

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51510; File No. SR-CBOE-2004-59)

April 8, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the Chicago Board Options Exchange, Incorporated Relating to Back-up Trading Arrangements

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 August 27, 2004, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) 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 Exchange. On October 21, 2004, the Exchange amended its proposal.<sup>3</sup> On October 26, 2004, the Exchange further amended its proposal.<sup>4</sup> On March 23, 2005, the Exchange submitted a third amendment.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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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 Jaime Galvan, Attorney, CBOE, to Nancy Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated October 20, 2004 (“Amendment No. 1”). In Amendment No. 1, the Exchange modified the text of proposed CBOE Rule 6.16 and made certain other clarifying changes to the original submission. Amendment No. 1 replaced CBOE’s original filing in its entirety.

<sup>4</sup> See letter from Jaime Galvan, Attorney, CBOE, to Brian Trackman, Special Counsel, Division, Commission, dated October 25, 2004 (“Amendment No. 2”). In Amendment No. 2, the Exchange corrected typographical errors in the proposed rule text.

<sup>5</sup> See Amendment No. 3, dated March 23, 2005 (“Amendment No. 3”) In Amendment No. 3, the Exchange modified portions of the proposed rule text and

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

The Exchange is filing with the Commission proposed new rules that will facilitate the CBOE entering into arrangements with one or more other exchanges that would provide back-up trading facilities for CBOE listed options at another exchange if CBOE's facility becomes disabled and trading is prevented for an extended period of time, and similarly provide trading facilities at CBOE for another exchange to trade its listed options if that exchange's facility becomes disabled. The Exchange also proposes to adopt a rule addressing general Exchange procedures under emergency conditions and to eliminate a rule adopted following the events of September 11, 2001. Additionally, the Exchange has submitted a corresponding back-up trading agreement between itself and the Philadelphia Stock Exchange as Exhibit B to its Form 19b-4 filing. This back-up trading agreement is available for viewing on the Commission's Web site, [www.sec.gov/rules/sro.shtml](http://www.sec.gov/rules/sro.shtml), and at the Exchange and the Commission.<sup>6</sup> The text of the proposed rule change, as amended, is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

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**Chicago Board Options Exchange, Inc.**

**Rules**

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corresponding sections of the Form 19b-4 describing the rule proposal. Amendment No. 3 replaces CBOE's previously amended filing in its entirety.

<sup>6</sup> See *infra* note 10. The Commission notes that the text of the back-up trading agreement that appears on the Commission's Web site was filed as part of Amendment No. 3.

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## **CHAPTER III**

### **MEMBERSHIP**

#### **Temporary Access**

##### **Rule 3.22**

[Until emergency conditions in the aftermath of the terrorist on New York City on September 11, 2001 cease, the Exchange may permit a person or organization to conduct business on the Exchange provided that the person or organization (i) is a member in good standing of the American Stock Exchange “AMEX”, (ii) is not subject to a statutory disqualification under the Exchange Act, and (iii) is not subject to an investigation conducted by any self-regulatory organization under the Exchange Act that may involve the fitness for membership on the Exchange of that person or organization. Any such person or organization granted temporary access to conduct business on the Exchange “TPO” shall only be permitted (i) to act in those Exchange capacities that are authorized by the Exchange and that are comparable to capacities which TPO has been authorized to act on the AMEX and (ii) to trade in those securities in which the TPO is authorized to trade on the AMEX. Each TPO shall be subject to, and obligated to comply with, the rules of the Exchange that are applicable to exchange members, but shall have none of the rights of a member of the Exchange except the right to conduct business on the Exchange to the extent permitted by this Rule. In the event that an individual TPO is associated with an organization, the TPO shall provide to the Exchange, in a form and manner prescribed by the Exchange, an agreement by the organization to be responsible

for all obligations arising out of that person's activities on or relating to the Exchange.]  
Reserved.

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## CHAPTER VI

### DOING BUSINESS ON THE EXCHANGE TRADING FLOOR

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#### Section A: General

#### Back-up Trading Arrangements

#### Rule 6.16

(a) CBOE is Disabled Exchange.

(1) CBOE Exclusively Listed Options.

A. For purposes of this Rule 6.16, the term “exclusively listed option” means an option that is listed exclusively by an exchange (because the exchange has an exclusive license to use, or has proprietary rights in, the interest underlying the option).

B. The Exchange (“CBOE”) may enter into arrangements with one or more other exchanges (each a “Back-up Exchange”) to permit CBOE and its members to use a portion of the Back-up Exchange's facilities to conduct the trading of some or all of CBOE’s exclusively listed options in the event that the functions of CBOE are severely and adversely affected by an emergency or extraordinary circumstances (a “Disabling Event”). Such option classes shall trade as listings of CBOE. The facility

of the Back-up Exchange used by CBOE for this purpose will be deemed to be a facility of CBOE.

C. Trading of CBOE exclusively listed options on CBOE's facility at the Back-up Exchange shall be conducted in accordance with the rules of the Back-up Exchange, except that (i) such trading shall be subject to CBOE rules with respect to doing business with the public, margin requirements, net capital requirements, listing requirements and position limits, (ii) CBOE members that are trading on CBOE's facility at the Back-up Exchange (not including members of the Back-up Exchange who become temporary members of CBOE pursuant to paragraph (a)(1)(F)) will be subject to CBOE rules governing or applying to the maintenance of a person's or a firm's status as a member of CBOE, and (iii) CBOE Rule 8.87.01 may be utilized to establish a lower DPM participation rate applicable to trading on CBOE's facility on the Back-up Exchange than the rate that is applicable under the rules of the Back-up Exchange if agreed to by CBOE and the Back-up Exchange. In addition, CBOE and the Back-up Exchange may agree that other CBOE rules will apply to such trading. CBOE and the Back-up Exchange have agreed to communicate to their respective members which rules apply in advance of trading. The Back-up Exchange rules that govern trading on CBOE's facility at the Back-up Exchange shall be deemed to be CBOE rules for purposes of such trading.

