

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62323; File No. SR-C2-2010-002)

June 17, 2010

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change Relating to the Corporate Restructuring of C2 in Connection with the Demutualization of the Chicago Board Options Exchange, Incorporated

I. Introduction

On May 14, 2010, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² C2 Options Exchange, Incorporated (“C2”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change relating to its corporate structure in connection with the plan of its parent company, the Chicago Board Options Exchange, Incorporated (“CBOE”), to restructure from a Delaware non-stock corporation to a Delaware stock corporation that would be a wholly-owned subsidiary of CBOE Holdings, Inc. (“CBOE Holdings”), a holding company organized as a Delaware stock corporation (“CBOE Demutualization”).³ The proposed rule change was published for comment in the Federal Register on May 25, 2010.⁴ The Commission received no comments on the proposal.

II. Discussion and Commission Findings

After careful review of the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁵ In particular, as discussed in more detail below, the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 62158 (May 24, 2010), 75 FR 30082 (May 28, 2010) (SR-CBOE-2008-88) (order approving the CBOE Demutualization).

⁴ See Securities Exchange Act Release No. 62118 (May 18, 2010), 75 FR 29375.

⁵ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

Commission finds that the proposed rule change is consistent with Section 6(b) of the Act⁶ in general, and furthers the objectives of Section 6(b)(1) of the Exchange Act,⁷ in particular, in that it enables C2 to be so organized as to have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of C2. The Commission also finds that this filing furthers the objectives of Section 6(b)(5) of the Act insofar as it would result in an exchange governance structure designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.⁸ In particular, the Commission believes that the Certificate of Incorporation and Bylaws of CBOE Holdings and C2 are designed to protect and maintain the integrity of the self-regulatory functions of C2 and to allow it to carry out its regulatory responsibilities under the Act.

C2 is currently a wholly-owned subsidiary of CBOE.⁹ When the corporate restructuring in connection with the CBOE Demutualization is complete, CBOE will become a wholly-owned subsidiary of CBOE Holdings. At the same time, C2 has proposed to become a wholly-owned subsidiary of CBOE Holdings by having CBOE dividend-up to CBOE Holdings all of the shares of

⁶ 15 U.S.C. 78f.

⁷ 15 U.S.C. 78f(b)(1).

⁸ 15 U.S.C. 78f(b)(5).

⁹ See Securities Exchange Act Release No. 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) (File No. 10-191) (order approving the application of C2 for registration as a national securities exchange). See also Securities Exchange Act Release No. 61140 (December 10, 2009), 74 FR 67294 (December 18, 2009) (SR-CBOE-2009-048) (order approving a proposed rule change regarding authority over C2 Options Exchange, Incorporated).

C2.¹⁰ Consequently, after the corporate restructuring in connection with the CBOE Demutualization is completed, CBOE Holdings would hold all of the outstanding common stock of both C2 and CBOE, as well as certain other entities that are currently subsidiaries of CBOE.¹¹ C2 and CBOE, however, would continue to be separately registered national securities exchanges under Section 6 of the Act¹² and would continue to operate their exchange businesses and facilities.

The Commission recently approved C2's registration as a national securities exchange and, in that context, approved C2's Certificate of Incorporation and Bylaws.¹³ In connection with its currently proposed corporate restructuring, C2 does not propose any significant changes to these governing documents but does propose, as discussed further below, to make certain changes to its Certificate of Incorporation to effect the change of ownership of C2 from CBOE to CBOE Holdings, to clarify certain aspects of C2's Bylaws as a result of this transfer of

¹⁰ After the restructuring, the owners of membership interests in CBOE will become stockholders of CBOE Holdings through the conversion of their memberships into shares of common stock of CBOE Holdings. In addition, members of the settlement class in the lawsuit brought by The Board of Trade of the City of Chicago, Inc., its parent company, CME Group, Inc., and a class of individuals (collectively, the "CBOT Parties") against CBOE and CBOE's board of directors will become stockholders of CBOE Holdings. CME Group Inc. et al. v. CBOE Inc. et al., Civil Action No. 2369-VCN (Filed Aug. 23, 2006). CBOE entered into a Stipulation of Settlement ("Stipulation") on August 20, 2008 with the CBOT Parties to resolve this lawsuit. The Stipulation and amendments to it can be found at (<http://www.cboe.org/Legal/>).

