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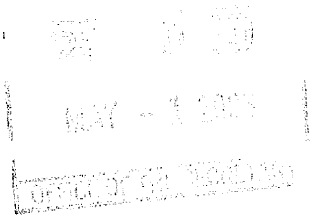

May 1,2003

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: File No. S7-07-03

Dear Mr. Katz:

The Chicago Board Options Exchange ("CBOE") is pleased to submit its comments on the petition of the New York Stock Exchange (the "NYSE Petition") that asks the Commission to amend the Consolidated Tape Association Plan and the Consolidated Quotation Plan (the CTA Plan and the CQ Plan, respectively; collectively, the "Plans"). In requesting comments on the NYSE Petition, the Commission asked commenters not only to address whether the Commission should act on the NYSE Petition, but also to comment on the effects of the NYSE Petition on participants in the CTA and CQ Plans and on the National Market System as a whole. It is CBOE's view, elaborated upon below, that the NYSE Petition does not present the type of "extraordinary circumstance" where the Commission intended to use its authority to initiate amendments to national market system plans under Rule 11Aa3-2. It is also CBOE's view that the particular amendments to the CTA and CQ Plans requested in the NYSE Petition would have an adverse impact on competition among the Plan participants and within the National Market System as a whole, For these reasons, CBOE urges the Commission not to take the action requested in the NYSE Petition. Instead, the CTA/CQ participants should be allowed a reasonable opportunity to decide for themselves what if any Plan amendments may be needed to address the issues identified in the NYSE Petition.

Before explaining our views in response to the NYSE Petition, we would first like to present some additional facts concerning the background of the NYSE. As stated in the release, in 1979 the Plans were amended *to* codify *the* practice of providing an exemption from market data device charges for devices of Plan participants located on their premises or on their trading floors and used for regulatory and surveillance purposes or for other approved purposes, In the early 1980s, one of the Plan participants, the Cincinnati Stock Exchange ("CSE"), ceased to maintain a trading floor and instead conducted all of its trading electronicaliy by means of computer terminals on the premises of its market-maker members located throughout the country. NYSE took the position that these CSE market-maker terminals, not being located on the premises or trading floor of a participant, were subject to device charges, and it submitted bills for

these terminals to CSE members on behalf of CTA/CQ. CSE maintained that its electronic market constituted a "virtual" trading floor and that market-maker terminals located on that virtual floor were within the scope of the exemption. CSE also maintained that the imposition of device charges on its market maker terminals while the terminals on the trading floors of other participant exchanges were fee-exempt constituted an impermissible discrimination against CSE and its members. CSE filed a petition with the Commission in which it repeated its claims of unfair discrimination, and in September 2000 the Commission initiated a hearing in the matter.

One month later, in October 2000, NYSE sought informally to obtain the sense of Plan participants concerning whether they would support Plan amendments to eliminate the device-fee exemption for all Plan participants. At that time it appeared that such a proposal would not receive the unanimous support of Plan participants necessary for its approval because CBOE objected to it on the ground that eliminating the exemption would have a substantial adverse financial impact on CBOE alone among Plan participants, and conversely would have a favorable financial impact upon NYSE and upon CBOE's main competitor, Amex, which were the two principle proponents of the amendment.[1] When it appeared that the amendment would not receive unanimous approval, it was withdrawn and was never submitted to a formal vote.

During *the* following several, months, NYSE made no effort to attempt to devise an alternative response to CSE's claim of discrimination that would not discriminate against other exchanges, such as CBOE, with relatively small trading volume in the securities subject to the CTA and CQ Plans. Instead, in February 2001 NYSE filed with the Commission the rule-making petition on which comment is now requested, asking the Commission to amend the Plans in the very same manner that CBOE had objected to.[2]

After its rule-making petition had been filed, NYSE and Amex proposed to settle the dispute with CSE by obtaining the agreement of CTA/CQ to waive CSE's asserted past liability for device fees in exchange for CSE's support of what was characterized as a Plan "interpretation" that purported to eliminate most of the purposes for which participants' devices had previously been fee exempt, and thus would have accomplished most of the purposes of the previously proposed Plan amendments. CSE accepted this settlement offer, and in April 2001 the Plan "interpretation" was submitted to a vote of CTA/CQ. CBOE and PHLX did not support this "interpretation". but it was nevertheless considered to have been approved by a majority of the Plan participants, and CTA/CQ began to bill participants for device fees. In August 2001, CBOE appealed this action, claiming that the "interpretation" of the Plans constituted a Plan amendment because the fee exemption sought to be "interpreted" out of existence was codified in the explicit

[1] Section IV(b) of the CTA Plan and Section IV(c) of the *CQ* Plan require generally that amendments to the respective Plans must be approved by each of the Plan participants.