D. The Back-up Exchange has agreed to perform the related regulatory functions with respect to trading of CBOE exclusively listed options on CBOE's facility at the Back-up Exchange, in each case except as CBOE and the Back-up Exchange may

specifically agree otherwise. The Back-up Exchange and CBOE have agreed to coordinate with each other regarding surveillance and enforcement respecting trading of CBOE exclusively listed options on CBOE's facility at the Back-up Exchange. CBOE shall retain the ultimate legal responsibility for the performance of its self-regulatory obligations with respect to CBOE's facility at the Back-up Exchange.

E. CBOE shall have the right to designate its members that will be authorized to trade CBOE exclusively listed options on CBOE's facility at the Back-up Exchange and, if applicable, its member(s) that will be an LMM or DPM in those options. If the Back-up Exchange is unable to accommodate all CBOE members that desire to trade on CBOE's facility at the Back-up Exchange, CBOE may determine which members shall be eligible to trade at that facility. Factors to be considered in making such determinations may include, but are not limited to, any one or more of the following: whether the member is a DPM or LMM in the applicable product(s), the number of contracts traded by the member in the applicable product(s), market performance, and other factors relating to a member's contribution to the market in the applicable product(s).

F. Members of the Back-up Exchange shall not be authorized to trade in any CBOE exclusively listed options, except that (i) CBOE may deputize willing floor brokers of the Back-up Exchange as temporary CBOE members to permit them to execute orders as brokers in CBOE exclusively listed options traded on CBOE's facility at the Back-up Exchange, and (ii) the Back-up Exchange has agreed that it will, at the instruction of CBOE, select members of the Back-up Exchange that are willing to be

deputized by CBOE as temporary CBOE members authorized to trade CBOE exclusively listed options on CBOE's facility at the Back-up Exchange for such period of time following a Disabling Event as CBOE determines to be appropriate, and CBOE may deputize such members of the Back-up Exchange as temporary CBOE members for that purpose.

(2) CBOE Singly Listed Options.

A. For purposes of this Rule 6.16, the term "singly listed option" means an option that is not an "exclusively listed option" but that is listed by an exchange and not by any other national securities exchange.

B. CBOE may enter into arrangements with a Back-up Exchange under which the Back-up Exchange will agree, in the event of a Disabling Event, to list for trading singly listed option classes that are then singly listed only by CBOE and not by the Back-up Exchange. Any such option classes listed by the Back-up Exchange shall trade on the Back-up Exchange and in accordance with the rules of the Back-up Exchange. Such option classes shall be traded by members of the Back-up Exchange and by CBOE members selected by CBOE to the extent the Back-up Exchange can accommodate CBOE members in the capacity of temporary members of the Back-up Exchange. If the Back-up Exchange is unable to accommodate all CBOE members that desire to trade singly listed options at the Back-up Exchange, CBOE may determine which members shall be eligible to trade such options at the Back-up Exchange. Factors to be considered in making such determinations may include, but are not limited to, any one or more of the following: whether the member is a DPM

or LMM in the applicable product(s), the number of contracts traded by the member in the applicable product(s), market performance, and other factors relating to a member's contribution to the market in the applicable product(s).

C. Any options class listed by the Back-up Exchange pursuant to paragraph (a)(2)(B) that does not satisfy the standard listing and maintenance criteria of the Back-up Exchange will be subject, upon listing by the Back-up Exchange, to delisting (and, thus, restrictions on opening new series, and engaging in opening transactions in those series with open interest, as may be provided in the rules of the Backup Exchange).

(3) Multiply Listed Options.

CBOE may enter into arrangements with a Back-up Exchange to permit CBOE members to conduct trading on a Back-up Exchange of some or all of CBOE's multiply listed options in the event of a Disabling Event. Such options shall trade as a listing of the Back-up Exchange and in accordance with the rules of the Back-up Exchange. Such options shall be traded by members of the Back-up Exchange and by CBOE members selected by CBOE to the extent the Back-up Exchange can accommodate CBOE members in the capacity of temporary members of the Back-up Exchange. If the Back-up Exchange is unable to accommodate all CBOE members that desire to trade multiply listed options at the Back-up Exchange, CBOE may determine which members shall be eligible to trade such options at the Back-up Exchange. Factors to be considered in making such determinations may include, but are not limited to, any one or more of the following: whether the member is a DPM

or LMM in the applicable product(s), the number of contracts traded by the member in the applicable product(s), market performance, and other factors relating to a member's contribution to the market in the applicable product(s).

(b) CBOE is Back-up Exchange.

(1) Disabled Exchange Exclusively Listed Options.

A. CBOE may enter into arrangements with one or more other exchanges (each a “Disabled Exchange”) to permit the Disabled Exchange and its members to use a portion of CBOE’s facilities to conduct the trading of some or all of the Disabled Exchange's exclusively listed options in the event of a Disabling Event. Such option classes shall trade as listings of the Disabled Exchange. The facility of CBOE used by the Disabled Exchange for this purpose will be deemed to be a facility of the Disabled Exchange.

