropriate as a basis for evaluation) on the exchange which is deemed to be the principal market therefor or, if there is no such appropriate closing sale price on such exchange, at the closing bid price (unless the Trustee deems such price inappropriate as a basis for evaluation.")

It is unclear what distinction ISE is attempting to make when it highlights that the settlement value it calculates may differ from the NAV published by the Trust, and that ambiguity needs to be resolved in the proposal and ISE's intent needs to be clearly stated. What does appear to be clear from ISE's description is that it intends to calculate settlement values using the same prices that S&P uses to calculate the S&P 500, regardless of what prices are used by the trustee of the Trust.

The ISE filing does not contain any explanation of why it proposes to calculate settlement values of the Proposed Benchmark differently from all other values of the Proposed Benchmark. ISE's plan to use the same prices to calculate settlement values that S&P uses to calculate the S&P 500 demonstrates that ISE's true purpose is to replicate the value of the S&P 500 as closely as possible, even though doing so creates the possibility of discontinuities between the settlement values of the Proposed Benchmark and all other values of that benchmark.

(c) The ISE Filing is Unclear in Describing How a Special Dividend or Other Extraordinary Distribution Would Be Addressed.

Companies in the S&P 500 Index from time to time pay special dividends and make special distributions to their shareholders. The ISE filing does not explain whether or how the relationship between settlement values of the Proposed Benchmark (calculated using the closing reported prices for the SPY portfolio components) and other values of the Proposed Benchmark (calculated by multiplying the share prices of SPY by a factor of ten) would be preserved in such a circumstance.

<u>The Options Disclosure Document Would Need to Be Supplemented Before the Proposed Options Could Be Listed and Traded</u>

If the Commission ultimately were to determine that the ISE proposal should be approved, the ODD would require supplementation in at least two respects before the Proposed Options could be listed and traded.

(a) Clarification as to Whether the Proposed Options Are Described in Chapter IV ("Index Options") or Chapter III ("Options on Equity Securities").

One might expect that standardized options overlying a benchmark that includes the word "index" in its name would be described in Chapter IV of the ODD ("Index Options"). Chapter IV, however, does not currently describe any standardized option that overlies an "index" whose values are calculated on the basis of only one component security. Indeed, the first sentence of Chapter IV states that "As referred to in this booklet, an index is a measure of the prices or other attributes of a group of securities or other interests."[19]

Chapter III of the ODD ("Options on Equity Securities"), on the other hand, provides disclosure with respect to "stock options," and states, "The term 'stock options' is used broadly

[19] March 2011 Supplement to the ODD at 1. (A footnote to the sentence quoted in the text is omitted.)

in this Booklet to include not only options on common stocks but also options on all other types of equity securities, such as ... fund shares. The term 'fund shares' includes interests in *exchange-traded funds* and other entities holding or trading in one or more types of investments ...."[20] To repeat a clause in the ISE filing that we quoted above on page 3 of this letter: "The ISE Max SPY is designed to represent 10 times the value of the published share prices in the SPDR® S&P 500® ETF Trust."[21]

Under the current form of the ODD, then, an investor looking for disclosure with respect to "Options on the ISE Max SPY index" may be uncertain as to whether the Proposed Options are described in Chapter III or Chapter IV of the ODD. The ODD would need to be revised to clarify the disclosure provisions applicable to the Proposed Options.

(b) Disclosure with Respect to the Difference between Settlement Values and Other Values of the Proposed Benchmark.

The ODD does not currently include disclosure with respect to any options for which the underlying benchmark is calculated in the manner in which ISE proposes to calculate the Proposed Benchmark – namely, with settlement values calculated using the closing reported prices for the SPY portfolio components and all other values calculated by multiplying the share prices of SPY by a factor of ten and rounding to the tenths place. The ODD does include detailed disclosure with respect to the calculation of values of "implied volatility options." Settlement values for implied volatility options are calculated using input values that are different from the values that are used to calculate all other values of these indexes. The ODD provides extensive disclosure with respect to this difference.[22] If the Commission ultimately were to determine to approve the ISE proposal, the ODD would need to be supplemented to provide comparable disclosure with respect to the difference between the calculation of the

[20] ODD at 107 (page 3 of the May 2007 Supplement). (Emphasis added.)

[21] 77 FR at 16883.

[22] See page 153 of the ODD (in the December 2009 Supplement):

> "An exercise settlement value for implied volatility options is calculated from *actual opening premium prices* of the relevant series of options on the reference index unless there is no trade in a series at the opening, in which case the *mid-point of the bid and offer premium quotations* for that series as determined at the opening to trading is used. All other index values for each of these implied volatility indexes are calculated using the *mid-points of the bid and offer premium quotations* of the options series that comprise the index. (Since these index values are based on quotations they are sometimes referred to as 'indicative values.'
>
> Because different values may be used in calculating the indicative values and exercise settlement values for the implied volatility options, there is a risk that there may be a divergence between the exercise settlement value for implied volatility options and an indicative value calculated at the opening on the date on which the exercise settlement value is being determined."

(Emphasis – both italics and underlining – in original. See also pp. 157-158 of the ODD (also in the December 2009 Supplement – providing additional description of the risks associated with the use of the different input values).)

settlement values of the Proposed Options and the calculation of all other values of the Proposed Options.

The ISE Filing is Not Consistent with the Act

The issues and concerns raised in this comment letter demonstrate that the ISE filing is not consistent with the requirements of Section 6(b)(5) of the Act and the rules promulgated thereunder, including Rule 9b-1.[23]

First, the proposed ISE rules are not designed to prevent fraudulent and manipulative acts and practices nor to promote just and equitable principles of trade. As discussed in detail earlier, the description of the proposed product is confusing and misleading. These ambiguities and uncertainties are particularly troubling because they involve as fundamental an issue as how the settlement values would be calculated (other than that it would involve a recalculation of the S&P 500).

