CBOE
CHICAGO BOARD OPTIONS EXCHANGE

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Via Facsimile and DHL

August 26,2003

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

Re: File No. SR-BSE-2003-04

Dear Mr. Katz:

The Chicago Board Options Exchange, Incorporated ("CBOE") is pleased to submit its comments on the referenced proposed rule change of the Boston Stock Exchange ("BSE"), which describes various regulatory aspects of BSE's proposal to create a new options exchange, the Boston Options Exchange ("BOX"). CBOE previously commented on BSE's proposal to develop a new options exchange (originally published for comment on January 22, 2003 as Amendment No. 2 to File No. SR-BSE-2002-15) in a letter dated February 14, 2003, from the undersigned, to the Secretary of Commission. In that letter we observed, among other things, that BSE's proposal was materially deficient because it failed adequately to describe the structure, ownership, governance and regulation of the proposed new options exchange. Among the elements missing from BSE's filing were a description of how BOX would be structured and who would be its owners; who would be the members of BOX and to what rules they would be subject; what, if any, role would the members of BOX have in the governance of BOX or BSE; what would be the relationship between BSE, BOX and members of BOX; what entity would be responsible for the operation and regulation of BOX; and finally, whether BSE or BOX was intended to function as the exchange on which options would be traded, and if BOX, why it was not applying for registration as a national securities exchange under the Securities Exchange Act of 1934 ("Exchange Act").

BSE has now submitted this new fiiing in an apparent attempt to cure these deficiencies. However, this filing makes little if any mention of governance issues apart from describing the proposed governance of a new wholly-owned subsidiary of BSE, Boston Options Exchange Regulation, L.L.C. ("BOXR"), to which BSE intends to delegate regulatory responsibilities for the new exchange, and it does not address at all the other areas where the original filing was deficient.[1] Instead, this filing, for the most

[1] These issues are also not addressed in the more recent BSE filing designated as Amendment No. 3 to SR-BSE-2002-15, noticed in Release No. 34-48355 dated August 15, 2003, in which BSE/BOX proposes to amend several of its proposed options trading rules.

part, consists of a description of what BSE characterizes as a Delegation Plan pursuant to which it proposes to delegate regulation of the new exchange to BOXR.'

Before commenting on BSE's proposed regulatory Delegation Plan we want to observe that by focusing so much attention in this filing on the regulation of the new exchange and its members and on the governance of its new regulatory subsidiary, BSE seems to be trying to divert attention from the material deficiencies of its prior filing in the areas of structure, ownership and governance of the proposed new exchange and of BSE itself, as well as to avoid broader questions concerning how the regulatory requirements of the Exchange Act will apply to this new exchange. While assuring adequate regulation of an exchange's market and its members is an important requirement of the Exchange Act, there are other equally important requirements of the Act and of the rules, regulations and policies of the Commission implementing the Act that are not addressed in the BSE proposal.

The failure to address these issues not only affects the protection of investors but it also affects us and the other options exchanges that will be competing with BOX. If BOX is permitted to enter the listed options business without having to satisfy the same regulatory requirements that we and all of the other options exchanges must satisfy, BOX will have an unfair competitive advantage over all of the rest of us. Similarly, if BOX is allowed to avoid exchange registration requirements, future new entrants into the listed options business will likely rethink their plans to register as national securities exchanges. Instead, new exchanges will only have to find an already registered exchange that, if given a minority interest in the new exchange, might be willing to "rent" its registration by allowing the new exchange to characterize itself as a "facility" of the registered exchange.

For example, by not seeking registration as a national securities exchange, BOX has avoided the degree of scrutiny of its ownership and governance that would have applied if it had sought exchange registration. This is especially critical in the case of a "for profit" exchange, as BOX is proposed to be, compounded by the fact that one or more of the owners of BOX are non-U.S. persons who may be outside of the Commission's reach. Failure. to seek registration as an exchange has prevented consideration of such critical issues as the potential conflict between BOX's regulatory responsibilities and its for-profit structure, and how the Commission's jurisdiction over BOX's non-U.S. owners can be assured.[3]

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[2]In an apparent recognition of the material omissions in its original filing, BSE represented in that filing that it "intends to file under the [regulatory] Delegation Plan a proposed rule change regarding the relationship between the BSE, BOXR and the BOX entities." Notwithstanding this statement of BSE's intention and despite the characterization of the instant filing as representing BOX's "governance plan" in a statement attributed to a "spokeswoman for BOX' in ***Securities Week,*** vol. **30,** no.31 (August **4,** 2003), little is said in this filing about the relationship between BSE and the BOX entities or about the governance of the BOX entities beyond describing the ownership and governance of BOXR.