B. Trading of the Disabled Exchange's exclusively listed options on the Disabled Exchange's facility at CBOE shall be conducted in accordance with CBOE rules, except that (i) such trading shall be subject to the Disabled Exchange's rules with respect to doing business with the public, margin requirements, net capital requirements, listing requirements and position limits, and (ii) members of the Disabled Exchange that are trading on the Disabled Exchange's facility at CBOE (not including CBOE members who become temporary members of the Disabled Exchange pursuant to paragraph (b)(1)(D)) will be subject to the rules of the Disabled Exchange governing or applying to the maintenance of a person’s or a firm’s status as a member of the Disabled Exchange. In addition, the Disabled Exchange and CBOE

may agree that other Disabled Exchange rules will apply to such trading. The Disabled Exchange and CBOE have agreed to communicate to their respective members which rules apply in advance of trading.

C. CBOE will perform the related regulatory functions with respect to trading of the Disabled Exchange's exclusively listed options on the Disabled Exchange's facility at CBOE, in each case except as the Disabled Exchange and CBOE may specifically agree otherwise. CBOE and the Disabled Exchange have agreed to coordinate with each other regarding surveillance and enforcement respecting trading of the Disabled Exchange's exclusively listed options on the Disabled Exchange's facility at CBOE. The Disabled Exchange has agreed that it shall retain the ultimate legal responsibility for the performance of its self-regulatory obligations with respect to the Disabled Exchange's facility at CBOE.

D. CBOE members shall not be authorized to trade in any exclusively listed options of the Disabled Exchange, except (i) that the Disabled Exchange may deputize willing CBOE floor brokers as temporary members of the Disabled Exchange to permit them to execute orders as brokers in exclusively listed options of the Disabled Exchange traded on the facility of the Disabled Exchange at CBOE, and (ii) at the instruction of the Disabled Exchange, CBOE shall select CBOE members that are willing to be deputized by the Disabled Exchange as temporary members of the Disabled Exchange authorized to trade the Disabled Exchange's exclusively listed options on the facility of the Disabled Exchange at CBOE for such period of time following a Disabling Event as the Disabled Exchange determines to be appropriate.

and the Disabled Exchange may deputize such CBOE members as temporary members of the Disabled Exchange for that purpose.

(2) Disabled Exchange Singly Listed Options.

A. CBOE may enter into arrangements with a Disabled Exchange under which CBOE will agree, in the event of a Disabling Event, to list for trading singly listed option classes that are then singly listed only by the Disabled Exchange and not by CBOE. Any such option classes listed by CBOE shall trade on CBOE and in accordance with CBOE rules. Such option classes shall be traded by CBOE members and by members of the Disabled Exchange selected by the Disabled Exchange to the extent CBOE can accommodate members of the Disabled Exchange in the capacity of temporary members of CBOE. CBOE may allocate such option classes to a CBOE DPM in advance of a Disabling Event, without utilizing the allocation process under CBOE Rule 8.95, to enable CBOE to quickly list such option classes upon the occurrence of a Disabling Event.

B. Any options class listed by CBOE pursuant to paragraph (b)(2)(A) that does not satisfy the listing and maintenance criteria under CBOE rules will be subject, upon listing by CBOE, to delisting (and, thus, restrictions on opening new series, and engaging in opening transactions in those series with open interest, as may be provided in CBOE rules).

(3) Multiply Listed Options.

CBOE may enter into arrangements with a Disabled Exchange to permit the Disabled Exchange's members to conduct trading on CBOE of some or all of the Disabled

Exchange's multiply listed options in the event of a Disabling Event. Such options shall trade as a listing of CBOE and in accordance with CBOE rules. Such options shall be traded by CBOE members and by members of the Disabled Exchange to the extent CBOE can accommodate members of the Disabled Exchange in the capacity of temporary members of CBOE.

(c) Member Obligations.

(1) Temporary Members of the Disabled Exchange

A. A CBOE member acting in the capacity of a temporary member of the Disabled Exchange pursuant to paragraph (b)(1)(D) shall be subject to, and obligated to comply with, the rules that govern the operation of the facility of the Disabled Exchange at CBOE, including the rules of the Disabled Exchange to the extent applicable during the period of such trading. Additionally, (i) such CBOE member shall be deemed to have satisfied, and the Disabled Exchange has agreed to waive specific compliance with, rules governing or applying to the maintenance of a person's or a firm's status as a member of the Disabled Exchange, including all dues, fees and charges imposed generally upon members of the Disabled Exchange based on their status as such, (ii) such CBOE member shall have none of the rights of a member of the Disabled Exchange except the right to conduct business on the facility of the Disabled Exchange at CBOE to the extent described in this Rule, (iii) the member organization associated with such CBOE member, if any, shall be responsible for all obligations arising out of that CBOE member's activities on or relating to the Disabled Exchange, and (iv) the Clearing Member of such CBOE

member shall guarantee and clear the transactions of such CBOE member on the Disabled Exchange.

B. A member of a Back-up Exchange acting in the capacity of a temporary member of CBOE pursuant to paragraph (a)(1)(F) shall be subject to, and obligated to comply with, the rules that govern the operation of the facility of CBOE at the Back-up Exchange, including CBOE rules to the extent applicable during the period of such trading. Additionally, (i) such temporary member shall be deemed to have satisfied, and CBOE will waive specific compliance with, rules governing or applying to the maintenance of a person's or a firm's status as a member of CBOE, including all dues, fees and charges imposed generally upon CBOE members based on their status as such, (ii) such temporary member shall have none of the rights of a CBOE member except the right to conduct business on the facility of CBOE at the Back-up Exchange to the extent described in this Rule, (iii) the member organization associated with such temporary member, if any, shall be responsible for all obligations arising out of that temporary member's activities on or relating to CBOE, and (iv) the Clearing Member of such temporary member shall guarantee and clear the transactions on CBOE of such temporary member.

