



DIVISION OF  
MARKET REGULATION

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

July 27, 2006

William J. Brodsky  
Chairman and CEO  
Chicago Board Options Exchange, Incorporated  
400 South LaSalle Street  
Chicago, IL 60605-1023

Re: Chicago Board Options Exchange Incorporated's Request for Exemption from Trade-Through Provisions of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage Relating to the Automatic Execution of Option Transactions During Crossed Markets

Dear Mr. Brodsky:

Rule 608(e) of Regulation NMS under the Securities Exchange Act of 1934 ("Exchange Act") provides that the Securities and Exchange Commission ("Commission") may exempt from the provisions of Rule 608 of Regulation NMS, either unconditionally or on specified terms and conditions, any self-regulatory organization, if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets, and the removal of impediments to, and perfection of the mechanisms of, a national market system.<sup>1</sup> As discussed below, the Commission is exempting the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") from Rule 608(c) of Regulation NMS, which requires CBOE to comply with, and enforce compliance by its members with, certain provisions of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Plan").<sup>2</sup>

**Exemption from Section 8(c) of the Plan**

In the Exchange's letter, dated July 25, 2006, CBOE seeks an exemption from Rule 608(c) of Regulation NMS, which requires CBOE to comply with, and enforce compliance

<sup>1</sup> 17 CFR 242.608. The Division of Market Regulation has delegated authority to grant an exemption pursuant to 17 CFR 200.30-3(a)(42).

<sup>2</sup> The Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Exchange Act, 15 U.S.C. 78k-1, and Rule 608 of Regulation NMS. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).

by its members with, the terms of the Plan regarding Trade-Throughs.<sup>3</sup> Specifically, CBOE requests that the Commission, pursuant to Rule 608(e) of Regulation NMS, exempt CBOE from the requirement of Rule 608(c) of Regulation NMS that CBOE comply, and enforce compliance by its members, with Section 8(c) of the Plan when trades are automatically executed while the CBOE's disseminated price is crossed by, or crosses the disseminated market of, another options exchange, whether through CBOE's Simple Auction Liaison ("SAL") system or as a result of any automatic execution on CBOE's Hybrid system, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the National Best Bid or Offer ("NBBO").<sup>4</sup>

Section 8(c) of the Plan provides that, "absent reasonable justification and during normal market conditions, members in [Participants'] markets should not effect Trade-Throughs." Section 8(c) of the Plan also requires the Participants to the Plan to file with the Commission for its consideration uniform rules which, among other things, provide that, "[w]hen purchasing or selling, either as principal or agent, any options series of an Eligible Options Class, or when sending a Linkage Order, members of a Participant should avoid initiating a Trade-Through" unless an exception applies. In accordance with this provision of the Plan, CBOE submitted, and the Commission approved, CBOE Rule 6.83, which provides that absent reasonable justification and during normal market conditions, CBOE members should not effect Trade-Throughs, unless an exception applies.<sup>5</sup>

Pursuant to the amendment to CBOE Rule 6.13 approved today by the Commission, CBOE automatically executes orders when the Exchange's disseminated market is crossed by, or crosses the disseminated market of, another options exchange and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.<sup>6</sup> Thus, CBOE rules allow an automatic execution that trades through one side of the market. Accordingly, you request an exemption from the requirement in Rule 608(c) of Regulation NMS that CBOE comply,

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<sup>3</sup> A "Trade-Through" is defined in Section 2(29) of the Plan as "a transaction in an options series at a price that is inferior to the NBBO."

<sup>4</sup> "NBBO" is defined in Section 2(19) of the Plan as the national best bid and offer in an options series calculated by a Participant.

<sup>5</sup> See CBOE Rule 6.83.

<sup>6</sup> Concurrent with the grant of this exemption, the Commission is approving a proposed rule change filed by CBOE (i) to permit automatic execution of eligible orders received when CBOE's disseminated market is crossed with the disseminated market of another exchange, provided CBOE is at the NBBO on the relevant side of the market, and (ii) to briefly auction inbound orders that would otherwise get filled at the NBBO for price improvement, even when the disseminated market for that option series is crossed. See Securities Exchange Act Release No. 34-54229 (July 27, 2006) (order approving SR-CBOE-2005-90).

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and enforce compliance by its members, with Section 8(c) of the Plan when orders are automatically executed when the Exchange's disseminated price is crossed by, or crosses the disseminated market of, another options exchange, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO. You request exemption whether such Trade-Through is a result of an automatic execution by the Exchange's SAL system or another automatic execution on the Exchange.

#### **Exemption from Section 4(b) of the Plan**

Section 4(b) of the Plan requires each Participant to enforce compliance with the provisions of the Plan by its members in their use of linkage through its facilities. You have requested that the Commission exempt CBOE from the requirement in Rule 608(c) of Regulation NMS that CBOE comply with Section 4(b) of the Plan by enforcing members' compliance with Section 8(c) of the Plan when orders are automatically executed when the Exchange's disseminated price is crossed by, or crosses the disseminated market of, another options exchange and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

#### **Response to Request for Exemption**

On the basis of the representations and facts presented in your letter, the Commission grants an exemption to CBOE from the requirement under Rule 608(c) of Regulation NMS that CBOE comply with Section 8(c) of the Plan, which provides in part that, "absent reasonable justification and during normal market conditions, members in [Participants'] markets should not effect Trade-Throughs." This exemption is expressly conditioned on CBOE automatically executing orders when its disseminated price is crossed by, or crosses the disseminated market of, another options exchange, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

In addition, the Commission grants an exemption to CBOE from the requirement in Rule 608(c) of Regulation NMS that CBOE comply with Section 4(b) of the Plan by enforcing its members' compliance with the requirements of Section 8(c) when orders are automatically executed on the Exchange when the Exchange's disseminated price is crossed by, or crosses the disseminated market of, another options exchange and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes or is equal to the NBBO.

The Commission finds that it is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system to grant the exemption described above because it will facilitate the resolution of crossed markets.

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This exemption is conditioned solely on the facts and representations presented in your letter. In the event that any material change occurs with respect to any of the facts or representations presented, the exemption will expire and CBOE must immediately resume operating in accordance with all provisions of the Plan.

For the Commission, by the Division of  
Market Regulation, pursuant to delegated  
authority,<sup>7</sup>



Robert L.D. Colby  
Acting Director

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<sup>7</sup> 17 CFR 200.30-3(a)(42).