¹¹ These subsidiaries are: CBOE Futures Exchange, LLC, which operates an electronic futures exchange; Chicago Options Exchange Building Corporation, which owns the building in which CBOE operates; CBOE, LLC, which holds a 24.01% interest in OneChicago, LLC, a security futures exchange; CBOE II, LLC, which has no assets or activities; DerivaTech Corporation, which owns certain educational software; Market Data Express, LLC, which distributes various types of market data; and The Options Exchange, Incorporated, which currently has no assets or activities.

¹² 15 U.S.C. 78f.

¹³ See Securities Exchange Act Release No. 61152, supra note 9.

ownership, and to make certain ministerial changes to C2's Certificate of Incorporation and Bylaws.

CBOE Holdings

As mentioned above, C2 is now proposing a corporate restructuring that would transfer ownership of C2 from CBOE to CBOE Holdings. C2 is not proposing any changes to the governing documents of CBOE Holdings, which already contemplate the ownership by CBOE Holdings of one or more self-regulatory organizations (“SRO”) (e.g., CBOE and C2) (the “Regulated Securities Exchange Subsidiaries”).¹⁴ Consequently, CBOE Holdings' Certificate of Incorporation and Bylaws approved by the Commission in connection with the CBOE Demutualization will continue to govern the activities of CBOE Holdings.

Although CBOE Holdings is not itself an SRO, its activities with respect to the operation of any SRO subsidiary, including C2, must be consistent with, and must not interfere with, the self-regulatory obligations of that SRO subsidiary. To this end, certain provisions of CBOE Holdings' Certificate of Incorporation and the Bylaws are designed to ensure that C2, though a wholly-owned subsidiary of CBOE Holdings, is able to maintain the independence of its self-regulatory function and operate unencumbered in a manner that complies with the federal securities laws, and, along with the Commission, is able to fulfill its regulatory and oversight obligations under the Act.

Specifically, the Certificate of Incorporation of CBOE Holdings provides that CBOE Holdings, its officers, directors, employees, and agents must irrevocably submit to the jurisdiction of the United States federal courts, the Commission, and the Regulated Securities

¹⁴ See infra note 15 (discussing the term “Regulated Securities Exchange Subsidiary”).

Exchange Subsidiaries¹⁵ for the purposes of any suit, action or proceeding pursuant to the United States federal securities laws, and the rules and regulations thereunder, commenced or initiated by the Commission arising out of, or relating to, the Regulated Securities Exchange Subsidiaries' activities.¹⁶ Further, so long as CBOE Holdings controls any Regulated Securities Exchange Subsidiaries, the books, records, premises, officers, directors, and employees of CBOE Holdings is deemed to be the books, records, premises, officers, directors, and employees of the Regulated Securities Exchange Subsidiary for purposes of and subject to oversight pursuant to the Act to the extent that they relate to the business of such Regulated Securities Exchange Subsidiary.¹⁷ In addition, all confidential information pertaining to the self-regulatory function of Regulated Securities Exchange Subsidiaries contained in the books and records of an exchange that comes into the possession of CBOE Holdings must not be made available to any persons other than to those officers, directors, employees and agents of CBOE Holdings that have a reasonable need to know the contents thereof, be retained in confidence by CBOE Holdings and the officers, directors, employees and agents of CBOE Holdings, and not be used for any commercial purposes.¹⁸ CBOE Holdings Certificate of Incorporation also contains a provision requiring each

¹⁵ “Regulated Securities Exchange Subsidiary” means any national securities exchange controlled, directly or indirectly, by the Corporation, including, but not limited to CBOE. See Article Fifth(xi) of the CBOE Holdings Certificate of Incorporation. Thus, C2 as a registered national securities exchange would fit within the definition of a Regulated Securities Exchange Subsidiary.

¹⁶ See Article Fourteenth of the CBOE Holdings Certificate of Incorporation.

¹⁷ The books and records of CBOE Holdings relating to the business of a Regulated Securities Exchange Subsidiary is subject at all times to inspection and copying by the Commission and the Regulated Securities Exchange Subsidiary. See Article Fifteenth of the CBOE Holdings Certificate of Incorporation. In addition, the CBOE Holdings Bylaws provide that the books of CBOE Holdings must be kept within the United States. See Section 1.3 of the CBOE Holdings Bylaws.

