

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55001; File No. SR-CBOE-2006-35)

December 21, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend its Trading Rotation Rules

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 6, 2006, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act³ and Rule 19b-4(f)(6) thereunder.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to amend its rules governing trading rotations. The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.com>), at the Exchange’s Office of the Secretary and at the Commission.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(iii).

⁴ 17 CFR 240.19b-4(f)(6).

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the rule change is to amend CBOE Rule 6.2B, Hybrid Opening System (“HOSS”), which pertains to both opening and closing trading rotations for series trading on the CBOE Hybrid Trading System (“Hybrid”), in order to make various updates and clarifications to the description of the rotation procedures described in the rule. Specifically, the existing rule provides that, prior to the opening, HOSS will accept orders and quotes and will disseminate information to market participants during the pre-opening period about resting orders in the Book that remain from the prior business day and any orders submitted before the opening. The rule will be revised to clarify that the information made available to market participants during this pre-opening period includes the expected opening price (“EOP”) and the expected opening size (“EOS”) given the current resting orders and quotes.⁵ In addition, the rule will be revised to clarify that the EOP and EOS are

⁵ The EOP is the price at which the greatest number of orders and quotes in the Book are expected to trade. An EOP may only be calculated if: (i) there are market orders in the Book, or the Book is crossed (highest bid is higher than the lowest offer) or locked (highest bid equals the lowest offer), and (ii) at least one quote is present.

updated intermittently at specific intervals of time (as opposed to a dynamic update).

Various references within the rule are also being revised to clarify that both orders and quotes are considered when calculating the EOP and EOS, as well as when calculating the actual opening price and size. The Exchange intended at all times, and built HOSS in such a way, that the calculations and allocation methodologies take into consideration both orders and quotes. The text of Rule 6.2B is simply being revised to more clearly state this fact.

Currently, the existing procedures call for the HOSS opening rotation process to be initiated by the system and an opening notice (the “Rotation Notice”) sent at a randomly selected time within a number of seconds after the primary market for the underlying security disseminates the opening trade or the opening quote, whichever occurs first. The rule will be revised to provide that the HOSS opening rotation process be initiated and the Rotation Notice sent at a randomly selected time within a number of seconds after the primary market for the underlying security disseminates the opening trade and/or opening quote.⁶ Thus, the system may be programmed on a class-by-class basis to initiate the opening process after one event occurs (i.e., opening trade, opening quote or the earlier of the two) or after both events occur. The applicable opening parameters will be determined by the appropriate Procedure Committee and announced to the membership via Regulatory Circular. Allowing for

Spread orders and contingency orders do not participate in the opening trade or in the determination of the opening price, EOP or EOS.

⁶ This process will apply for non-index option classes. For index option classes, HOSS will continue to initiate the opening procedure and send the Rotation Notice at a randomly selected time within a number of seconds after 8:30 a.m. unless unusual circumstances exist. See renumbered paragraph (b) of CBOE Rule 6.2B.

flexibility on when the system initiates the opening process and disseminates the opening Rotation Notice will assist in ensuring a fair and orderly opening.⁷

The existing procedures also provide that the appropriate Exchange Procedure Committee establish the duration of time between when HOSS sends the Rotation Notice and HOSS begins opening series on a class basis at between five and sixty seconds. The rule will be revised to eliminate the minimum five second requirement but will retain the maximum sixty second requirement. Thus, under the revised provision, the appropriate Exchange Procedure Committee will establish the duration of time between when HOSS sends the Rotation Notice and begins opening series on a class basis, but the established duration will not exceed sixty seconds. Pronouncements regarding the applicable duration will be announced to the membership via Regulatory Circular.

⁷ In the event an underlying security has not opened within a reasonable time after 8:30 a.m. (CT), the proposed text of Rule 6.2B provides that the DPM or LMM, as applicable, acting in option contracts on such security shall report the delay to a Floor Official and an inquiry shall be made to determine the cause of the delay. The opening rotation for option contracts in such security shall be delayed until the underlying security has opened unless two Floor Officials determine that the interest of a fair and orderly market are best served by opening trading in the option contracts. In those classes that initiate the Rotation Notice following both the opening print trade and opening quote, the Exchange anticipates that the underlying print and quote will generally occur within a few seconds of one another, and for the most part within sixty seconds. However, in the particular event where the underlying security of an option class has not opened within a reasonable time after 8:30 a.m. (CT) and the DPM or LMM believes the delay is because the primary market where it has traded (i) has not reported an opening trade in the underlying security (ii) but has disseminated opening quotations and not given an indication of a delayed opening, the DPM or LMM, as applicable, acting in option contracts on such security shall report the delay directly to the Exchange's Help Desk (referred to in the rule text as the "Control Room") instead of to a Trading Official. Following such a report, or following notification by the Control Room to the DPM or LMM of such an event, the senior official in the Control Room may authorize the initiation of the opening process in the affected class where necessary to ensure a fair and orderly market.