Second, the proposed rules do not "foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities[.]" Specifically, the Proposed Options are subject to a pending state court proceeding that they violate an existing injunction. If the SEC were to approve ISE's filing and ISE were to start trading the Proposed Options before the Illinois state court ruled on the Motion, significant market disruption could occur. For example, CBOE expects the Illinois state court to determine that the Proposed Options violate the Injunction and therefore to enjoin trading, clearing, and settlement of exercises of, the Proposed Options. An injunction would leave investors with no readily available means to trade out of or exercise their positions in these options. By exposing investors to these undisclosed risks, ISE's proposed rules fail to protect investors or the public interest.

Finally, as discussed above, an amendment to the ODD Supplement would need to be made and approved by the Commission prior to listing and trading the Options. As currently styled, the ISE proposal is confusing and misleading. At a minimum, the ODD would need to be amended to include disclosure of a product that upon exercise would settle to a value that is calculated in an entirely different manner than how the daily value is calculated and disseminated over the life of the option. Without such an amendment to the ODD, the "information contained in the options disclosure document...will become materially inaccurate or incomplete or there is or will be an omission of material information necessary to make the options disclosure document not misleading[.]"[24]

* * * * *

[23] 15 U.S.C. 78f(b)(5) and 17 CFR 240.9b-1 (Options Disclosure Document).

[24] 17 CFR 240.9b-1(b)(2).

In conclusion, we strongly urge the Commission to disapprove ISE's filing. In any event, the Commission should exercise restraint and at least not take any action to approve ISE's proposed rule change until litigation over the Proposed Options has concluded. At a minimum, CBOE strongly believes that extensive revision of the ISE proposal would be required to address the issues highlighted in this comment letter. CBOE appreciates the opportunity to provide these comments. Should you require any further information, please contact Jenny Klebes, Senior Attorney, at (312) 786-7466.

Sincerely,

Edward T. Tilly
President and Chief Operating Officer
Chicago Board Options Exchange, Incorporated

cc: Richard Holley (SEC)
Heather Seidel (SEC)
Joanne Moffic-Silver (CBOE)

Attachment 1

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, CHANCERY DIVISION

CHICAGO BOARD OPTIONS EXCHANGE, INCORPORATED, et al., Plaintiffs, v. INTERNATIONAL SECURITIES EXCHANGE, LLC, et al., Defendants.	Case No. 06 CH 24798

MOTION TO ENFORCE PERMANENT INJUNCTION

On July 8, 2010, this Court permanently restrained and enjoined defendant International Securities Exchange, LLC ("ISE") "from listing or providing an exchange market for the trading of . . . S&P 500 index options and from thereby attempting to cause OCC to issue such options, clear trades in, or settle the exercise of such options." Memorandum Opinion and Order (July 8, 2010) (the "Injunction") at 16.[1] In flagrant disregard of the Injunction, ISE has embarked upon a plan to do just that. It has publicly announced its intention – and already filed plans with the U.S. Securities and Exchange Commission (the "SEC") – to list and offer trading in options that, in ISE's own words, would provide its members and investors "with additional opportunities to trade S&P 500® options . . . in an exchange environment." SR-ISE-2012-22 at 15.[2]

Plaintiffs Chicago Board Options Exchange, Incorporated ("CBOE") and The McGraw-Hill Companies, Inc., on behalf of itself and its wholly-owned subsidiary, Standard & Poor's

[1] A copy of the Injunction is attached as Exhibit 1.

[2] A copy of ISE's SEC filing is attached as Exhibit 2.

Financial Services LLC ("S&P"), bring this motion to prevent ISE from violating the Court's Injunction. In particular, CBOE and S&P (collectively, "Plaintiffs")[3] respectfully request that the Court enter an order (1) enjoining, as a violation of the Injunction, ISE's plan to provide a market for so-called Max SPY index options, which ISE admits are, in fact, cash-settled options based on the S&P 500 Composite Stock Price Index ("S&P 500"), and (2) further enjoining ISE from attempting to cause defendant The Options Clearing Corporation ("OCC") to issue, clear trades in, or settle the exercise of, ISE's options. In the alternative, Plaintiffs respectfully request that the Court declare that ISE's planned actions would violate the Injunction. In support of this motion, Plaintiffs state as follows:

1. The Court entered the Injunction on cross-motions for summary judgment to prevent ISE from carrying out its stated intent to offer options based on the S&P 500 and the Dow Jones Industrial Average and to clear trades in those options through OCC without a license from S&P or CME/Dow. Ex. 1. The Court held that the Illinois Supreme Court's decision in *The Board of Trade of the City of Chicago v. Dow Jones & Co., Inc.*, 98 Ill.2d 109 (1983), was "dispositive of the issues presented" and concluded that "the trading of index options on the . . . S&P 500 by ISE would misappropriate [S&P's] rights" in that index. Ex. 1 at 15. Accordingly, the Court permanently restrained and enjoined ISE "from listing or providing an exchange market for the trading of . . . S&P 500 index options" and from "attempting to cause OCC to issue such options, clear trades in, or settle the exercise of such options." Ex. 1 at 16. The Injunction resolved four years of litigation in this Court, the Northern District of Illinois, the

[3] CME Group Index Services (successor to Dow Jones & Company, Inc.) ("CME/Dow"), one of the original plaintiffs in this action, is not a party to this Motion because the options ISE plans to trade are based on the S&P 500 index, not on an index in which CME/Dow has an ownership interest.

Illinois Appellate Court (which affirmed this Court's denials of ISE's motions to dismiss), and the Illinois Supreme Court (which denied ISE's motion for a writ of prohibition) – and followed parallel litigation in the federal trial and appellate courts of New York. Thus, the Injunction was entered after an exhaustive review of the issues surrounding ISE's planned actions.

2. ISE has appealed the Injunction. This appeal has been fully briefed, was argued on September 22, 2011, and is awaiting decision by the Appellate Court.

