

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49620; File No. SR-CBOE-2004-16)

April 26, 2004

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Relating to an Interpretation of Paragraph (b) of Article Fifth of its Certificate of Incorporation and an Amendment to Rule 3.16(b)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 4, 2004, the Chicago Board Options Exchange, Inc. (“CBOE”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. On April 9, 2004, the CBOE filed an amendment to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The CBOE proposes to adopt a proposed rule change consisting of an interpretation of paragraph (b) of Article Fifth of the CBOE Certificate of Incorporation (“Article Fifth(b)”) pertaining to the right of the 1,402 Full Members of CBOT to become members of CBOE without having to purchase a CBOE membership (“Exercise Right”). The proposed interpretation of the Exercise Right is embodied in an agreement dated December 17, 2003 (“2003 Agreement”), between the CBOE and the Board of Trade of the City of Chicago, Inc.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Arthur B. Reinstein, Deputy General Counsel, CBOE, to Lisa N. Jones, Special Counsel, Division of Market Regulation (“Division”), Commission, dated April 8, 2004 (“Amendment No. 1”). Amendment No. 1 provides further clarification to the proposal by including three additional exhibits to the proposed rule change.

("CBOT"). The CBOE also proposes related revisions to CBOE Rule 3.16. Below is the text of the proposed amendment to CBOE Rule 3.16. Proposed language is in italics; proposed deletions are in brackets.

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**Rule 3.16 Special Provisions Regarding Chicago Board of Trade Exerciser Memberships**

- (a) *Termination of Nontransferable Memberships.* [No change]
- (b) *Board of Trade Exercisers.* For the purpose of entitlement to membership on the Exchange in accordance with Paragraph (b) of Article Fifth of the Certificate of Incorporation of the Exchange ("Article Fifth(b)") the term "member of the Board of Trade of the City of Chicago" (the "CBOT"), as used in Article Fifth(b), is interpreted to mean an individual who is either an "Eligible CBOT Full Member" or an "Eligible CBOT Full Member Delegate," as those terms are defined in the Agreement entered into on September 1, 1992 (the "1992 Agreement") between the CBOT and the Exchange, and in the Agreement entered into on December 17, 2003, ("the 2003 Agreement") between the CBOT and the Exchange, and shall not mean any other person. In order to permit Eligible CBOT Full Members and Eligible CBOT Full Member Delegates to participate in an offer, distribution or redemption of the kind referred to in the last two sentences of Paragraph 3(a) of the 1992 Agreement, and solely for such purpose, the Exchange will waive all membership dues, fees and other charges and all qualification requirements, other than those that may be imposed by law, that may be applicable to the application for membership on the Exchange of each Eligible CBOT Full Member and Eligible CBOT Full Member Delegate who wishes to exercise the Exercise Right during

the period commencing on the date the Exchange gives notice to the CBOT pursuant to Paragraph 3(b) of the 1992 Agreement and ending on the date such individual participates in such offer, distribution or redemption (as the case may be); provided, however, that (i) no Exerciser Member (as defined in the 1992 Agreement) for whom dues, fees and other charges and qualification requirements are waived in accordance with the foregoing shall have any rights as a member of the Exchange other than to participate in such offer, distribution or redemption, and (ii) the membership on the Exchange of each such Exerciser Member shall terminate immediately following the time such individual participates in such offer, distribution or redemption.

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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 CBOE 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 these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposed rule change is to provide an interpretation to the rules of the CBOE as set forth in Article Fifth(b) that will apply, upon the distribution by the CBOT to each of its 1,402 Full Members upon their individual request, a separately transferable interest representing the Exercise Right component of each CBOT Full Membership. According to the

CBOE, the CBOT's willingness to issue transferable Exercise Right interests is reflected in the 2003 Agreement and recently adopted changes to the CBOT Rules and Regulations. The CBOE notes that the 2003 Agreement, resulting from negotiations with the CBOT, is intended to result in the issuance by the CBOT of a separately transferable interest representing the Exercise Right component of CBOT Full Membership in advance of the consummation of the CBOT's proposed corporate restructuring, which contemplates a similar structure. The CBOE believes that the CBOT's proposed restructuring has not yet been consummated and it is uncertain as to when such proposed restructuring will occur.<sup>4</sup>