In addition, the rule is being revised to eliminate outdated references to a “Lock Interval,” which is no longer applicable to the operation of the HOSS system.⁸ The existing procedures also describe various conditions under which HOSS will not open a series and the alternate process that is followed in the event one of the conditions is present. The rule will be revised to clarify that, if the opening price is not within an acceptable range determined by the appropriate Exchange Procedure Committee compared to the lowest quote offer and highest quote bid, a notification will be sent to market participants and the senior official in the Exchange’s Control Room may authorize the opening of the affected series where necessary to ensure a fair and orderly market. The existing rule merely indicated that a notification would be sent, but did not make explicit the senior official’s authority if this condition should occur.

The existing rule also provides that the HOSS rotation procedures may be employed to conduct a closing rotation whenever the Exchange concludes that such action is appropriate in the interests of a fair and orderly market. Revisions to the rule clarify that the decision whether to employ a closing rotation in a series trading on HOSS will be governed by the provisions of Rule 6.2B, and not the various provisions of Rule 6.2, Trading Rotations. These changes are intended to clarify that Hybrid closing rotations may be conducted at expiration for expiring series per Rule 6.2B, but are not mandatory. The proposal seeks also to make various changes to simplify the text in Rule 6.2B. Lastly, the

⁸ The Lock Interval was described in the rule a brief period during which HOSS established the opening price and during which orders and quotes could be submitted but not included in the opening trade.

rule change will amend various other related trading rotation rules.⁹ Specifically, the Exchange is seeking to amend Rule 6.2, to provide that the Designated Primary Market-Maker (“DPM”), Lead Market-Maker (“LMM”) or Order Book Official (“OBO”) conducting a rotation for a particular class shall hold the opening promptly after the primary market for the underlying security disseminates the opening trade and/or the opening quote unless unusual circumstances exist.¹⁰ The current rule provides that the rotation process should promptly follow the dissemination of the underlying market’s opening trade or quote, whichever occurs first. These changes to Rule 6.2 are intended to parallel the changes proposed for Rule 6.2B HOSS rotations. Rule 6.2, as well as Rule 24.13, are also being revised to clarify that DPMs and LMMs have the discretion to determine the appropriate rotation order and manner if the appropriate procedure committee has not acted to establish any policy applicable to the particular class of options in question, or to deviate from a previously established rotation policy or procedure with the approval of two concurring Floor Officials.¹¹ This authority is currently explicit in the text of the two rules with respect to

⁹ By way of background, CBOE has four options-related rotation rules: Rule 6.2 defines options trading rotations generally and describes procedures for modification of a rotation that are applicable to all options; Rule 24.13 sets forth particularized procedures relating to trading in index options; Rule 6.2A pertains to the Exchange’s Rapid Opening System (“ROS”), which is an automated system for opening and reopening non-Hybrid classes; and Rule 6.2B, as discussed above, pertains to the Exchange’s automated system for opening and reopening Hybrid classes.

¹⁰ The “unusual circumstances” exception to the general procedure that the series of a class be opened promptly after the primary market opens is carried over from similar language in the Rule 6.2B HOSS rotation procedures. The inclusion of this language in Rule 6.2 is intended to acknowledge that, if unusual conditions or circumstances exist, openings conducted pursuant to that rule may be delayed in the interest of maintaining a fair and orderly market. An unusual circumstance might include, but is not limited to, a market order imbalance or system problems.

¹¹ For example, specific procedures for trading rotations are described in the

OBOs,¹² and the changes are intended to update the text in order to clarify that similar authority applies to a DPM or LMM in their respective appointed classes. Finally, Rules 6.2, 6.2A, 6.6 (Unusual Market Conditions) and 24.13 are also being revised to update cross references and to make various typographical changes to standardize the terminology used throughout the text.

2. Statutory Basis

CBOE believes the proposed rule change is consistent with Section 6(b) of the Act,¹³ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁴ in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to enhance competition, and to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

CBOE does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received comments on the proposal.

Interpretations and Policies to Rules 6.2 and 24.13, as well as in Rules 6.2A and 6.2B.

¹² See Rules 6.2 and 24.13; see also Securities Exchange Act Release No. 35742 (May 19, 1995), 60 FR 28188 (May 30, 1995)(SR-CBOE-95-04)(order approving changes to certain trading rotation and opening procedures, including changes related to OBO discretion regarding the rotation order and manner).

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁵ and Rule 19b-4(f)(6) thereunder.¹⁶ The proposed rule change will become operative 30 days after the date of the filing.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

¹⁵ 15 U.S.C. 78s(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(6).

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2006-35 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2006-35. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 100 F Street, NE, Washington, DC 20549-1090. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All comments received will be posted without change; the Commission

does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2006-35 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Nancy M. Morris
Secretary

¹⁷ 17 CFR 200.30-3(a)(12).