[2] In its petition, NYSE questioned the legitimacy of CBOE's interest in CTA by claiming that at the time NYSE presented its proposal, CEOE accounted for an insignificant fraction o ftrading in CTA securities. The statistics presented by NYSE referred to CBOE's share of Tape A trading only, and ignored the fact that CBOE trades a small but growing share of certain Tape B securities, consisting of a number of ETFs, which necessitates CBOE's participation in CTA and gives it a real and legitimate interest in how the CTA and CQ Plan are administered and amended.

terms of the Plans, and because the elimination of this exemption raised significant issues of competitive fairness. CBOE's appeal is still pending.

Regardless of how CBOE's appeal may be decided, if the Commission were to grant the request made in the NYSE Petition, the result would be to amend the Plans in ways that go beyond the April 2001 "interpretation". This is because the language of the Plans as amended in 1979 not only provided a fee exemption for participants' devices used for previously approved purposes, but also provided that participants' devices used for regulatory and surveillance purposes would also be fee exempt. Here, even NYSE has recognized that this aspect of the participants' fee exemption cannot be eliminated by interpretation, but can be removed only by Plan amendment. The Plan amendments requested in the NYSE Petition, if implemented by the Commission, would have the effect of eliminating all fee exemptions for participants, including the exemption that has heretofore applied to participants' regulatory and surveillance devices.

While there can be no doubt that the Commission has the authority under Exchange Act Rule 11Aa3-2 to propose and approve by rule amendments to national market system plans such as the CTA and CQ Plan on its own initiative or in response to a petition to engage in rulemaking, the Commission has recognized that this authority is only to be used in extraordinary circumstances.[3] CBOE respectfully submits that the circumstances described in the NYSE Petition do not represent the kind of extraordinary circumstances in which it is appropriate for the Commission to exercise its authority to mandate amendments to the CTA and CQ Plans. Instead, under existing circumstances we believe the Commission should defer to the amendment process that is provided for in the terms of the Plans as approved by the Commission at the time the Plans were first established.

Although there may well be good reason for the Plans to be amended to revise or even eliminate existing exemptions from device fees for participants' devices in light of changes to exchange markets that have occurred since those exemptions were put in place 25 years ago, there is no basis to conclude that the Plan participants themselves are unable to reach agreement on Plan amendments that address this need. As described above, the NYSE Petition was filed only a few months after NYSE had failed to obtain unanimous agreement on an amendment that would have resulted in a significant financial benefit for NYSE but would have imposed a great financial burden on CBOE and on any other CTA/CQ participants that account far a relatively small share of

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[3] In proposing the adoption of Rule 11Aa3-2 which proposed to give the Commission the authority *to* amend national market system plans, the Commission stated, "To date, *the* Commission has not felt that the operation of those NMS Plans which have been approved by the Commission has necessitated the exercise of Cammission authority to modify the terms of those plans. However, the Commission believes that, in unusual circumstances, it may be necessary for the Commission to take the initiative in seeking amendment of an effective NMS Plan." [Exchange Act Release No. 16410 dated December 7, 1979] In the release adopting that same Rule the Commission stated, "The Commission hopes that the Commission and industry will cooperate to the maximum extent feasible in the development of the national market system and therefore anticipates that it will be necessary to use the Commission's authority [to initiate amendments to NMS Plans] only in extraordinary circumstances." [Exchange Act Release No. 17580 dated February 26, 1981]

transaction volume:. No effort was made by NYSE as Plan administrator to develop or consider alternative proposals that might have addressed CSE's claims of discrimination without creating new types of discrimination against CBOE and other similarly situated exchanges. In recent months CBOE and PHLX have jointly presented an alternative approach to charging for participants' devices, but NYSE has shown no interest in this proposal and instead has preferred to rely on its pending Petition as the only way to address the matter, Similarly, several Plan participants, including Amex and NASD, have recently presented suggestions for changing the manner in which market data revenue is allocated among Plan participants, which could have a direct bearing on the effect on individual exchanges of eliminating the participants' device fee exemption. No action has yet been taken on these proposals, but there is reason to believe agreement can be reached on one or more of them, and the Plans can be amended accordingly. Even if agreement ultimately cannot be reached on any of these proposals, the participant exchanges and the Commission will all be better informed on the competitive issues raised in the NYSE Petition after these other proposals have been thoroughly discussed and evaluated.

