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January 8, 2005

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

Re: File Number SR-CBOE-2004-73

Dear Mr. Katz:

Citadel Derivative Group LLC (“Citadel”) is submitting this letter to comment on File Number SR-CBOE-2004-73 (the “Filing”). Citadel is a designated primary market-maker (“DPM”) on the Chicago Board Options Exchange (“CBOE” or the “Exchange”), in addition to being an options market maker on other exchanges. Pursuant to the Filing, the CBOE has proposed amendments to Exchange Rule 8.85 – *DPM Obligations*. Specifically, the Exchange has proposed to amend Rule 8.85 to further limit a DPM’s ability to charge a brokerage commission with respect to orders executed in the DPM’s appointed option classes. As part of the Filing, the CBOE has proposed the following amendments (new language is in italics):

(iv) not charge any brokerage commission with respect to:

- (1) the execution of any *portion of an order* for which the DPM has acted as both agent and principal, unless the customer who placed the order has consented to paying a brokerage commission to the DPM with respect to the DPM’s execution of the order while acting as both agent and principal;
or
- (2) *any portion of an order for which the DPM was not the executing floor broker, including any portion of the order that is automatically executed through an Exchange system; or*
- (3) *any portion of an order that is automatically cancelled; or*
- (4) *any portion of an order that is not executed and not cancelled.*

Citadel would like to commend the CBOE for taking steps to limit the ability of DPMs to charge commissions. Unlike ordinary floor brokers, DPMs occupy special Exchange-granted positions. As a result of a DPM’s quasi-monopolistic role, investors have little if any freedom to choose not to have their orders handled by a particular DPM. Thus, DPMs should not be free unilaterally to impose charges for their regulatorily-mandated functions. Moreover, the ability to impose non-

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uniform charges not reflected in market maker quotes would be destructive to best execution and the Intermarket Linkage system because quotes that appear to be the NBBO may not really be the best if one must pay an extra charge to access them. Thus, it is critical for best execution, price transparency, and the success of the Intermarket Linkage System that hidden access fees be prohibited.

We believe that the proposed rule change does just this. It clarifies in subsection (2) that DPMs may not charge commissions for actions taken in their capacities as DPMs. Instead, DPMs may charge only for orders or portions of orders for which they act as “the executing floor broker.” That is, DPMs may charge only for the provision of agency services that any floor broker could provide.

But we believe that this distinction is so important that the proposed rule should be revised to make the distinction even more clear. That will avoid the problem of DPMs attempting to charge for functions that are uniquely the province of DPMs (and therefore not true floor broker functions), such as routing orders for execution over Linkage or otherwise handling orders on DPM PAR workstations. This may be accomplished adding a new subsection (5), which would provide, “any portion of an order for which the DPM acted in its capacity as a DPM.” Thus, the revised rule would provide:

(iv) not charge any brokerage commission with respect to:

- (1) the execution of any *portion of an order* for which the DPM has acted as both agent and principal, unless the customer who placed the order has consented to paying a brokerage commission to the DPM with respect to the DPM’s execution of the order while acting as both agent and principal;
or
- (2) *any portion of an order for which the DPM was not the executing floor broker, including any portion of the order that is automatically executed through an Exchange system; or*
- (3) *any portion of an order that is automatically cancelled; or*
- (4) *any portion of an order that is not executed and not cancelled; or*
- (5) *any portion of an order for which the DPM acted in its capacity as a DPM.*

Thank you for the opportunity to comment on the proposed rule.

Sincerely,

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