¹⁸ Notwithstanding this restriction, nothing in the CBOE Holdings Certificate of Incorporation is to be interpreted so as to limit or impede the rights of the Commission or

director of the CBOE Holdings board to take into consideration the effect that CBOE Holdings' actions would have on CBOE's ability to carry out its responsibilities under the Act.¹⁹ Pursuant to the CBOE Holdings Certificate of Incorporation, for so long as CBOE Holdings controls any Regulated Securities Exchange Subsidiary, each officer, director and employee of CBOE Holdings must give due regard to the preservation of the independence of the self-regulatory function of the Regulated Securities Exchange Subsidiaries and to their obligations under the Exchange Act.²⁰ Finally, CBOE Holdings Certificate of Incorporation provides that for so long as CBOE Holdings controls any Regulated Securities Exchange Subsidiary, before any amendment, alteration or repeal of any provision of the Certificate of Incorporation and Bylaws of CBOE Holdings becomes effective, such amendment, alteration or repeal will be submitted to the board of directors of each Regulated Securities Exchange Subsidiary, and if such amendment, alteration or repeal must be filed with or filed with and approved by the Commission, then such amendment, alteration or repeal will not become effective until filed with or filed with and approved by the Commission, as the case may be.²¹

In approving the CBOE Demutualization and permitting CBOE Holdings to wholly own CBOE, the Commission noted that the governing documents of CBOE Holdings are designed to facilitate Regulated Securities Exchange Subsidiaries' ability to fulfill their self-regulatory

CBOE to access and examine such confidential information or to limit or impede the ability of any officers, directors, employees or agents of CBOE Holdings to disclose such confidential information to the Commission or CBOE. See Article Fifteenth of the CBOE Holdings Certificate of Incorporation.

¹⁹ See Article Sixteenth(d) of the CBOE Holdings Certificate of Incorporation.

²⁰ See Article Sixteenth(c) of the CBOE Holdings Certificate of Incorporation.

²¹ See Article Eleventh of the CBOE Holdings Certificate of Incorporation and Section 10.2 of the CBOE Holdings Bylaws.

obligations and are, therefore, consistent with the Act.²² C2's proposal to become a wholly-owned subsidiary of CBOE Holdings is identical to the SRO ownership structure the Commission approved in the CBOE Demutualization and does not raise any new regulatory issues. Consistent with its approval of the CBOE Demutualization, the Commission similarly believes that the governing documents of CBOE Holdings are designed to protect the independence of the self-regulatory function of a wholly-owned C2, enable C2 to operate in a manner that complies with the federal securities laws, and facilitate the ability of C2 and the Commission to fulfill their regulatory and oversight obligations under the Act.²³

C2

Although CBOE Holdings would replace CBOE as the parent company and sole shareholder of C2, C2 would continue to be registered as a national securities exchange under Section 6 of the Exchange Act. In this respect, certain provisions of C2's Certificate of Incorporation and Bylaws are designed to enable C2 to carry out the purposes of the Act and to comply and enforce compliance by its members and persons associated with its members with all applicable rules and regulations.²⁴

²² See supra note 3.

²³ The Commission also notes that the Certificate of Incorporation of CBOE Holdings places certain ownership and voting limits on the holders of CBOE Holdings stock and their Related Persons. These restrictions are intended to address the possibility that a person holding a controlling interest in an SRO could use that interest to affect the SRO's regulatory responsibilities under the Act. In particular, these restrictions provide that no person, either alone or together with its Related Persons, may own directly or indirectly more than 10% of the CBOE Holdings or more than 20% in the event a public offering of the CBOE Holdings. Further, no person, either alone or together with its Related Persons, will be entitled to vote more than 10% of the CBOE Holdings common interest or more than 20% in the event a public offering of the CBOE Holdings. See Article Sixth(a) and (b) of the CBOE Holdings Certificate of Incorporation.