3. This Court retains the power and jurisdiction to enforce the Injunction and to enjoin violations of it during the pendency of the appeal. *See A.R. Barnes & Co. v. Chicago Typographical Union No. 16*, 232 Ill. 402, 405 (1908) (the "doing of the act enjoined may be punished as a contempt notwithstanding the appeal"); *see also City of Chicago v. Rago*, 188 Ill. App. 3d 482, 487 (1st Dist. 1989) (court has inherent jurisdiction to enforce injunction notwithstanding appeal).

4. ISE's plan to offer these new options violates the Injunction. On March 9, 2012, ISE submitted to the SEC a proposed rule filing (the "Filing") that would "provide for the listing and trading" of so-called ISE Max SPY Index options (the "Options").[4] Ex. 2 at 3. ISE misleadingly asserts that a new and purportedly proprietary index – the Max SPY Index – would serve as the underlying interest of these cash-settled Options. The ISE Max SPY Index that ISE plans to calculate and disseminate is asserted to be "designed to represent 10 times the value of

[4] The Filing addresses only the federal securities law requirements for proposed exchange-traded products, and it does not address whether the Options would violate Plaintiffs' intellectual property rights or license rights.

the published share prices in the SPDR® S&P 500® ETF Trust" (the "Trust"), shares of which are known by their exchange symbol of "SPY."[5] Ex. 2 at 3.

5. In a diversionary tactic, ISE labels its Options as Max SPY Index options. As explained below, though, the Options in fact would be based on the S&P 500, in direct violation of the Injunction. Indeed, ISE admits in its Filing that its Options would be S&P 500 options, proclaiming that the Options would provide its members and investors "with additional opportunities to trade S&P 500® options . . . in an exchange environment." Ex. 2 at 15; *see also id.* at 12 (describing expectation that ISE's proposed product also would attract trading interest away from licensed over-the-counter index options based on the S&P 500).

6. The true nature of the Options as S&P 500 options is determined by the fact that ISE would use the prices and weightings of the stocks that comprise the S&P 500, not the published value of the Max SPY Index, to calculate the settlement value of the Options. The principal defining characteristic of any option is the identity of the underlying interest with respect to which settlement will be accomplished. ISE proposes that the Options would be cash-settled.[6] A cash-settled index option gives the option holder the right to receive, upon exercise, a

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[5] The Trust, as its name suggests, is an exchange-traded fund that is designed to track the performance of the S&P 500 index. S&P granted a license to an affiliate of the trustee of the Trust to use the S&P 500 as the basis for determining the composition and weightings of the portfolio of securities held by the Trust and to use certain S&P trade names and trademarks in connection with that portfolio. *See* Prospectus for the Trust, dated January 25, 2012 (a copy of which is attached as Exhibit 3), at page 52. The Trust adjusts the composition and weightings of the portfolio whenever there is a change in the identity of any security in the S&P 500 index and further adjusts the portfolio to ensure that the weighting of the stocks it holds tracks S&P's weighting of securities in the S&P 500 index within hundredths of a percentage point. *Id.* at 45-46. These portfolio adjustments by the Trust are non-discretionary. *Id.* at 46.

[6] While ISE attempts in its Filing to imply a link between its Options and the Trust, the Options are cash-settled index options. Unlike the case with options on shares of the Trust, the Options are not equity options that convey any rights to future delivery of shares of the Trust, which (continued)

cash payment based on the difference between the strike price and the underlying settlement index value at the expiration of the index option. *See* Ex. 1 at 2-3. The contract specifications for the Options reveal that ISE would determine the settlement value of the Options not with reference to the Max SPY Index value, but instead by ISE's retabulating itself the closing value of the S&P 500 on the settlement date, using both the closing prices of the exact stocks that S&P has selected for the S&P 500 and S&P's proprietary weightings of those stocks. *See* Ex. 2 at 40; *see also id.* at 6 n.3 (admitting that the settlement value ISE calculates may be different from the net asset value published by the trustee of the Trust). In particular, ISE admits that the "securities that comprise the S&P 500® . . . are the same portfolio securities whose published prices are used to calculate the settlement value of the ISE Max SPY." Ex. 2 at 13; *see also* Ex. 2 at 12. ISE further admits that the weighting of the component stocks in the SPY Trust would be identical to the weighting of those same stocks in the S&P 500. *See* Ex. 2 at 3-4; *see also supra* note 5. Those weightings in turn would reflect the proprietary adjustments that S&P – and only S&P – decides are appropriate for the S&P 500. *See* Ex. 2 at 3-4. ISE admits that it would use those proprietary weightings and adjustments in a retabulated "total value" of the S&P 500 component securities that ISE would use as the settlement value for its Options. *See* Ex. 2 at 6. In other words, in direct violation of the Injunction, ISE plans to list and trade Options whose essential characteristic – namely, their settlement value upon exercise – would be based on the closing value of the S&P 500, not on the published value of the Max SPY Index.

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distinguishes the facts at issue here from those at issue in *Dow Jones & Co. v. Int'l Sec. Exch., Inc.*, 451 F.3d 295 (2d Cir. 2006). *See* Ex. 2 at 7 n.5.

7. The Court should not be misled by ISE's name for its option product or by ISE's tactic of purporting to offer a new index[7] and to relate its Options to that index. If anything, ISE's ruse of calculating its own settlement value for its Options that will replicate the settlement value of S&P 500 options makes ISE's actions here even more comparable to the actions enjoined in *Board of Trade* and *Comex* than its prior attempt to offer S&P 500 options. *See Board of Trade*, 98 Ill. 2d 109, 114 (describing the CBT indexes); *Standard & Poor's Corp. v. Commodity Exch., Inc.*, 538 F. Supp. 1063, 1064-65 (S.D.N.Y. 1982) ("*Comex*") (rejecting purported Comex 500 Stock Index and Comex's emphasis in regulatory filing that the "Comex Index would use the same 500 stocks and the same method of computations as the Standard & Poor's 500 Stock Index"). When it comes to the tort of misappropriation, ISE's use of its own computation of the S&P 500, rather than S&P's published value, is, in the words of the Appellate Court, "a distinction without a difference." *Board of Trade of the City of Chicago v. Dow Jones & Co., Inc.*, 108 Ill. App. 3d 681, 695 (1st Dist. 1982), *aff'd*, 98 Ill. 2d 109 (1983).