(2) Temporary Members of the Back-up Exchange

A. A CBOE member acting in the capacity of a temporary member of the Back-up Exchange pursuant to paragraphs (a)(2)(B) or (a)(3) shall be subject to, and obligated to comply with, the rules of the Back-up Exchange that are applicable to the Back-up Exchange's own members. Additionally, (i) such CBOE member shall be deemed to

have satisfied, and the Back-up Exchange has agreed to waive specific compliance with, rules governing or applying to the maintenance of a person's or a firm's status as a member of the Back-up Exchange, including all dues, fees and charges imposed generally upon members of the Back-up Exchange based on their status as such, (ii) such CBOE member shall have none of the rights of a member of the Back-up Exchange except the right to conduct business on the Back-up Exchange to the extent described in this Rule, (iii) the member organization associated with such CBOE member, if any, shall be responsible for all obligations arising out of that CBOE member's activities on or relating to the Back-up Exchange, (iv) the Clearing Member of such CBOE member shall guarantee and clear the transactions of such CBOE member on the Back-up Exchange, and (v) such CBOE member shall only be permitted (x) to act in those capacities on the Back-up Exchange that are authorized by the Back-up Exchange and that are comparable to capacities in which the CBOE member has been authorized to act on CBOE, and (y) to trade in those option classes in which the CBOE member is authorized to trade on CBOE.

B. A member of a Disabled Exchange acting in the capacity of a temporary member of CBOE pursuant to paragraphs (b)(2)(A) or (b)(3) shall be subject to, and obligated to comply with, CBOE rules that are applicable to CBOE's own members.

Additionally, (i) such temporary member shall be deemed to have satisfied, and CBOE will waive specific compliance with, rules governing or applying to the maintenance of a person's or a firm's status as a member of CBOE, including all dues, fees and charges imposed generally upon CBOE members based on their status as such, (ii) such temporary member shall have none of the rights of a CBOE member

except the right to conduct business on CBOE to the extent described in this Rule, (iii) the member organization associated with such temporary member, if any, shall be responsible for all obligations arising out of that temporary member's activities on or relating to CBOE, (iv) the Clearing Member of such temporary member shall guarantee and clear the transactions of such temporary member on the CBOE, and (v) such temporary member shall only be permitted (x) to act in those CBOE capacities that are authorized by CBOE and that are comparable to capacities in which the temporary member has been authorized to act on the Disabled Exchange, and (y) to trade in those option classes in which the temporary member is authorized to trade on the Disabled Exchange.

(d) Member Proceedings.

(1) If CBOE initiates an enforcement proceeding with respect to the trading during a back-up period of the singly or multiply listed options of the Disabled Exchange by a temporary member of CBOE or the exclusively listed options of the Disabled Exchange by a member of the Disabled Exchange (other than a CBOE member who is a temporary member of the Disabled Exchange), and such proceeding is in process upon the conclusion of the back-up period, CBOE may transfer responsibility for such proceeding to the Disabled Exchange following the conclusion of the back-up period. Arbitration of any disputes with respect to any trading during a back-up period of singly or multiply listed options of the Disabled Exchange or of exclusively listed options of the Disabled Exchange on the Disabled Exchange's facility at CBOE will be conducted in accordance with CBOE rules, unless the parties to an arbitration

agree that it shall be conducted in accordance with the rules of the Disabled Exchange.

(2) If the Back-up Exchange initiates an enforcement proceeding with respect to the trading during a back-up period of CBOE singly or multiply listed options by a temporary member of the Back-up Exchange or CBOE exclusively listed options by a CBOE member (other than a member of the Back-up Exchange who is a temporary member of CBOE), and such proceeding is in process upon the conclusion of the back-up period, the Back-up Exchange may transfer responsibility for such proceeding to CBOE following the conclusion of the back-up period. Arbitration of any disputes with respect to any trading during a back-up period of CBOE singly or multiply listed options on the Back-up Exchange or of CBOE exclusively listed options on the facility of CBOE at the Disabled Exchange will be conducted in accordance with the rules of the Back-up Exchange, unless the parties to an arbitration agree that it shall be conducted in accordance with CBOE rules.

(e) Member Preparations.

CBOE members are required to take appropriate actions as instructed by CBOE to accommodate CBOE's back-up trading arrangements with other exchanges and CBOE's own back-up trading arrangements.

**...Interpretations and Policies:**

.01 This Rule 6.16 reflects back-up trading arrangements that CBOE has entered into or may enter into with one or more other exchanges. To the extent that this Rule provides that another exchange will take certain action, the Rule is reflecting what

that exchange has agreed to do by contractual agreement with CBOE, but the Rule itself is not binding upon the other exchange.

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**Authority to Take Action Under Emergency Conditions**

**Rule 6.17**

The Chairman of the Board, the President or such other person or persons as may be designated by the Board shall have the power to halt or suspend trading in some or all securities traded on the Exchange, to close some or all Exchange facilities, to determine the duration of any such halt, suspension or closing, to take one or more of the actions permitted to be taken by any person or body of the Exchange under Exchange rules, or to take any other action deemed to be necessary or appropriate for the maintenance of a fair and orderly market or the protection of investors, or otherwise in the public interest, due to emergency conditions or extraordinary circumstances, such as (1) actual or threatened physical danger, severe climatic conditions, natural disaster, civil unrest, terrorism, acts of war, or loss or interruption of facilities utilized by the Exchange, or (2) a request by a governmental agency or official, or (3) a period of mourning or recognition for a person or event. The person taking the action shall notify the Board of actions taken pursuant to this Rule, except for a period of mourning or recognition for a person or event, as soon thereafter as is feasible.