[3] CBOE is aware that in other contexts the Commission's Staff has recently proposed to apply a number of special requirements to the situation where non-U.S. entities, including Canadian exchanges, might acquire an ownership interest in a U.S. registered national securities exchange. These relate to such matters as disclosure of the ownership and governance structure of the non-U.S. owners and of the relationship

More generally, as we pointed out in our prior comment letter, throughout the BSE proposal and related filings BOX is described as an exchange both semantically and functionally. This makes us perplexed as to why BOX has not applied for registration as a national securities exchange. If it had submitted such an application, BOX would not only have had to assure the Commission that its members will be subject to appropriate regulation, but it also would have had to satisfy other specific requirements of Section 6(b) of the Exchange Act. In particular, every applicant for registration as a national securities exchange must satisfy the Commission that it is organized and has the capacity to carry out the purposes of that Act and to comply with its provisions. (Exchange Act, Section 6(b)(1)) As already noted, this is hardly a trivial matter in the case of an entity such as BOX, which is organized as a for-profit limited liability company and is owned and controlled not by its members, but by named and unnamed persons both within and without the United States. None of this is addressed in either BSE's original filing or this latest so-called "governance" filing.

. Additionally, an applicant for registration as a national securities exchange must be structured so that its members are assured a fair representation in the selection of the directors of the exchange and in the administration of its affairs. (Exchange Act, Section 6(b)(3)) Again, this is barely mentioned in BSE's "governance" filing. To the extent this filing deals with governance matters at all, it does so only in respect of the governance of the new regulatory subsidiary, BOXR, LLC, and not in respect of the governance of BOX LLC or of BSE itself. As to the governance of BSE, all that is said is that the 22-person board of directors of BSE will include one director who represents a BOX participant.[4] Nothing is said about how members of BOX will have any representation in selecting the directors of BOX or in the administration of the affairs of BSE or BOX. The token representation of one BOX member on the BSE board strikes us as falling far short of satisfying the statutory requirement that members must be fairly represented in the governance of a national securities exchange and in the administration of its affairs.

Even as to BOXR, the governance provisions described in this filing fail to satisfy the requirements of the Exchange Act. The Board of Directors of BOXR is apparently not to be elected by the members of BOX, but will be appointed annually by the Board of Directors of BSE. Thus while at least 20% of the BOXR board must be representatives of BOX participants, BOXR participants (i.e., its members) do not have the right to choose which BOX participants serve on the BOXR board – the BSE board does this. Even if the BSE Board can be viewed as representing the membership of that exchange – something that cannot be determined from the BSE filing – that does not explain how the proposed governance structure of BOXR provides for the fair representation of members

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between the non-U.S. owners and the U.S. exchange, and obtaining agreements from the non-U.S. owners ***to*** assure that the Commission would have access to their books, records and personnel as may be needed to permit enforcement of the Exchange Act to the same extent as if all owners were U.S. persons.

[4] The filing proposes ***to*** amend the Constitution of BSE to provide a single seat on its 22-person board to be held by a BOX participant, appointed by the BSE board based upon the nomination of BOXR's Nominating Committee, which itself is elected by BOX participants.

of BOX in the governance or operation of BOXR. And, of course, none of this has anything to do with the governance and operations of BOX itself.

Furthermore, BOXR's only function would be in the area of regulation, and even there only to the extent delegated to BOXR by BSE pursuant to an imprecise and ambiguous Delegation Plan. This Plan is not clearly set forth in the filing, but it appears to be embodied in proposed amendments to the Rules of the Board of Governors of BSE. Under these Rules, on the one hand BSE purports to delegate regulatory responsibility over BOX to BOXR, but on the other hand BSE expressly reserves to itself the authority "to delegate authority to BOXR to take actions on behalf of the Exchange," presumably meaning that BSE may at any time change what it does or does not delegate to BOXR. BSE also reserves to itself the right of "review, ratification or rejection" of anything BOXR might do pursuant to its delegated authority.[5] This makes the delegation of regulatory authority to BOXR little more than a charade, and it makes the provisions for involving members of BOX in the governance of BOXR potentially no more than an irrelevancy insofar as satisfaction of the requirement of Section 6(b)(3) of the Exchange Act is concerned. In light of this, we wonder whether all of the focus in this filing on BOXR is simply intended to distract attention from the real and substantial issues of structure and governance that are raised by the BOX proposal but are not addressed in any of BSE's filings.

Finally, if BOX had sought registration as a national securities exchange, its principle governing document, the Operating Agreement of BOX LLC, would have been filed as an exhibit to its application. Furthermore, once BOX became registered any changes to this document would be subject to the requirements of Section 19(b) of the Exchange Act, as are changes to governing documents of all registered exchanges. By avoiding exchange registration, BOX has thus far managed to hide this important document from us and other commenters (and perhaps from the Commission), and has avoided the filing, public notice and approval requirements that apply to comparable organizational documents of registered exchanges.[6]

Rather than addressing how applicable statutory requirements are satisfied in its BOX proposal, BSE's filing attempts to sidestep this issue by simply stating that notwithstanding the characterization and functional description of BOX as an exchange, BOX is not an exchange but is a "facility" of an exchange. In support of this rather astonishing conclusion, BSE simply quotes the Exchange Act's definition of "facility", as if saying this is so makes it so,

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[5] Proposed amendment to Rules of the Board of Governors of BSE, Ch. XXXVI, Sec. 2A.