8. Because ISE's Options are admitted to be, and by their structure inherently are, options on the S&P 500, ISE will be "listing or providing an exchange market for the trading of . . . S&P 500 index options." *See* Ex. 1 at 16. Indeed, because the Filing commences the listing process, the Filing itself constitutes a violation of the Injunction's prohibition against "listing" S&P 500 options. Because the Injunction found that it was an undisputed fact that all exchange-traded standardized options must be issued and cleared through OCC (*see* Ex. 1 at 2), ISE's Filing also necessarily involves "attempting to cause OCC to issue [S&P 500 options],

[7] There is no legitimate basis for ISE to claim proprietary rights *for itself* in an index that simply multiplies by 10 the share price of an ETF designed to track the S&P 500 – or even to claim that such a straightforward multiplication of the share price of a single equity could be an index.

clear trades in, or settle the exercise of such options," in further violation of the Injunction. *See* Ex. 1 at 16.

9. The Court need not wait to act until ISE has commenced trading the Options in violation of the Injunction. *See Bowman Dairy Co. v. Lyons*, 2 Ill. 2d 625, 629-30 (1954) (an injunction "operates as a continuing adjudication" that stays actions that threaten to violate the injunction, so a restraining order to prevent threatened violations is appropriate). Through its Filing, ISE has taken an unambiguous overt act to accomplish a result that would violate the Injunction. The SEC published official notice of the Filing in the Federal Register on March 22, 2012. Notice of Proposed Rule Change to Add an Index Option Product, 77 Fed. Reg. 16,883 (Mar. 22, 2012). Interested parties have 21 days from that date to provide comments to the SEC on any federal securities laws issues raised by the Filing. The Filing could be approved by the SEC at any time thereafter without advance notice to Plaintiffs, and ISE could commence trading at any time after receiving that approval. Unless the Court acts, Plaintiffs therefore will be deprived of the protection the Injunction was intended to provide them. ISE's planned violation of the Injunction is ripe for the Court's action.

For the foregoing reasons, Plaintiffs respectfully request an order:

a. restraining and enjoining ISE from violating the Injunction by listing or providing an exchange market for the trading of the Options and from attempting to cause OCC to issue, clear trades in, or settle the exercise of, such Options; or

b. in the alternative, declaring that it would violate the Injunction for ISE to list or provide an exchange market for the trading of the Options or to attempt to cause OCC to issue, clear trades in, or settle the exercise of, such Options; and

c. ordering ISE to reimburse Plaintiffs for attorneys' fees incurred in bringing this motion, which was necessitated by ISE's disregard of its obligations under the Injunction; and

d. granting such additional relief as the Court deems just and appropriate.

Dated: March 23, 2012

Respectfully submitted,

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Exhibit 1

IN THE CIRCUIT COURT OF COOK COUNTY
COUNTY DEPARTMENT, CHANCERY DIVISION

CHICAGO BOARD OF OPTIONS EXCHANGE, DOW JONES & COMPANY, INC., and THE MCGRAW-HILL COMPANIES, INC.,	
Plaintiffs,	Case No. 06 CH 24798
v.	Hon. William O. Maki
INTERNATIONAL SECURITIES EXCHANGE, LLC, and THE OPTIONS CLEARING CORPORATION,	ENTERED JUL - 8 2010 JUDGE WILLIAM MAKI CIRCUIT COURT - 1604
Defendants	

MEMORANDUM OPINION AND ORDER

This matter comes before the court on Plaintiffs' Joint Motion for Partial Summary Judgment and ISE's Motion for Summary Judgment. Having considered the briefing and exhibits in support, and having heard arguments of counsel on May 26, 2010, and therefore being fully informed of the premises, the Court finds as follows:

Background

Plaintiffs Dow Jones & Company, Inc.,[1] and The McGraw-Hill Companies through its wholly owned subsidiary, Standard & Poor's Financial Services LLC, (collectively, the "Index Providers") are the creators of two widely recognized indexes: the Dow Jones Industrial Average ("DJIA") and S&P 500 Composite Stock Price Index ("S&P 500"). The DJIA reflects the average of the stock market values of the shares of thirty leading companies in the United States,

[1] On March 18, 2010, CME Group, Inc. acquired 90% of the Dow Jones index business, including the Dow Jones Industrial Average. CME Group Index Services, LLC ("CGIS") was substituted as a party-plaintiff for Dow Jones on May 3, 2010.

while the S&P 500 reflects that of five hundred leading companies. The S&P 500 is computed at fifteen-second intervals, while the DJIA is calculated in real time and distributed every two seconds. Investors use the published index values to make investment decisions.

Plaintiff Chicago Board Options Exchange, Inc. ("CBOE") is a national securities exchange that specializes in the trading of standardized securities options. Headquartered in Chicago, CBOE is the largest options exchange in the United States. CBOE was the first options exchange to offer trading in index options and holds the exclusive license to offer options based on the S&P 500 and DJIA.

Defendant International Securities Exchange, LLC ("ISE") operates a national securities exchange specializing in the trading of standardized options contracts with a principal place of business in New York. ISE offers trading in index options, and is also a creator and provider of its own indexes and index option products.

Defendant Options Clearing Corporation ("OCC") is the sole clearing agency for standardized index options in the United States. Neither ISE, nor CBOE, or any other options exchange in the United States can offer trading in index options without the participation of OCC in clearing and settling such option trades.