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**CHICAGO BOARD OPTIONS EXCHANGE, INC.**

**FEE SCHEDULE**

**APRIL 1, 2005**

**1. Option Transaction Fees (1)(3)(4)(7)(17):**

Remainder unchanged.

**2. Market-Maker, e-DPM & DPM Marketing Fee (in option classes in which a DPM has been appointed) (6)(17):**

Remainder unchanged.

**3. Floor Brokerage Fee (1)(5)(17):**

Remainder unchanged.

**4. RAES Access Fee (Retail Automatic Execution System) (1)(4)(17):**

Remainder unchanged.

**5. ETFs, Structured Products, Rights, Warrants (per round lot) (17):**

Remainder unchanged.

**6. Indexes Customer Order Book Official (OBO) Execution Fees (17):**

Remainder unchanged.

**Footnotes:**

(1)-(16) Unchanged.

(17) If CBOE exclusively listed options are traded at CBOE's facility on a Back-up Exchange pursuant to CBOE Rule 6.16, the Back-up Exchange has agreed to apply the per contract and per contract side fees in this fee schedule to such transactions. If any other CBOE listed options are traded on the Back-up Exchange (such as CBOE singly listed options that are listed by the Back-up Exchange) pursuant to CBOE Rule 6.16, the fee schedule of the Back-up Exchange shall apply to such trades.

If the exclusively listed options of a Disabled Exchange are traded on the Disabled Exchange's facility at CBOE pursuant to CBOE Rule 6.16, CBOE will apply the per contract and per contract side fees in the fee schedule of the Disabled Exchange to such transactions. If any other options classes of the Disabled Exchange are traded on CBOE (such as singly listed options of the Disabled Exchange) pursuant to CBOE Rule 6.16, the fees set forth in the CBOE fee schedule shall apply to such trades.

**Remainder of Fee Schedule: Unchanged.**

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

In its filing with the Commission, CBOE included statements concerning the purpose of, and basis for, the proposed rule and discussed any comments it received on the proposed rule. 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

1. Purpose

a. Introduction

The Exchange proposes to adopt new CBOE Rule 6.16, Back-Up Trading Arrangements, which will facilitate the CBOE entering into arrangements with one or more other exchanges (each a "Back-up Exchange") to permit CBOE and its members to use a portion of a Back-up Exchange's facilities to conduct the trading of CBOE

exclusively listed options<sup>7</sup> in the event of a Disabling Event, and similarly will permit the CBOE to provide trading facilities at CBOE for another exchange's exclusively listed options if that exchange (a "Disabled Exchange") is prevented from trading due to a Disabling Event. Proposed Rule 6.16 would also permit the CBOE to enter into arrangements with a Back-up Exchange to provide for the listing and trading of CBOE singly listed options<sup>8</sup> by the Back-up Exchange if CBOE's facility becomes disabled, and conversely provide for the listing and trading by CBOE of the singly listed options of a Disabled Exchange.

The Exchange also proposes an amendment to its Fee Schedule relative to the fees that shall apply to transactions in the options of a Disabled Exchange effected on a Back-up Exchange. Additionally, the Exchange proposes to adopt a new Rule 6.17, which addresses Exchange procedures under emergency conditions and is similar to rules that have been adopted by other exchanges. Finally, the rule proposal will replace and supersede current CBOE Rule 3.22, which the Exchange adopted following the events of September 11, 2001.

b. Background

The back-up trading arrangements contemplated by proposed Rule 6.16 represent CBOE's immediate plan to ensure that CBOE's exclusively listed and singly listed

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<sup>7</sup> For purposes of proposed CBOE Rule 6.16, the term "exclusively listed option" means an option that is listed exclusively by an exchange (because the exchange has an exclusive license to use, or has proprietary rights in, the interest underlying the option).

<sup>8</sup> For purposes of proposed Rule 6.16, the term "singly listed option" means an option that is not an "exclusively listed option" but that is listed by an exchange and not by any other national securities exchange.

options will have a trading venue if a catastrophe renders its primary facility inaccessible or inoperable. The Commission has suggested measures that CBOE should undertake to expedite reopening of CBOE's exclusively listed securities if a catastrophic event prevents trading at CBOE for an extended period of time.<sup>9</sup> Proposed Rule 6.16 would facilitate CBOE entering into back-up trading arrangements with other exchanges that would address the measures suggested by the Commission. In addition to these back-up trading arrangements, CBOE is currently working on other back-up trading plans.

In September 2003, CBOE entered into separate Memoranda of Understanding with the American Stock Exchange LLC ("Amex"), Pacific Exchange ("PCX") and Philadelphia Stock Exchange ("Phlx") to memorialize their mutual understanding to work together to develop bi-lateral back-up trading arrangements in the event that trading is prevented at one of the exchanges. Since then, CBOE has been working with each of these exchanges to put in place written agreements outlining essential commercial terms with respect to the arrangements as well as operational plans that describe the operational and logistical aspects of the arrangements.

CBOE and Phlx have signed an agreement relative to back-up trading arrangements and are in the process of completing the operational plan for those arrangements. The Exchange submitted a copy of this agreement as Exhibit 3.A to its

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<sup>9</sup> See letter from Annette L. Nazareth, Director, Division of Market Regulation, Commission, to William J. Brodsky, Chairman and Chief Executive Officer, CBOE, dated April 17, 2003. The Exchange states that comparable letters were also sent to the other options exchanges.

