

December 15, 2004

Mr. Jonathan G. Katz
Secretary
United States Securities
and Exchange Commission
450 Fifth Street, NW.
Washington, DC 20549-0609

Re: File Number SR-CBOE-2004-45

Dear Mr. Katz:

Citadel Derivatives Group LLC (“Citadel”) is submitting this letter in response to the Chicago Board Options Exchange’s (“CBOE”) proposed rule amendments related to File Number SR-CBOE-2004-45 (the “Proposed Rule”). As part of the Proposed Rule, the CBOE has proposed new rule 6.53C – “Complex Orders on the Hybrid System” to address priority, execution and allocation of complex orders (e.g., spread orders) on the Hybrid System (“Hybrid”), the CBOE’s electronic trading platform.

As an initial matter, Citadel would like to commend the CBOE for proposing a mechanism by which complex orders may be executed automatically via Hybrid (the Complex Order Book (“COB”)). We believe that COB will provide for more efficient executions for market participants whose complex orders are eligible for routing to COB.

As part of Proposed Rule 6.53C, however, the CBOE included a provision that allows certain CBOE committee members to determine where, when and what type of orders may be routed to COB. Specifically, section (c)(i) of Proposed Rule 6.53C reads as follows:

“Routing of Complex Orders: Complex orders will route either to PAR or the Complex Order Book (“COB”), as determined by the appropriate Exchange committee on a class by class basis. All pronouncements regarding routing procedures will be announced to the membership via Regulatory Circular. The appropriate Exchange committee also will determine whether to allow complex orders from non-broker-dealer public customers and from broker-dealers that are not market makers or specialists on an options exchange to route from PAR to the COB.”

We believe this provision should not be approved as proposed because it takes order routing decisions out of the hands of the individuals who are most qualified to make such decisions. Rather, we believe that designated primary market makers (“DPMs”) and participants who route their orders (collectively, “Order Routers”) to the CBOE should decide when and where complex orders are routed.

A DPM is responsible for, among other things, providing liquidity by making markets and for acting in an agency capacity by executing orders routed to the DPM’s trading crowd. These obligations are equally important. The DPM must make continuous markets to facilitate the automated execution of orders routed over the CBOE’s electronic systems in a fast, fair and efficient manner. At the same time, the DPM must also address orders that “kick-out” to the DPM’s floor broker workstation (“PAR”), including spread orders, in a timely manner.¹ The DPM has certain strict, mandatory obligations with respect to handling certain orders. Specifically, a DPM must address all limit orders in a timely manner by either executing or displaying limit orders as soon as possible, however, no later than 30 seconds after receipt. Spread orders that route to PAR may take longer to address than simple orders due to more complicated pricing issues associated with certain complex orders. Such issues may delay the DPM’s ability to address limit orders resting on the PAR. In addition to making markets and addressing orders on PAR, the DPM must also deal with floor brokers who may enter the DPM’s trading crowd to represent orders for execution or to seek market quotes.

As a result of performing all of these obligations, the DPM may become overwhelmed quickly. We believe that a DPM, however, could perform its obligations in a more efficient manner by making the decisions regarding whether orders should route to COB (including the types of orders that may route to COB and the classes in which such orders may be routed). The DPM has first-hand knowledge and experience with respect to the level of trading activity in its crowd and therefore knows when it would be beneficial to route orders directly for automatic execution. Most importantly, however, by giving the DPM the direct ability to determine to route orders directly to COB, the DPM has the ability to exercise its judgment regarding the most efficient way to handle complex orders and to free itself to perform other functions – including promptly addressing other orders routed to PAR.

We would add that we believe routing orders to COB increases transparency in the marketplace because such orders would be disseminated to all market participants. As a result of increased transparency, we believe that such orders would have more opportunities for price improvement and would be executed in a faster, more efficient manner. Ultimately, this will ease a DPM’s order handling burden and improve response and execution times for Order Routers.

¹ An order may kick-out to the PAR terminal for various reasons, such as the incoming order locks or crosses an away market.

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Order Routers also should have the option of routing their orders directly to COB. While we believe that it is generally most efficient to route all orders directly for display and/or electronic execution, certain Order Routers may determine, for their own reasons, to have their orders represented manually in the trading crowd. We believe that they should be given this choice.

Finally, we would add that the manner in which the CBOE proposes to announce routing procedures related to COB is inefficient. The CBOE has indicated that "All pronouncements regarding routing procedures will be announced to the membership via Regulatory Circular." CBOE regulatory circulars require significant time to draft and receive approval from the Securities and Exchange Commission. Accordingly, any changes to COB routing procedures would take significant time, and therefore, DPMs would be unable to obtain such changes on an immediate or as-needed basis. Furthermore, unless DPMs receive this notice in a timely manner, they would be unaware of when orders were being routed to COB.

In conclusion, we do not believe the Proposed Rule should be approved in its current form. Rather, we believe that DPMs and Order Routers should determine whether complex orders should route to COB. Thank you for your consideration.

Sincerely,

Matthew Hinerfeld
Managing Director and
Deputy General Counsel
Citadel Investment Group, L.L.C.
on behalf of Citadel Derivatives Group LLC