



DIVISION OF  
MARKET REGULATION

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

November 18, 2005

James M. Flynn  
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400 South LaSalle Street  
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Re: Exemption Under Rule 608(e) of Regulation NMS under the Securities Exchange Act of 1934 from Certain Provisions of the "Plan for the Purpose of Creating and Operating an Intermarket Option Linkage" Relating to the Representation of Principal Acting as Agent Orders on the Chicago Board Options Exchange

Dear Mr. Flynn:

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 ("CBOE") 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 ("Linkage Plan").<sup>2</sup>

**Exemption from Certain Provisions of the Linkage Plan**

In your letter, dated November 17, 2005, you state that the CBOE seeks an exemption from Rule 608(c) of Regulation NMS, which requires CBOE to enforce the terms of the Linkage Plan regarding Principal Acting as Agent Orders ("P/A Orders")<sup>3</sup> directed to the Intermarket

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<sup>1</sup> 17 CFR 242.608(e).

<sup>2</sup> The Linkage Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Exchange Act, and Rule 608 of Regulation NMS (formerly 11Aa3-2 under the Exchange Act). *See* Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). The exchanges that currently participate in the Linkage Plan are the American Stock Exchange, the Boston Stock Exchange, the CBOE, the International Securities Exchange, the Pacific Exchange, and the Philadelphia Stock Exchange (collectively, the "Participants").

<sup>3</sup> *See* Section 2(16)(a) of the Linkage Plan.

Option Linkage (“Linkage”)<sup>4</sup> by its Designated Primary Market Makers (“DPMs”). 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 enforce compliance by its members with Sections 7(a)(ii)(A) and (B) of the Linkage Plan, which requires that P/A Orders sent through Linkage satisfy the definition of “P/A Order” as set forth in Section 2(16)(a) of the Linkage Plan. In addition, CBOE requests an exemption from Rule 608(c) of Regulation NMS, which requires CBOE to comply with Section 4(b) of the Linkage Plan, which requires the CBOE to enforce compliance with Sections 7(a)(ii)(A) and (B) of the Linkage Plan.

1. Exemption from the Requirement to Enforce Compliance with Sections 7(a)(ii)(A) and (B)

Section 7(a)(ii) of the Linkage Plan provides that a member of a Participant who wishes to buy or sell contracts of a series of an Eligible Option Class, as defined in the Linkage Plan, by sending an order through Linkage may do so by using one of three defined order types. The P/A Order is one order type that may be sent through Linkage. Section 2(16)(a) of the Linkage Plan defines a P/A Order as an order for the “principal account of a Market Maker that is *authorized to represent* Customer orders, reflecting the terms of a related unexecuted Customer order *for which the Market Maker is acting as agent.*” (Emphasis added.)

Sections 7(a)(ii)(A) and (B) of the Linkage Plan contemplate market makers sending P/A Orders, as defined in Section 2(16)(a) of the Linkage Plan, through the Linkage. CBOE has requested an exemption from Rule 608(c) of Regulation NMS, which requires it to enforce compliance by its members with these provisions. Specifically, CBOE wishes to allow its DPMs to send P/A Orders through the Linkage pursuant to Sections 7(a)(ii)(A) and (B) of the Linkage Plan that do not satisfy all of the elements of the “P/A Order” definition set forth in Section 2(16)(a) of the Linkage Plan.

Under CBOE’s rules,<sup>5</sup> the P/A Order would be placed through the DPM’s principal account, and the P/A Order would reflect the “terms of a related unexecuted Customer order.” However, an Exchange employee known as a PAR Official, not a market maker, would have custody of, and be responsible for executing, the related, unexecuted Customer order.<sup>6</sup> Accordingly, the related, unexecuted Customer order would *not* be one for which the DPM would be “acting as agent.” In fact, upon the implementation of the proposed rule change establishing PAR Officials, DPMs will no longer be authorized to act as agent. Therefore, you request an exemption from the requirement in Rule 608(c) of Regulation NMS that CBOE

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<sup>4</sup> The term “Linkage” means the systems and data communications network that link electronically the Participants to one another for the purposes of sending and receiving Linkage Orders, related confirmations, order statuses and Administrative Messages. See Section 2(14) of the Linkage Plan.

<sup>5</sup> Concurrent with the grant of this exemption, the Commission is approving a proposed rule change submitted by the CBOE to remove the responsibility of DPMs to act as agents for customer orders. The proposed rule change establishes PAR Officials, employees or independent contractors of CBOE who will represent customer orders routed to the PAR workstation and handle outbound P/A Orders. See Securities Exchange Act Release No. 52798 (November 18, 2005) (Order approving SR-CBOE-2005-46, the “PAR Official Proposal”).

<sup>6</sup> *Id.*

enforce compliance by its members with the requirement in Sections 7(a)(ii)(A) and (B) of the Linkage Plan that P/A Orders be for the account of a market maker that is authorized to represent Customer orders and that is acting as agent for a related unexecuted Customer order, as defined in Section 2(16)(a) of the Linkage Plan.

2. Request for Exemption from the Requirement to Comply with the Terms of Section 4(b) of the Linkage Plan (Compliance Undertaking)

Section 4(b) of the Linkage Plan requires each Participant to enforce compliance by its members in their use of Linkage through its facilities with the provisions of the Linkage Plan. You have requested that the Commission, pursuant to Rule 608(e) of Regulation NMS, exempt CBOE from the requirement Rule 608(c) of Regulation NMS that CBOE comply with Section 4(b) by enforcing members' compliance with Sections 7(a)(ii)(A) and (B) of the Linkage Plan.

**Response to Requests 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 Exchange Act Rule 608(c) of Regulation NMS that CBOE enforce compliance by its members with the requirement in Sections 7(a)(ii)(A) and (B) of the Linkage Plan that P/A Orders be for the account of a market maker that is authorized to represent Customer orders and that is acting as agent for the related unexecuted Customer order, as defined in Section 2(16)(a) of the Linkage Plan. This exemption permits DPMs to send a P/A Order through Linkage for their own account, reflecting the terms of a related unexecuted Customer order held by a PAR Official, even though the DPM is not acting as agent for such Customer order and is not authorized to represent Customer orders.

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 Linkage Plan by enforcing its members' compliance with the requirements of Sections 7(a)(ii)(A) and (B) of the Linkage Plan that P/A Orders be for the account of a market maker that is authorized to represent Customer orders and that is acting as agent for the related unexecuted Customer order, as defined in Section 2(16)(a) of the Linkage Plan.

This exemption is expressly conditioned on CBOE meeting the following conditions:

- (1) The P/A Orders that are routed through Linkage are for the DPM's principal account;
- (2) The P/A Order reflects the terms of a related, unexecuted Customer order, as that term is defined under Section 2(5) of the Linkage Plan;
- (3) The Customer order is routed to the PAR workstation in a DPM crowd, where the order is in the custody of the PAR Official; and
- (4) The resulting execution is transferred from the DPM to the Customer by means of an appropriate offsetting transaction.

The Commission has determined that this 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 the perfection of the mechanisms of a national market system because it will enable customer orders routed to CBOE to be executed through Linkage at another exchange disseminating the NBBO following the approval of the PAR Official proposal.

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 the provisions in the Linkage Plan.

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



Robert L.D. Colby  
Acting Director