Although the CBOT recently reconfirmed to the CBOE its commitment to pursue its proposed restructuring, the CBOT also agreed with the CBOE that, before it implements such restructuring, it is willing to implement a structure that provides for the issuance of separately transferable interests representing the Exercise Right component of CBOT Full Memberships. As described above, the CBOT's membership has approved changes to the CBOT Rules and Regulations, which were proposed by the CBOT pursuant to the terms of the 2003 Agreement to give effect to a structure providing for the issuance of these interests. The CBOE proposes to interpret how Article Fifth(b) of the CBOE Certificate of Incorporation will apply once these

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<sup>4</sup> The CBOE notes that the CBOT's proposal to issue a separately transferable interest representing the Exercise Right as part of its restructuring was the subject of a prior proposed interpretation by the CBOE of Article Fifth(b), which was filed with the Commission as a proposed rule change in File No. SR-CBOE-2002-01. On April 7, 2004, the CBOE withdrew this filing. See letter from Arthur B. Reinstein, Deputy General Counsel, CBOE, to Lisa N. Jones, Special Counsel, Division, Commission, dated April 6, 2004.

interests are issued. Such an interpretation is embodied in the 2003 Agreement, and it constitutes the substance of the proposed rule change that is the subject of this filing.<sup>5</sup>

According to the CBOE, the interpretation of Article Fifth(b) embodied in the 2003 Agreement includes definitions of who will be “Eligible CBOT Full Members” and “Eligible CBOT Full Member Delegates” entitled to exercise after the CBOT has issued separately transferable interests representing the Exercise Right component of CBOT Full Memberships to those CBOT Full Members who request them. (Such interests are referred to in the 2003 Agreement and in this filing as “Exercise Right Privileges.”) Under these definitions, to be able to become a member of the CBOE by virtue of the Exercise Right, the holder or delegate (i.e., a lessee under CBOT Rules and Regulations) of one of the 1,402 outstanding CBOT Full Memberships in which an Exercise Right Privilege has been issued must be in possession of one Exercise Right Privilege, whether bundled or unbundled from the related CBOT Full Membership. In addition, as holder or delegate of a CBOT Full Membership, one must also be in possession of all of the other rights or privileges appurtenant to a CBOT Full Membership and must meet the applicable membership and eligibility requirements of the CBOT and be deemed to be a “CBOT Full Member” or a “CBOT Full Member Delegate” under the CBOT Rules and Regulations.

As noted above, under the proposed interpretation of Article Fifth(b) embodied in the 2003 Agreement, Exercise Right Privileges may be separately bought and sold and bundled and rebundled with the other rights and privileges of CBOT Full Membership for purposes of making the holder of an Exercise Right Privilege eligible to exercise. The 2003 Agreement also provides

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<sup>5</sup> The CBOE notes that the only other change proposed in this filing is a conforming amendment to CBOE Rule 3.16 that adds a reference to the 2003 Agreement.

that the CBOT will adopt and maintain rules and procedures acceptable to the CBOE governing the issuance and subsequent transfer of Exercise Right Privileges and CBOT Full Memberships, to enable the CBOE to administer the operation of the Exercise Right in a manner consistent with the interpretation embodied in the 2003 Agreement. In addition, the CBOT and the CBOE have each agreed to provide to the other certain current information regarding the status of their members, including exercisers and persons who own or lease an Exercise Right Privilege.