Form 19b-4 for the rule change proposal, together with a copy of a first amendment to the agreement as Exhibit 3.B.<sup>10</sup>

c. Proposed Rule 6.16

If CBOE is the Disabled Exchange

The Exchange proposes to adopt Rule 6.16 to make effective its back-up trading arrangements with other exchanges. Section (a) of proposed Rule 6.16 describes the back-up trading arrangements that would apply if CBOE were the Disabled Exchange. Under proposed paragraph (a)(1)(B), the facility of the Back-up Exchange used by CBOE to trade some or all of CBOE's exclusively listed options will be deemed to be a facility of CBOE, and such option classes shall trade as listings of CBOE. This approach of deeming a portion of the Back-up Exchange's facilities to be a facility of the Disabled Exchange is an approach approved by the Commission in previous emergency situations.<sup>11</sup>

Since the trading of CBOE exclusively listed options will be conducted using the systems of the Back-up Exchange, proposed paragraph (a)(1)(C) provides that the trading of CBOE exclusively listed options on CBOE's facility at the Back-up Exchange shall be

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<sup>10</sup> These exhibits are available for viewing on the Commission's Web site, [www.sec.gov/rules/sro.shtml](http://www.sec.gov/rules/sro.shtml), and at the Exchange and the Commission. The Exchange states that the first amendment to the agreement between CBOE and Phlx has been agreed to in principle by the parties but remains subject to final approval by Phlx.

<sup>11</sup> The Commission approved a similar approach when options listed on the Pacific Stock Exchange were physically moved to other exchanges in October 1989 due to an earthquake (See Exchange Act Release No. 27365 (October 19, 1989), 54 FR 43511 (October 25, 1989)), and when Dell options were relocated from Phlx to Amex on a temporary basis in June 1998 (See Exchange Act Release No. 40088 (June 12, 1998), 63 FR 33426 (June 18, 1998)).

conducted in accordance with the rules of the Back-up Exchange, except that (i) such trading shall be subject to CBOE rules with respect to doing business with the public, margin requirements, net capital requirements, listing requirements and position limits, (ii) CBOE members that are trading on CBOE's facility at the Back-up Exchange (not including members of the Back-up Exchange who become temporary members of CBOE pursuant to paragraph (a)(1)(F)) will be subject to CBOE rules governing or applying to the maintenance of a person's or a firm's status as a member of CBOE, and (iii) CBOE Rule 8.87.01 may be utilized to establish a lower DPM participation rate applicable to trading on CBOE's facility on the Back-up Exchange than the rate that is applicable under the rules of the Back-up Exchange if agreed to by CBOE and the Back-up Exchange. In addition, CBOE and the Back-up Exchange may agree that other CBOE rules will apply to such trading. The Back-up Exchange rules that govern trading on CBOE's facility at the Back-up Exchange shall be deemed to be CBOE rules for purposes of such trading.

Proposed paragraph (a)(1)(D) reflects that the Back-up Exchange has agreed to perform the related regulatory functions with respect to trading of CBOE exclusively listed options on CBOE's facility at the Back-up Exchange, in each case except as CBOE and the Back-up Exchange may specifically agree otherwise. The Back-up Exchange and CBOE will coordinate with each other regarding surveillance and enforcement respecting such trading. CBOE shall retain the ultimate legal responsibility for the performance of its self-regulatory obligations with respect to CBOE's facility at the Back-up Exchange.

Under proposed paragraph (a)(1)(E), CBOE shall have the right to designate its members that will be authorized to trade CBOE exclusively listed options on CBOE's facility at the Back-up Exchange and, if applicable, its member(s) that will be a Lead

Market-Maker (“LMM”) or Designated Primary Market-Maker (“DPM”) in those options. If the Back-up Exchange is unable to accommodate all CBOE members that desire to trade on CBOE's facility at the Back-up Exchange, CBOE may determine which members shall be eligible to trade at that facility by considering factors such as whether the member is a DPM or LMM in the applicable product(s), the number of contracts traded by the member in the applicable product(s), market performance, and other factors relating to a member's contribution to the market in the applicable product(s).

Under proposed paragraph (a)(1)(F), members of the Back-up Exchange shall not be authorized to trade in any CBOE exclusively listed options, except that (i) CBOE may deputize willing floor brokers of the Back-up Exchange as temporary CBOE members to permit them to execute orders as brokers in CBOE exclusively listed options traded on CBOE's facility at the Back-up Exchange,<sup>12</sup> and (ii) the Back-up Exchange has agreed that it will, at the instruction of CBOE, select members of the Back-up Exchange that are willing to be deputized by CBOE as temporary CBOE members authorized to trade CBOE exclusively listed options on CBOE's facility at the Back-up Exchange for such period of time following a Disabling Event as CBOE determines to be appropriate, and CBOE may deputize such members of the Back-up Exchange as temporary CBOE members for that purpose. The second of the foregoing exceptions would permit members of the Back-up Exchange to trade CBOE exclusively listed options on the CBOE facility on the Back-up Exchange if, for example, circumstances surrounding a

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<sup>12</sup> The exchanges that acted as Back-up Exchanges in the emergency situations noted above also deputized its floor brokers in this manner. See supra note 11.

Disabling Event result in CBOE members being delayed in arriving at the Back-up Exchange in time for prompt resumption of trading.