²⁴ For example, C2's current board composition is designed to be comparable to the board compositions the Commission has approved for other SROs. Namely, the number of Non-Industry Directors on C2 board must equal or exceed the sum of the number of

As noted above, C2 does not propose any significant changes to its governing documents but does propose to make certain changes to its Certificate of Incorporation to effect the change of ownership of C2 from CBOE to CBOE Holdings, to clarify certain aspects of C2’s Bylaws as a result of this transfer of ownership, and to make certain ministerial changes to C2’s Certificate of Incorporation and Bylaws. Namely, C2 proposes to amend its Certificate of Incorporation in connection with the transfer of ownership of all of the common stock of C2 from CBOE to CBOE Holdings and to require Commission approval if CBOE Holdings sells, transfers, or assigns any shares of C2 common stock.²⁵ In addition, C2 proposes a number of other changes to reflect and generally conform to the most recent version of the corresponding governing documents of CBOE that were approved by the Commission in connection with the CBOE Demutualization. These changes include amending C2’s Bylaws to provide that all directors of the C2 board would serve one-year terms, rather than staggered two-year terms²⁶ and to remove a

Industry Directors and the number of Industry Directors must equal or exceed 30% of the board. Further, at least 20% of the directors on the board must be nominated (or otherwise selected by a petition of C2 members) by the Industry-Director Subcommittee of the Nominating and Governance Committee (such directors, “Representative Directors”). See Section 3.1 of the C2 Bylaws. For definitions of “Non-Industry Directors” and “Industry Directors,” see Section 3.1 of the C2 Bylaws. For the definition of “Industry-Director Subcommittee of the Nominating and Governance Committee,” see Section 3.2 of the C2 Bylaws. Further, C2 has a Regulatory Oversight Committee (“ROC”) that monitors its regulatory operations. See Section 4.6 of C2 Bylaws.

²⁵ See Article Fourth of the C2 Certificate of Incorporation. In addition, C2 proposes to delete Article Twelfth of the Certificate of Incorporation because it is no longer necessary.

²⁶ See Section 3.1 of the C2 Bylaws. Further, C2 proposes to delete the second sentence of Section 3.1, which provides that “[t]he Board shall initially consist of 23 directors, including the Chief Executive Officer, twelve Non-Industry Directors and ten Industry Directors,” because the initial board of directors of C2 has already been appointed. C2 also proposes to change the reference to the “Board of the Corporation” in Section 3.1 to the “Board” and to delete a reference in the last sentence of the first paragraph regarding the initial C2 Board, because that Board has already been appointed.

reference to electing a class of directors;²⁷ amending its Bylaws to provide that Representative Directors (as opposed to any Director) may be removed for cause by the holders of a majority of the shares of stock then entitled to vote at an election of directors;²⁸ and amending its Bylaws to provide that the C2 Regulatory Oversight Committee would consist of at least three directors instead of at least four directors.²⁹ Finally, because the rules of C2 use terms from the CBOE rules, and also incorporate by reference certain CBOE rules, C2 also proposes to make minor, non-substantive changes to its rules to reflect the changes in terminology and other technical changes that CBOE plans to make to its rules in connection with the CBOE Demutualization.³⁰

²⁷ See Section 3.2 of the C2 Bylaws. C2 would no longer have different classes of directors.

²⁸ See Section 3.4(c) of the C2 Bylaws. C2 also proposes to amend Section 3.4(c) to replace a reference to “SEC” with “Securities and Exchange Commission (“SEC”).” In addition, C2 proposes to move a reference to “Representative Directors” (described below) in the first sentence of the seventh paragraph of Section 3.1 of the C2 Bylaws to clarify the intent of that sentence.

²⁹ See Section 4.6 of the C2 Bylaws. C2 also proposes to amend Section 5.8 of the Bylaws to modify the responsibilities of the Treasurer of C2. Specifically, C2 is proposing to delete the second sentence in Section 5.8, which reads “[i]n addition, the Treasurer shall perform such duties and have such powers that are incident to the office of Treasurer, including without limitation the duty to keep and be responsible for all funds of the Corporation,” to make this section consistent with the Treasurer provision in CBOE’s post-demutualization Bylaws.