In general, "[o]ptions are contracts which give the purchaser of the option the right, but not the obligation, to buy or sell a security at a specified price (the "strike price"), on or before a specified date." *Dow Jones & Co., Inc. v. Int'l Sec. Exch., Inc.*, 451 F.3d 295, 298 (2d Cir. 2006). Unlike options on equities or exchange traded funds, index options have no underlying security such as a share of common stock. The holder of an index option has the right to receive a cash amount based on the difference between the strike price established when the option was purchased and a settlement index level at the expiration of the option. Put simply, an index option is "a bet on the future value of the index." *Dow Jones,* 451 F.3d at 300, n.6.

The settlement index level for options based on the DJIA and the S&P 500 is known as the Special Opening Quotation ("SOQ"). The SOQ is calculated by the respective index owner and reflects the opening prices of each of the component stocks in the index, weighted accordingly to the methodology devised by the index provider. The Index Providers publish the SOQ values daily on various financial websites. In order to clear an index option, OCC must consult the SOQ value published by the Index Providers.

ISE seeks to offer options based on the DJIA and the S&P 500, which would be cleared by OCC, without a license from the Index Providers. The Index Providers allege that due to their substantial investments of resources, skill, judgment, creativity and efforts required to develop and maintain their indexes, they possess proprietary interests in the DJIA and the S&P 500 which gives them the exclusive right to authorize the creation, issuance, listing, trading, clearing, and settlement of financial products, including index options, that are based on the underlying indexes.

In Count I, Plaintiffs allege that ISE's proposed actions would misappropriate the proprietary interests of the Index Providers in their indexes, as well as CBOE's exclusive rights under its licenses. In Count II, CBOE alleges that ISE's proposed actions would tortiously interfere with its relationships with customers involving index options, as well as other options. In Count III, Plaintiffs allege that ISE's proposed actions constitute unfair competition under Illinois common law.

In their motion for partial summary judgment, Plaintiffs have moved for summary judgment on Counts I and III arguing that the Illinois Supreme Court's decision in *The Board of*

Trade of the City of Chicago v. Dow Jones & Co, Inc., 98 Ill.2d 109 (1983) ("Board of Trade") controls as a matter of law. ISE has moved for summary judgment as to all three counts arguing that: (1) this action is preempted by the federal Copyright Act; (2) if not preempted, New York law applies and does not afford Plaintiffs the relief they seek; and (3) even if Illinois law applies, Board of Trade is not dispositive and there are genuine issues of material fact precluding summary judgment.

Standard of Review

Summary judgment is appropriate where the pleadings, affidavits, depositions, admissions, and exhibits on file, when viewed in the light most favorable to the non-moving party, reveal that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law. 735 ILCS 5/2-1005(c). When, as here, the parties file cross-motions for summary judgment, they concede the absence of a genuine issue of material fact and invite the court to decide the questions presented as a matter of law. *Steadfast Ins. Co. v. Caremark Rx Inc.*, 359 Ill. App. 3d 749, 755 (1st Dist. 2005).

Federal Preemption

ISE contends that this Court lacks jurisdiction because the federal Copyright Act completely preempts Plaintiffs' state law claims for misappropriation and tortious interference.[2]

[2] In its Response brief, for the first time, ISE argues that the Securities Exchange Act of 1934 also preempts Plaintiffs' claims. By failing to assert this as an affirmative defense in its Answer, ISE has waived it. *Dickman v. El Du Pont De Nemours & Co.*, 278 Ill. App. 3d 776, 781 (3d Dist. 1996)(holding "[a] claim that a Federal statute preempts the plaintiff's cause of action meets the test for an affirmative defense under section 2-613(d) and must be raised in the defendant's answer. When a defendant fails to raise the issue, he has waived the defense."). To the extent that the issue has not been waived, the court finds ISE's arguments unpersuasive.

Recognizing that this Court previously rejected this argument in April 2009 when it denied ISE's motion to dismiss, ISE asks for reconsideration of that ruling in light of a recent Illinois Supreme Court decision in *People v. Williams*, 235 Ill.2d 178 (2009). The *Williams* court considered Illinois statutory provisions criminalizing the pirating of sound recordings produced by others. The *Williams* court found that such criminal provisions are a form of copyright protection and that Congress "clearly expressed an intent to abrogate such laws in section 301 of the Act." 235 Ill.2d at 194. ISE asserts that the new principal of law established in *Williams* is that "uniformity of decision is an important consideration when state courts interpret federal statutes." *Id.* at 186-187. ISE asserts that the majority of federal courts have held that the state law claim of misappropriation is always preempted by the Copyright Act where any copying occurs. According to ISE, to agree with Judge Gettleman's decision remanding this action from federal court to the circuit court would be to follow the minority (of one). *See Chi. Bd. Options Exch., Inc. v. Int'l Sec. Exch., LLC*, No. 06 C 6852, 2007 U.S. Dist. LEXIS 13007 (N.D. Ill. Feb. 23, 2007). ISE is incorrect.

Section 301 of the Copyright Act establishes a two-part test to determine whether federal law preempts a cause of action. Under that test, a state law claim is preempted:

> (1) if the works at issue are fixed in tangible form and come within the subject matter of copyright as defined by section 102 of the Act (subject matter prong) and
>
> (2) the rights granted under state law are "equivalent" to any of those exclusive rights "within the general scope of copyright" that are provided by the Act in section 106 (equivalency prong).

Williams, 235 Ill.2d at 187-188; 17 U.S.C. § 301. Both prongs must be met in order for a claim to be preempted. *Id.*

Section 102 protects as copyright subject matter "original works of authorship fixed in any tangible medium of expression." 17 U.S.C. § 102. Categories meeting the definition of "works of authorship" include: literary and musical works, including any accompanying words and music; pantomimes and choreographic works; pictorial, graphic, and sculptural works; motion pictures; sound recordings; and architectural works. Section 103 protects compilations and derivative works. 17 U.S.C. § 103.