Section (a)(2) of the proposed rule provides for the continued trading of CBOE singly listed options at a Back-up Exchange in the event of a Disabling Event at CBOE. Proposed paragraph (a)(2)(B) provides that CBOE may enter into arrangements with a Back-up Exchange under which the Back-up Exchange will agree, in the event of a Disabling Event, to list for trading option classes that are then singly listed only by CBOE. Such option classes would trade on the Back-up Exchange as listings of the Back-up Exchange and in accordance with the rules of the Back-up Exchange. Under proposed paragraph (a)(2)(C), any such options class listed by the Back-up Exchange that does not satisfy the standard listing and maintenance criteria of the Back-up Exchange will be subject, upon listing by the Back-up Exchange, to delisting (and, thus, restrictions on opening new series, and engaging in opening transactions in those series with open interest, as may be provided in the rules of the Back-up Exchange).

CBOE singly listed option classes would be traded by members of the Back-up Exchange and by CBOE members selected by CBOE to the extent the Back-up Exchange can accommodate CBOE members in the capacity of temporary members of the Back-up Exchange. If the Back-up Exchange is unable to accommodate all CBOE members that desire to trade CBOE singly listed options at the Back-up Exchange, CBOE may determine which members shall be eligible to trade such options at the Back-up Exchange by considering the same factors used to determine which CBOE members are eligible to trade CBOE exclusively listed options at the CBOE facility at the Back-up Exchange.

Proposed Section (a)(3) provides that CBOE may enter into arrangements with a Back-up Exchange to permit CBOE members to conduct trading on a Back-up Exchange of some or all of CBOE's multiply listed options in the event of a Disabling Event. While continued trading of multiply listed options upon the occurrence of a Disabling Event is not likely to be as great a concern as the continued trading of exclusively and singly listed options, CBOE nonetheless believes a provision for multiply listed options should be included in the rule so that the exchanges involved will have the option to permit members of the Disabled Exchange to trade multiply listed options on the Back-up Exchange. Such options shall trade as a listing of the Back-up Exchange and in accordance with the rules of the Back-up Exchange.

If CBOE is the Back-up Exchange

Section (b) of proposed Rule 6.16 describes the back-up trading arrangements that would apply if CBOE were the Back-up Exchange. In general, the provisions in Section (b) are the converse of the provisions in Section (a). With respect to the exclusively listed options of the Disabled Exchange, the facility of CBOE used by the Disabled Exchange to trade some or all of the Disabled Exchange's exclusively listed options will be deemed to be a facility of the Disabled Exchange, and such option classes shall trade as listings of the Disabled Exchange. Trading of the Disabled Exchange's exclusively listed options on the Disabled Exchange's facility at CBOE shall be conducted in accordance with CBOE rules, except that (i) such trading shall be subject to the Disabled Exchange's rules with respect to doing business with the public, margin requirements, net capital requirements, listing requirements and position limits, and (ii) members of the Disabled Exchange that are trading on the Disabled Exchange's facility at CBOE (not

including CBOE members who become temporary members of the Disabled Exchange pursuant to paragraph (b)(1)(D)) will be subject to the rules of the Disabled Exchange governing or applying to the maintenance of a person's or a firm's status as a member of the Disabled Exchange. In addition, the Disabled Exchange and CBOE may agree that other Disabled Exchange rules will apply to such trading.

CBOE will perform the related regulatory functions with respect to such trading, in each case except as the Disabled Exchange and CBOE may specifically agree otherwise. Proposed paragraph (b)(1)(C) reflects that the Disabled Exchange has agreed to retain the ultimate legal responsibility for the performance of its self-regulatory obligations with respect to the Disabled Exchange's facility at CBOE.

Sections (b)(2) and (b)(3) describe the arrangements applicable to trading of the Disabled Exchange's singly and multiply listed options at CBOE, and are the converse of Sections (a)(2) and (a)(3). One difference is in paragraph (b)(2)(A), which includes a provision that would permit CBOE to allocate singly listed option classes of the Disabled Exchange to a CBOE DPM in advance of a Disabling Event, without utilizing the allocation process under CBOE Rule 8.95, to enable CBOE to quickly list such option classes upon the occurrence of a Disabling Event.

#### Member Obligations

Section (c) describes the obligations of members and member organizations with respect to the trading by "temporary members" on the facilities of another exchange pursuant to Rule 6.16. Section (c)(1) sets forth the obligations applicable to members of a Back-up Exchange who act in the capacity of temporary members of the Disabled Exchange on the facility of the Disabled Exchange at the Back-up Exchange.

Section (c)(1) provides that a temporary member of the Disabled Exchange shall be subject to, and obligated to comply with, the rules that govern the operation of the facility of the Disabled Exchange at the Back-up Exchange. This would include the rules of the Disabled Exchange to the extent applicable during the period of such trading, including the rules of the Disabled Exchange limiting its liability for the use of its facilities that apply to members of the Disabled Exchange. Additionally, (i) such temporary member shall be deemed to have satisfied, and the Disabled Exchange has agreed to waive specific compliance with, rules governing or applying to the maintenance of a person's or a firm's status as a member of the Disabled Exchange, including all dues, fees and charges imposed generally upon members of the Disabled Exchange based on their status as such, (ii) such temporary member shall have none of the rights of a member of the Disabled Exchange except the right to conduct business on the facility of the Disabled Exchange at the Back-up Exchange to the extent described in the Rule, (iii) the member organization associated with such temporary member, if any, shall be responsible for all obligations arising out of that temporary member's activities on or relating to the Disabled Exchange, and (iv) the Clearing Member of such temporary member shall guarantee and clear the transactions of such temporary member on the Disabled Exchange.