³⁰ For example, CBOE is replacing the term “member” (or variations of it) with the term “Trading Permit Holder” (or variations of it) throughout its rulebook in connection with its demutualization. Similarly, C2 proposes to replace references in its rules to a CBOE “member” with the term “CBOE Trading Permit Holder” (or “Trading Permit Holder” in certain instances where there is a direct cross-reference to CBOE rules). Further, C2 proposes to adopt in C2 Rule 1.1 the term “CBOE Trading Permit,” which is defined as a “Trading Permit” as such term is defined in CBOE’s Bylaws and rules, and the term “CBOE Trading Permit Holder,” which is defined as a “Trading Permit Holder” as such term is defined in CBOE’s Bylaws and rules. C2 also proposes to replace the term CBOE “membership” with the term “CBOE Trading Permit” (or “Trading Permit” in certain instances where there is a direct cross-reference to CBOE rules) and a CBOE “Clearing Member” (or variations of it) with the term “Clearing Trading Permit Holder.” In addition, C2 proposes to make a few minor, non-substantive fixes to its rules. For example, C2 proposes to replace references to a C2 “member” in its rules with the term

C2 currently has in place a voting agreement with CBOE in which CBOE agrees to vote in favor of those individuals nominated by C2's Nominating and Governance Committee for election as C2 Representative Directors. After the demutualization, CBOE Holdings, and not CBOE, would be the sole stockholder of C2. Accordingly, C2 has proposed to enter into a new voting agreement with CBOE Holdings that similarly would require CBOE Holding to vote in favor of those individuals nominated by C2's Nominating and Governance Committee for election as C2 Representative Directors. In addition, C2 proposes to add a provision in the voting agreement to reflect the "for cause" removal standard for Representative Directors in C2's Bylaws, as discussed above.

The Commission notes that changes proposed by C2 in its governing documents and rules are mostly technical in nature. Further, the Commission notes that C2's proposed amendment to require the removal of Representative Directors, rather than any director, for cause by the holders of a majority of the shares of stock is consistent with provisions approved by the Commission for other SROs' governing documents.³¹ Moreover, as the ROC would continue to be composed solely of Non-Industry Directors, the Commission does not believe C2's proposal to decreased size of the committee compromises its ability to monitor the adequacy and effectiveness of C2's regulatory program. Finally, the Commission believes that a new voting agreement, as proposed by C2, is appropriate to ensure that C2 meet its statutory

"Permit Holder" or "Participant" (which both have the same meaning under C2 rules). C2 also proposes to delete a reference in C2 Rule 3.3(b) regarding member organizations not registered as broker-dealers, because C2 does not have such organizations (*i.e.*, all Permit Holders of C2 are required to be registered as broker-dealers). In addition, C2 proposes to fix some of the cross-references in its rules to CBOE rules.

³¹ See, e.g., Section 7 of the Amended and Restated By-Laws of BATS Exchange, Inc. and Section 7 of the Amended and Restated Bylaws of EDGX Exchange, Inc.

obligation to provide for the fair representation of its members in the administration of C2.³² As the Commission has previously noted in the context of other exchange governance proposals, this requirement helps to ensure that an exchange's members have a voice in the governing body of the exchange and the corresponding exercise by the exchange of its self-regulatory authority, and that the exchange is administered in a way that is equitable to all who trade on its market or through its facilities.³³

III. Conclusion

For the foregoing reasons, the Commission believes that the proposed rule changes in connection with the transfer of ownership of C2 from CBOE to CBOE Holdings is consistent with the Act and that C2 will be so organized and have the capacity to be able to carry out the purposes of the Act. The provisions in the applicable governing documents, discussed above, should minimize the potential that any person could interfere with or restrict the ability of C2 or the Commission to effectively carry out their respective regulatory oversight responsibilities. Further, the Commission notes that CBOE Holding has undertaken to ensure and maintain the regulatory independence of C2 to enable C2 to operate in a manner that complies with the federal securities laws, including the objectives of Sections 6(b) of the Act.

³² Section 6(b)(3) of the Act, 15 U.S.C. 78f(b)(3).

³³ See, e.g., Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550, 3553 (January 23, 2006) (File No. 10-131); 53382 (February 27, 2006), 71 FR 11251, 11259 (March 6, 2006) (File No. SR-NYSE-2005-77); and 58375 (August 18, 2008), 73 FR 49498, 49501 (August 21, 2008) (File No. 10-182).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁴ that the proposed rule change (SR-C2-2010-002) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁵

Florence E. Harmon
Deputy Secretary

³⁴ 15 U.S.C. 78s(b)(2).

³⁵ 17 CFR 200.30-3(a)(12).