The fundamental concept of self-regulation embodied in the Exchange Act is reflected in the terms of all national market system plans, including the CTA and CQ Plans, which provide that *they* can be amended only with the unanimous approval of the parties to these plans. As the Commission has recognized, this suggests the Commission should exercise great restraint in the use of its extraordinary power to amend these Plans. The Commission has always exercised such restraint in the past, which is why there have been so few occasions when the Commission has found it necessary to amend any national market system plans on its own initiative. In particular, the Commission has never amended the CTA or CQ Plans in this way. We see no reason for the Commission to depart from its past practice in this respect.

Turning to the substance of the Plan amendments requested in the NYSE Petition, it is plain that the adoption of these amendments can only benefit the NYSE, regardless of their impact on any of the other participants. As the participant that receives the lion's share of all CTA/CQ Tape A revenue, NYSE would not only receive back most of the fees it would have to pay if its market data devices were no longer fee-exempt, but it would be allocated the same share of the fees required to be paid by all other participants, resulting in aggregate additional revenues to NYSE that would always exceed its added costs. Although there is nothing new about NYSE's receiving the largest share of CTA/CQ Tape A revenue, it raises new competitive concerns when additional revenue is allocated to NYSE as the direct result of new fees being imposed on other markets that compete with NYSE and with each other.

These competitive considerations are not addressed in the NYSE Petition. They do, however, underlie recent suggestions made by other CTA/CQ participants to revise the method of allocating market data revenue among the participants. A major aspect of the justification for charging market data fees is that the revenue derived from these fees can help defray some of the costs of regulating the markets that generate the market data in the first place. Since these regulatory costs are incurred by all participants in CTA/CQ

and not necessarily in proportion to the amount of trading done in each market, it is difficult to justify allocating market data revenue among the participants solely on the basis of relative transaction volume. The problems resulting from the allocation of market data revenues based solely on relative transaction volume are heightened when the revenues are generated from fees charged directly to the exchange markets themselves. Unless and until this issue can be resolved, for the Commission to order *the* amendment of the Plans in the manner requested by NYSE would result in competitive injury to CBOE and to other exchanges that account for only a small percentage of transaction volume in securities reported over CTA and CQ, and would thereby fail to satisfy the standards of the Exchange Act.[4] For the same reason, any action that would impose unfair competitive burdens on exchanges would ultimately be harmful to the national market system as a whole and to investors, since full and fair competition among participants in the national market system would be impaired and investors would be deprived of the benefits of such competition in the manner intended by the Exchange Act.

For these reasons, CBOE strongly urges the Commission not to amend the CTA and *CQ* Plans as requested in the NYSE Petition. Instead, building on the foundation of *the* Commission's September 14,200 1, Report of Dean Seligman's Advisory Committee on Market Information, which addressed issues of cornpetition in the distribution of securities market information including the manner of charging for such information, the Commission should invite participants in the CTA/CQ Plans (as well as participants in plans of other registered exclusive securities infomation processors and other interested persons) to consider the changes that have taken place in *the* operation of securities markets in the more than 25 *years* since these plans were first developed, and to consider how, if *at* all, these plans should be amended in response to these changes so as to promote fair competition rather than impede it.

Very truly yours,

Jeanne Moffic-Silver

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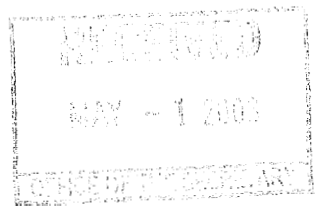
GG: Annette Nazareth, Director
Robert L.D.Colby, Deputy Director
Edward Joyce
Phillip Slocum
Thomas Knorring

[4] CBOE estimates that the elimination of all device fee exemptions would cost it over $600,000 annually, little of which would be returned to CBOE as its allocated share of CTA/CQ revenue, but instead would largely be allocated to the NYSE and other participant exchanges under the Plans' current allocation formula.



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FAX

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TO: Jonathan G. Katz

Firm: Securities and Exchange Commission

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From: Joanne Moffic-Silver

Date: May 3, 2093

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