The CBOE believes that the proposed interpretation of Article Fifth(b) is consistent with the language of Article Fifth(b), which provides in part that “every present and future member of the [CBOT] who applies for membership in the [CBOE] and who otherwise qualifies shall, so long as he remains a member of said Board of Trade, be entitled to be a member of the [CBOE] notwithstanding any such limitation on the number of members and without the necessity of acquiring such membership for consideration or value from the [CBOE], its members or elsewhere.” The CBOE believes that this filing does not propose to amend Article Fifth(b) in any respect, but only to interpret how it should apply in circumstances that were not envisioned when Article Fifth(b) was adopted, and therefore were not addressed in the language of Article Fifth(b).<sup>6</sup>

The CBOE believes that the proposed interpretation of Article Fifth(b) is also consistent with the interpretation of the Exercise Right embodied in the 1992 Agreement. According to the CBOE, the 1992 Agreement served to resolve a dispute between the CBOE and the CBOT concerning the meaning of certain terms in Article Fifth(b) regarding the Exercise Right and

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<sup>6</sup> By its terms, Article Fifth(b) may be amended only with the approval of 80% of CBOE’s members admitted by exercise, and 80% of CBOE’s members admitted other than by exercise, each voting as a separate class.

concerning action taken or proposed to be taken by the CBOT at that time to unbundle certain of the trading rights held by CBOT members, issue transferable evening trading permits to its members, and allow CBOT members to “delegate” (i.e., lease) the trading rights associated with their memberships. According to the CBOE, to preserve the original intent of the Exercise Right, Article Fifth(b) was interpreted in the 1992 Agreement so that, in the event of any division of the trading rights and privileges appurtenant to a CBOT Full Membership, or any division of the CBOT full membership itself, a CBOT member retained the right to exercise only if he held all of the parts into which his membership may have been divided and all of the trading rights and privileges appurtenant thereto. According to the CBOE, as a result of the interpretation of Article Fifth(b) embodied in the 1992 Agreement, the number of potential “exerciser” members of the CBOE is limited to the 1,402 Full Members of the CBOT or their delegates (lessees), but not both in respect of the same CBOT membership.<sup>7</sup>

The CBOE notes that the proposed interpretation of the Exercise Right that is the subject of this filing does not displace the interpretation embodied in the 1992 Agreement, except it provides that if there are any inconsistencies between the interpretation embodied in the 2003 Agreement and the interpretation embodied in the 1992 Agreement, then the interpretation embodied in the 2003 Agreement would control. Because CBOE Rule 3.16 refers to certain terms that were previously interpreted and defined in the 1992 Agreement and are now further interpreted and defined in the modified 2003 Agreement, the proposed rule change also amends Rule 3.16 to include the definitions and interpretations in both Agreements.

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<sup>7</sup> The CBOE asserts that the interpretation of Article Fifth(b) embodied in the 1992 Agreement and an amendment to Rule 3.16 referring to the 1992 Agreement were approved by the Commission in Securities Exchange Act Release No. 32430 (June 8, 1993), 58 FR 32969 (June 14, 1993).

According to the CBOE, the interpretation of Article Fifth(b) embodied in the 2003 Agreement is intended to apply solely in the circumstances involving the issuance of Exercise Right Privileges to some or all of its 1,402 Full Members as described in that Agreement, so as to make it clear that such interpretation is not intended to cover any other circumstances that might arise and might also have an impact on the Exercise Right.

2. Statutory Basis

The CBOE believes that the proposed interpretation of the Exercise Right embodied in the 2003 Agreement and the related proposed amendment to CBOE Rule 3.16 that together constitute the proposed rule change is consistent with and furthers the objectives of the Act, and Section 6(b)(5) of the Act in particular,<sup>8</sup> in that it constitutes an interpretation of, and an amendment to, the rules of the Exchange that are designed to promote just and equitable principles of trade, to perfect the mechanisms of a free and open market, and to protect investors and the public interest.

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

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

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

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 days of the date of publication of this notice in the Federal Register or within

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<sup>8</sup> 15 U.S.C. 78f(b)(5).

such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### 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:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an E-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number **SR-CBOE-2004-16** on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number **SR-CBOE-2004-16**. 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 Room. 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-2004-16** 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.<sup>9</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>9</sup> 17 CFR 200.30-3(a)(12).