ISE contends that Plaintiffs' misappropriation and tortious interference claims satisfy the subject matter prong because in order to offer options on the DJIA and S&P 500, ISE must be able to copy and use the published S&P 500 and DJIA index values. However, as this court recognized in denying ISE's motion to dismiss, as did Judge Gettleman in granting Plaintiffs' motion to remand, Plaintiffs' claims are not premised upon the copying of published index values from websites and other sources. *See Chi. Bd. Options Exch., Inc. v. Int'l Sec. Exch., LLC*, No. 06 C 6852, 2007 U.S. Dist. LEXIS 13007 (N.D. Ill. Feb. 23, 2007). Rather, it is the connection of ISE's proposed financial product to, and association with, the DJIA and S&P 500 that will allow ISE to exploit Plaintiffs' research efforts, skills, expertise, reputation and goodwill that are embodied in the indexes. Such intangible assets are not capable of being fixed in a tangible medium and are therefore not the subject matter of copyright. *See Toney v. L'Oreal USA Inc.*, 406 F.3d 905, 908-909 (7th Cir. 2005)(holding that a claim for misappropriation arising out of the unauthorized use of the plaintiff's likeness in advertising was not preempted as there was no fixation of identity or persona despite "dozens or hundreds of photographs which fix certain moments in that person's life."). Plaintiffs' claims fail to satisfy the subject matter prong.

The second prong of the preemption analysis concerns whether the elements of a cause of action for copyright infringement are equivalent to the elements of the state law claim. *Williams*, 235 Ill.2d at 187-188. ISE asserts that Plaintiffs' claims are preempted since no claim for "hot news" misappropriation is alleged, citing *Nat'l Basketball Ass'n v. Motorola, Inc,* 105 F.3d 841 (2d Cir. 1997)("NBA") for the proposition that "hot news" is the only misappropriation claim that is not preempted. ISE ignores that the NBA court recognized that "certain forms of commercial misappropriation otherwise within the general scope requirement will survive preemption if an 'extra-element' test is met." *Id.* at 850. If an extra element is "required instead of or in addition to the acts of reproduction, performance, distribution or display, in order to constitute a state-created cause of action, then the right does not lie 'within the general scope of copyright,' and there is no preemption." *Id.* Here, Plaintiffs do not complain of any copying or dissemination of index values from websites by ISE. In fact, Plaintiffs are aware that they may assert no rights in the published index values themselves, which have been held by courts to constitute "a matter of basic market fact." *NY Mercantile Exch., Inc. v. Intercontinental Exch., Inc.,* 389 F. Supp. 2d 527, 542 (S.D.N.Y. 2005)(holding that published settlement values of oil futures contracts are not protected by copyright and available for a competitor exchange to copy and use for settlement of its own futures contracts).

The parties disagree as to the amount of copying required for ISE to conduct its proposed actions. Plaintiffs assert that the trading of index options, which is when an exchange profits, does not require or involve any copying or reproduction of index values. (Plts. SOF in Opp. ¶4). ISE responds that copying occurs throughout the life of the index option—first, the exchange copies the index level when the new series of index options is opened (as published index values are used to set strike prices[3]); next, investors copy the existing level of the underlying index into standard formulas to determine the current value of an index option; and finally an exchange copies the settlement values when the option is exercised by its holder. Even accepting ISE's

[3] When ISE opens of new series of index options for trading, it offers a range of strike prices. ISE uses the day's SOQ value to determine the midpoint of that range because investors prefer to trade options with strike prices near the current index reference value. (ISE SOF ¶74-76).

statements as true, ISE's chief executive Gary Katz admitted that ISE does not earn a fee for the dissemination of the index values. (Katz Dep. at 280:2-4). Though the research performed by investors, including consultation of index values, might lead to the trading of an index option and fees to the exchange, such trading does not involving copying by the Defendants. Finally, while copying of the settlement values occurs when the option is exercised, again Katz admitted that no fee is earned at the time an option contract is settled. (Id. at 280:10-12). It is further undisputed that only 9% of index options are exercised. (Id.). The remaining 91% expire unexercised or are closed out by offsetting trades before expiration. (Id.). Therefore, copying of the index values, if any, is incidental as it relates to how Defendants would profit from the unlicensed use of the Plaintiffs' indexes.

Numerous cases cited to the court and discovered in its own research support Plaintiffs' assertion that misappropriation claims other than "hot news" claims survive preemption analysis. *See e.g., Toney,* 406 F.3d 905 (*supra.* p. 6); *Stewart Title of Cal., Inc, v. Fid. Nat'l Title Co.*, 279 Fed. Appx. 473, 476 (9th Cir. Cal. 2008)(finding that California law protects against improper use and that plaintiff's claim for misappropriation of contract forms was not preempted by the Copyright Act); *National Car Rental Sys., Inc. v. Computer Assocs. Int'l, Inc.*, 991 F.2d 426, 432-433 (8th Cir. Minn. 1993)(claim alleging use of a computer program, which is copyrightable, in breach of a contractual restriction not preempted); *G.S. Rasmussen & Assocs. v. Kalitta Flying Serv.*, 958 F.2d 896 (9th Cir. 1992)(finding claims involving unauthorized use of an FAA-approved design certificate not preempted even though certificate was necessarily copied to modify another plane).

The Illinois Supreme Court has recognized that because "[t]he publication of the indexes involves valuable assets of [Dow Jones], its good will and its reputation for integrity and accuracy," the index provider is entitled to protection against misappropriation from the proposed use. *Board of Trade*, 98 Ill.2d at 121-122. As noted above, Plaintiffs do not object to the copying of their index values which are widely published. Rather, Plaintiffs seek to protect their interests in the basis of the index options ISE seeks to offer—the indexes themselves, which embody the research, skills, efforts to maintain, reputation and goodwill of the Index Providers.

For these reasons, the Court finds that Plaintiffs claims are not preempted as they fail to satisfy both the subject matter and the equivalency prongs of the preemption analysis.