Section (c)(2) sets forth the obligations applicable to members of a Disabled Exchange who act in the capacity of temporary members of the Back-up Exchange for the purpose of trading singly and multiply listed options of the Disabled Exchange. Such temporary members shall be subject to, and obligated to comply with, the rules of the Back-up Exchange that are applicable to the Back-up Exchange's own members,

including the rules of the Back-up Exchange limiting its liability for the use of its facilities that apply to members of the Back-up Exchange. Temporary members of the Back-up Exchange have the same obligations as those set forth in Section (c)(1) that apply to temporary members of the Disabled Exchange, except that, in addition, temporary members of the Back-up Exchange shall only be permitted (i) to act in those capacities on the Back-up Exchange that are authorized by the Back-up Exchange and that are comparable to capacities in which the temporary member has been authorized to act on the Disabled Exchange, and (ii) to trade in those option classes in which the temporary member is authorized to trade on the Disabled Exchange.

#### Member Proceedings

As noted above, proposed Rule 6.16 provides that the rules of the Back-up Exchange shall apply to the trading of the singly and multiply listed options of the Disabled Exchange traded on the Back-up Exchange's facilities, and (with certain limited exceptions) the trading of exclusively listed options of the Disabled Exchange traded on the facility of the Disabled Exchange at the Back-up Exchange. The Back-up Exchange has agreed to perform the related regulatory functions with respect to such trading (except as the Back-up Exchange and the Disabled Exchange may specifically agree otherwise).

Section (d) of proposed Rule 6.16 provides that if a Back-up Exchange initiates an enforcement proceeding with respect to the trading during a back-up period of singly or multiply listed options of the Disabled Exchange by a temporary member of the Back-up Exchange or exclusively listed options of the Disabled Exchange by a member of the Disabled Exchange (other than a member of the Back-up Exchange who is a temporary

member of the Disabled Exchange), and such proceeding is in process upon the conclusion of the back-up period, the Back-up Exchange may transfer responsibility for such proceeding to the Disabled Exchange following the conclusion of the back-up period. This approach to the exercise of enforcement jurisdiction is also consistent with past precedent.

With respect to arbitration jurisdiction, proposed Section (d) provides that arbitration of any disputes with respect to any trading during a back-up period of singly or multiply listed options of the Disabled Exchange or of exclusively listed options of the Disabled Exchange on the Disabled Exchange's facility at the Back-up Exchange will be conducted in accordance with the rules of the Back-up Exchange, unless the parties to an arbitration agree that it shall be conducted in accordance with the rules of the Disabled Exchange.

#### Member Preparations

To ensure that members are prepared to implement CBOE's back-up trading arrangements, proposed Section (e) requires CBOE members to take appropriate actions as instructed by CBOE to accommodate CBOE's back-up trading arrangements with other exchanges and CBOE's own back-up trading arrangements.

#### Interpretations and Policies

Proposed Interpretation and Policy .01 to Rule 6.16 clarifies that to the extent Rule 6.16 provides that another exchange will take certain action, the Rule is reflecting what that exchange has agreed to do by contractual agreement with CBOE, but Rule 6.16 itself is not binding on the other exchange.

d. Fee Schedule

The Exchange proposes to add a footnote to its Fee Schedule to inform its members regarding what fees will apply to transactions in the listed options of a Disabled Exchange effected on a Back-up Exchange under Rule 6.16. The footnote provides that if CBOE is the Disabled Exchange, the Back-up Exchange has agreed to apply the per contract and per contract side fees in the CBOE fee schedule to transactions in CBOE exclusively listed options traded on the CBOE facility on the Back-up Exchange.<sup>13</sup> If any other CBOE listed options are traded on the Back-up Exchange (such as CBOE singly listed options that are listed by the Back-up Exchange) pursuant to CBOE Rule 6.16, the fee schedule of the Back-up Exchange shall apply to such trades. The footnote contains a second paragraph stating the converse if CBOE is the Back-up Exchange under Rule 6.16.

e. Proposed Rule 6.17

The Exchange proposes to adopt a general emergency rule in proposed Rule 6.17. Although not directly related to the implementation of the back-up trading arrangements, the Exchange believes that it is appropriate to adopt such a rule in conjunction with implementing the back-up trading arrangements. Currently, there is no Exchange rule that grants specific authority in an emergency to any person or persons to take all actions necessary or appropriate for the maintenance of a fair and orderly market or the protection of investors. Authority to take actions affecting trading or the operation of CBOE systems is currently granted to the Board of Directors, floor officials and other

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<sup>13</sup> When Phlx Dell options relocated to Amex in June 1998, Phlx fees applied to transactions in Dell options on the Amex. See supra note 11.

individuals under several Exchange rules (e.g., CBOE Rules 4.16, 6.3, 6.6 and 24.7).

Several other exchanges already have adopted general emergency rules (e.g., NYSE Rule 51).

Finally, the Exchange proposes to delete CBOE Rule 3.22, which is a temporary rule adopted in response to the events of September 11, 2001.

## 2. Statutory Basis

The Exchange states that the proposed rule change is intended to ensure that CBOE's exclusively listed and singly listed products will have a trading venue in the event that trading at CBOE is prevented due to a Disabling Event, thus minimizing potential disruptions for the markets and investors under those circumstances. The Exchange thus believes that the proposed rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act,<sup>14</sup> in that it is designed 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

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

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<sup>14</sup> 15 U.S.C. 78f(b)(5).

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 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 self-regulatory organization 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-2004-59 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-2004-59. 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, 450 Fifth Street, NW, Washington, DC 20549. 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-2004-59 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>15</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>15</sup> 17 CFR 200.30-3(a)(12).