[6] The instant filing states that "the books, records, premises, officers, directors, agents and employees of BOXR and BOX LLC would be the books, records, premises, officers, directors, agents **and** employees of the BSE for purposes of, and subject to, oversight pursuant to the Act." BSE is already violating this commitment by not including in its filings on which public comment is requested any of the governing documents of BOX LLC and the other agreements between BSE and BOX that are referred to but not described in these filings. CBOE urges the Commission to require that BOX submit these documents for public review and comment.

BSE also refers to the Commission's prior acceptance of Archipelago's automated trading facility as a facility of the Pacific Exchange ("PCX"), but this ignores the many ways the BOX proposal differs from PCX/Arca. The Commission's approval of Archipelago as a facility of PCX, which was viewed by some as a controversial action taken over the strong objection of a number of commenters, was based on factors that plainly do not apply to the BOX proposal. The special circumstances that led the Commission to approve treating Archipelago as a facility of PCX are apparent on the face of the Commission's approval order. When it issued that order the Commission stated, "In proposing to establish ArcaEx as the equities trading facility of the PCXE, the PCX has sought to replace its floor trading model with a sophisticated electronic trading system. In the Commission's view, the proposed ArcaEx facility would provide a new and technologically advanced way for trading interest to be matched and orders to be executed on the PCX."[7] The approval order made special note of the fact that, wholly apart from Archipelago, "... the PCX has regulated both a traditional trading floor as well as the OptiMark electronic trading facility.[8]

In other words, all that was proposed in the case of PCX/Arca was to provide PCX with a new automated facility on which it would be able to trade exactly the same kinds of securities that it had always traded, and which it would regulate just as it had always regulated its market. Instead of this new facility being owned by PCX, it would be owned by a separate entity, Archipelago Holdings, LLC, through a subsidiary, Archipelago Exchange LLC. As would have been the case if the facility had been owned directly by PCX, the PCX-Arca proposal provided that all books, records, premises, officers, directors, agents and employees of Archipelago Exchange LLC and all officers and directors of the parent holding company would be deemed to be those of PCX for purposes of the Exchange Act.' Under these circumstances, the Commission accepted the characterization of Arca as a facility of PCX and did not require it to be registered as an independent national securities exchange.

What BSE has now done in its BOX proposal is take the approach of PCX-Arca that was approved in the special circumstances cited in the PCX-Arca approval order, and distort it beyond recognition to cover circumstances that, if allowed, will result in the effective elimination from the Exchange Act of many of the requirements applicable to the registration of national securities exchanges. In contrast to PCX-Arca, BSE proposes to create an entirely new exchange that will trade an entirely new product line. Instead of simply providing a facility that might enable BSE to be more competitive in its existing business by applying new technology to its operations, as was the case in PCX/Arca, BSE proposes to create an entirely new exchange that would trade products never before traded on BSE. The result would be to introduce a new entrant in **an** extremely competitive business – the listed options business – where all of the other competitors are registered national securities exchanges.

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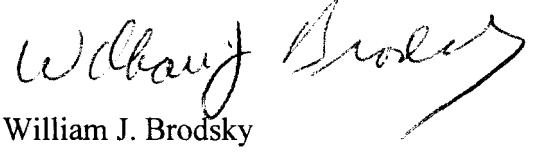
[7] Exchange **Act** Release No. 44983 dated October 25,2001, at **p. *29*.**
[8] Id. at note 70.
[9] Id at **p. *6*.**

Furthermore, BSE proposes to do this through a veiled ownership and governance structure that, unlike PCX/Arca, falls far short of assuring that the Commission will have the ability to enforce the requirements of the Exchange Act and its own rules and policies. To allow BSE and BOX to avoid having to satisfy the requirements of the Exchange Act by effectively leasing the registration of an already existing exchange is in our view not at all consistent with encouraging "fair competition ... among exchange markets" as mandated by Section 11A(a)(1)(C)(ii) of the Exchange Act.

This is not to say that as circumstances have changed and technology has developed, provisions of the Exchange Act enacted almost seventy years ago and last amended in any significant way almost thirty years ago may not be in need of review and revision. We agree that the ability of exchange functions increasingly to be performed by computer and communications systems located, owned and operated apart from the location, ownership and operation of sponsoring exchanges has caused profound issues to be raised concerning whether and how traditional concepts of the Exchange Act might be modified to better fit current circumstances. In our view, these issues should be addressed as part of a comprehensive analysis of all of the changes that have taken place in securities markets since 1934 and 1975, instead of being addressed piecemeal and without adequate consideration in a series of individual applications, each of which will seek to push the envelope of those that have been previously approved.

Because the approach we are suggesting will undoubtedly take time does not mean that we should be insulated from further competition from new entrants in the meanwhile. We have already seen in the case of the International Securities Exchange how a new entrant can be a successful competitor in the listed options business while at the same time fully satisfying the requirements of the Exchange Act. We understand that at least one other new entrant – Eurex – is on the horizon, and it too plans to register as an exchange. We urge the Commission to require no less from BOX, so that whatever additional competition it may bring to an already extremely competitive field of exchanges will be fair competition. We stand ready to discuss these concerns with the Commission and its staff.

Very truly yours,



William J. Brodsky

cc: Chairman William Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
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