Choice of Law Analysis

It is well-settled that a "choice of law determination is required only when a difference in law will make a difference in outcome." *Towsend v. Sears, Roebuck & Co.*, 227 Ill.2d 147, 155 (2007). If a conflict exists, the court applies the principles of the Second Restatement of Conflict of Laws to determine the state "which retains the 'most significant relationship' to the occurrence and the parties." *Barbara's Sales, Inc. v. Intel Corp.*, 227 Ill.2d 45, 58 (2007).). "In the absence of a conflict, Illinois law applies as the law of the forum." *SBC Holdings, Inc. v. Travelers Cas. & Sur. Co.*, 374 Ill. App. 3d 1, 13 (1st Dist. 2007).

ISE asserts that, assuming Plaintiffs' claims are not preempted, New York law applies and does not consider ISE's proposed conduct to be tortious. ISE argues that under New York law, unfair competition claims involving misappropriation require direct competition and the only recognized misappropriation claim involving published information is a "hot news" case. While the Board of Trade court rejected the requirement of direct competition to sustain a misappropriation claim, ISE ignores the fact that the first case enjoining misappropriation of a stock index for use in trading products was issued by a court applying New York law. *See*

Standard & Poor's Corp. v. Commodity Exchange, Inc., 538 F. Supp. 1063 (S.D.N.Y. 1982), *aff'd* 683 F.2d 704 (2d Cir. 1982)("Comex"). In Comex, the district court entered a preliminary injunction enjoining the unlicensed use of the S&P 500 as the basis for index futures. The district court held that "Comex is misappropriating the S&P 500 Index and the skills, expenditures, labor and reputation of S&P in generating and producing the S&P 500 Index, for Comex's own advantage and profit by creating a futures contract based on the S&P 500 Index." 538 F. Supp. at 1071. On appeal, the Second Circuit affirmed. As to the direct competition requirement, the appellate court stated, "[w]hile S&P has traditionally been in the business of disseminating financial information, it now has a significant interest in the futures contracts business by virtue of its licensing agreement with CME . . . S&P and Comex are, at least to this extent, in competition." 683 F.2d at 710. Therefore, Illinois and New York law are in agreement that the Index Providers may sustain an action for misappropriation against ISE for its proposed actions.

Next, ISE argues that New York law does not recognize a claim of misappropriation based on a theory of "free-riding," citing *H.L. Hayden Co. v. Siemens Med. Sys., Inc.*, 879 F.2d 1005 (2d Cir. 1989). In that case, an authorized dealer of Siemens dental equipment brought an unfair competition claim claiming a mail order company was "free-riding" by encouraging dentists to inspect goods at the authorized dealer's facility before buying from the mail order company. *H.L. Hayden* is both factually and legally distinguishable. The authorized dealer did not, and could not, assert that the mail order company's unauthorized sale of the Siemens product was itself wrongful. *See H.L. Hayden*, 879 F.3d 1005, 1023 (dismissing Siemens' Lanham Act claim failed because the product was "genuine" and there was no risk of deception or confusion.). Here, Plaintiffs contend that ISE has no right without a license to <u>create</u> and sell a new security based upon the intellectual property of the Index Providers.

Finally, and without authority, ISE argues that New York courts are more likely than Illinois courts to: (a) reject Plaintiffs' claims on public policy grounds; (b) follow the reasoning of decisions from foreign jurisdictions, including courts outside the United States; or (c) give weight to the views of commentators and academics. These arguments are mere speculation by ISE and do not point to an articulable difference between Illinois and New York misappropriation law.

It should be recognized that in recent prior litigation between the parties, a federal court applying New York law expressly declined to rule on the issue presented to this court. *See Dow Jones & Co. v. Int'l Sec. Exch., Inc.*, 451 F.3d 295 (2d Cir. 2006). *Dow Jones* concerned whether ISE could, without a license, offer options on shares of exchange traded funds ("ETFs") that track the performance of the DJIA and S&P 500. In the 1990s, the Index Providers licensed creation of ETFs that track the performance of their indexes. Members of the public are able to buy shares in these ETFs. The court found that ISE, in creating and hosting the trading of such options, would not infringe upon the Index Providers' rights in their indexes and that the Index Providers had failed to "specify any use of the indexes likely to be made by the defendants that would constitute misappropriation." *Id.* at 303. Despite this finding, the court expressly stated that "[its] holding does not address the situation where a proprietary index is employed in the creation of a financial instrument," citing to <u>Comex</u> and <u>Board of Trade</u>. *Id.* at 303, n.9. The *Dow Jones* court had the opportunity to make a broad finding that the Index Providers could assert no rights in their indexes because of the intentional dissemination of index values, yet declined to do so, thus preserving the arguments Plaintiffs assert here under New York law.

In light of the foregoing review of case law, the court finds that there is no conflict between Illinois and New York misappropriation law. Therefore, Illinois law applies as the law of the forum state. *SBC Holdings,* 374 Ill. App. 3d at 13.

Board of Trade

In Board of Trade, the Chicago Board of Trade sought declaratory judgment that "its offering of a commodity futures contract utilizing the Dow Jones Industrial Average as the underlying commodity would not violate [Dow Jones'] legal or proprietary rights." 98 Ill.2d at 110-111. The Illinois Supreme Court disagreed, finding that the index provider's consent was required. Specifically, the court found that "[t]he publication of the indexes involves valuable assets of defendant, its good will and its reputation for integrity and accuracy." *Id.* at 121-122. Even though the Chicago Board of Trade's proposed use would not have been in competition with a use Dow Jones made of its index at the time as Dow Jones had not yet begun to offer financial products based upon the DJIA, the court found that the index provider "is entitled to protection against their misappropriation. *Id.* at 122.

Two factual differences exist between Board of Trade and the instant action. First, the financial product that Chicago Board of Trade wished to offer was a futures contract based upon the DJIA. *Id.* at 109. Second, the index provider was not, at the time, in the business of licensing its index for the purpose of creating financial products based thereupon. Both factual differences are insignificant and, if anything, weigh more heavily in favor of finding in prohibiting ISE from its proposed conduct. The parties agree that a futures contract and an option contract based upon an index use the underlying index in the same manner. That the DJIA was not then licensed or otherwise made use of as the underlying basis of financial products meant that the Board of Trade court was content to prevent unauthorized use of the index even though the index provider had no plans to allow such use of its index in the future. In addressing this concern, the court stated:

> We conclude that the possibility of any detriment to the public which might result from our holding that defendant's indexes and averages may not be used without its consent in the manner proposed by plaintiff are outweighed by the resultant encouragement to develop new indexes specifically designed for the purpose of hedging against the "systematic" risk present in the stock market.

Id. at 121. The Board of Trade court correctly predicted that its holding would encourage the development of new indexes—tens of thousands of indexes currently exist that track every segment of the market. The Index Providers and ISE have created and maintain numerous indexes and license them for use. Licensing of index-based products is the industry norm. (Krell Dep. 63-64). Consistent with Board of Trade, Plaintiffs are entitled to protection of their rights in their indexes from ISE's proposed use.

In efforts to distinguish Board of Trade, ISE argues that: (1) a balancing of harm analysis favors ISE's position: (2) considerations of federal policy favor unlicensed use; and (3) since Board of Trade was decided following full trial, summary judgment is not proper. The court will address each argument in turn.

In support of its assertion that a balancing of harm analysis favors its position, ISE argues that its proposed use would neither harm the Index Providers' reputation, nor their incentive to maintain the S&P 500 and the DJIA, nor CBOE's incentive to continue investing and offering new options products. ISE ignores the Board of Trade court's express rejection of a similar argument—that Dow Jones had failed to prove that use of its index would cause it injury—and the finding that the "publication of the indexes involves valuable assets of [Dow Jones], its good will and its reputation for integrity and accuracy." *Id.* at 121.

In further support of its contention that others will suffer more harm than Plaintiffs, ISE offers its retained expert, Professor Erik Sirri who posits a wide margin of $2 – 9.7 billion in potential savings to investors arising from inter-exchange price competition if options on the DJIA and S&P 500 are listed on multiple exchanges. Notwithstanding the numerous issues raised as to Professor Sirri's methodology by Plaintiffs' expert Dr. Dennis Carlton, such theoretical savings ignore the findings of the Board of Trade court. As discussed above, the court was willing to deny the investing public all access to a financial product based upon the DJIA in favor of protecting Dow Jones' rights in its indexes and in the interest of encouraging innovation. The effect of the Board of Trade decision includes the thousands of indexes in the marketplace today that did not exist in 1983.

It bears noting that ISE unabashedly admits that it attempted to create a competitive product, the ISE 250, which was an index highly correlated to the S&P 500. After spending a large sum of money developing and promoting options on the ISE 250, ISE discontinued the project which had failed to garner significant trading volume. The court fails to understand how ISE's failure somehow entitles it to profit for free from the efforts, skills, and reputation of the Index Providers.

As to its federal policy argument, ISE contends that the SEC has recognized the public's interest in multiple listing and inter-exchange competition for securities trades because such competition results in lower spreads and prices. ISE points to the SEC's 1989 adoption of Rule 19c-5, 17 CFR 240.19c-5, which prohibits exchanges from adopting any rule that would bar the listing on other exchanges of any stock options class. However, Rule 19c-5 clearly does not provide ISE with authority for its proposed actions as ISE petitioned the SEC in 2002 to create a rule that would "prohibit an options exchange from being a party to exclusive or preferential licensing arrangements with respect to index options products." (Plts. Opp. SOF ¶55). The SEC declined to adopt the proposed rule. ISE also quotes statements from SEC Commissioner Annette Nazareth in support of its position, however Ms. Nazareth prefaced her statements by stating that she was expressing her own opinions, not those of the SEC. Therefore, contrary to ISE's contentions, there is no SEC policy directly contrary to Board of Trade.

The Court finds that Board of Trade is on all fours with the facts and issues presented by Plaintiffs' claims for misappropriation and unfair competition. The Index Providers are entitled to protection against the misappropriation of their indexes from unlicensed use in the creation of index options by ISE. Having failed to distinguish Board of Trade in any significant way or to identify any genuine issues of material fact, ISE's contention that this matter may only be decided following a trial is unsupported.

Conclusion

This court finds that no genuine issues of material fact exist. Plaintiffs' cause of action is not preempted by the Copyright Act. Because there is no conflict between Illinois and New York misappropriation law, Illinois law controls. Therefore, the case of *Board of Trade of the City of Chicago v. Dow Jones & Co, Inc.*, 98 Ill.2d 109 (1983) is dispositive of the issues presented and the Court finds that the trading of index options on the DJIA and S&P 500 by ISE would misappropriate the Index Providers' rights in their indexes.

The court further finds:

A. Plaintiffs have shown that they have a clearly ascertainable right in need of protection;

B. Plaintiffs have shown that they will suffer irreparable harm if an injunction does not issue;

C. Plaintiffs have succeeded on the merits;

D. Plaintiffs have shown that they have no adequate remedy at law.

WHEREFORE, IT IS HEREBY ORDERED AS FOLLOWS:

Plaintiffs' motion for partial summary judgment is granted and summary judgment is entered in favor of Plaintiffs as to Counts I (misappropriation) and III (unfair competition).

ISE is hereby permanently restrained and enjoined from listing or providing an exchange market for the trading of DJIA and/or S&P 500 index options and from thereby attempting to cause OCC to issue such options, clear trades in, or settle the exercise of such options.

OCC is hereby permanently restrained and enjoined from participating in the facilitation of an ISE index option based upon the DJIA and/or S&P 500 and from issuing, clearing or settling the exercise of such DJIA and S&P 500 index options.

Having granted all relief sought by CBOE, Count II is dismissed as moot.

ISE motion for summary judgment is denied.

ENTERED

JUL - 8 2010

JUDGE WILLIAM MAKI
CIRCUIT COURT - 1604

Entered: ______________________
Judge William O. Maki

Dated: July 8, 2010