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CHICAGO BOARD OPTIONS EXCHANGE

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SENT VIA FEDERAL EXPRESS AND FAX

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

RE: File No. SR-CBOE-2004-73

Dear Mr. Katz:

The Chicago Board Options Exchange, Incorporated ("CBOE") is taking the opportunity to respond to the comment letter ("Comment Letter") dated January 8, 2005, from Citadel Derivative Group, LLC ("Citadel") regarding proposed rule change SR-CBOE-2004-73 (the "Rule Change").[1] In its letter, Citadel approves of and commends CBOE for initiating the Rule Change, which proposes to prohibit a DPM from charging a brokerage commission for (newly proposed language in *italics*):

> "*(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.*"

However, Citadel proceeds to suggest that the Rule Change be expanded to restrict a DPM from charging brokerage for "*any portion of an order for which the DPM act*[s] *in its capacity as a DPM.*" CBOE believes that such a provision is overreaching and is inconsistent with the purpose of the proposed Rule Change.

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[1] Letter dated January 8, 2005, from Matthew Hinerfeld, Managing Director and Deputy General Counsel, Citadel, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, regarding File No. SR-CBOE-2004-73.

As provided in SR-CBOE-2004-73, the purpose of the rule change is to clarify within CBOE rules that DPMs cannot charge a brokerage commission on orders for which they do not perform an agency function. The Exchange believes that such a rule change is necessary to clarify to the investing public that orders sent to the CBOE will not be subject to excessive or arbitrary costs and that it would be unreasonable for a DPM to charge a customer a commission for an order that is executed without any assistance or handling by the DPM or that is not executed at all. In addition to protecting investors, this Rule Change also serves to protect the competitiveness of the Exchange.

In its Comment Letter, Citadel argues that DPMs should not be allowed to ". . . charge commissions for actions taken in their capacities as DPMs." CBOE Rule 8.80 defines a DPM as a "member organization that is approved by the Exchange to function in allocated securities as a Market-Maker . . . as a Floor Broker (as defined in Rule 6.70), and as an Order Book Official." (Emphasis added). As a practice, most CBOE DPMs maintain brokerage staff who are responsible for representing customer orders in an agency capacity. Many of the functions that the typical DPM's brokerage staff perform are hardly distinguishable from the functions performed by any non-DPM affiliated independent floor broker. CBOE does not support Citadel's position that, simply because an order is being represented by the brokerage staff of a DPM the DPM is not entitled to charge a reasonable commission for their efforts. Such a position is certainly not supported by CBOE rules.

We note that CBOE rules clearly contemplate that DPMs may charge brokerage commissions for orders that they represent in an agency capacity. CBOE Rule 8.85(b)(iv) provides that a DPM may not charge a brokerage commission " . . . with respect to the execution of any order for which the DPM has acted as both agent and principal, unless the customer who placed the order has consented . . .". If CBOE intended to prohibit a DPM from charging brokerage commissions at all, the existing rules would not go through the exercise of prohibiting the charge of commissions only for the portion of an order in which the DPM acts as principal, but instead would have summarily banned DPM's from charging commissions. This rule necessarily provides that a DPM may charge a commission for an order it represents as agent. CBOE does not intend to repeal this authority.

CBOE will take this opportunity to reiterate the purpose of the Rule Change; which is to clarify that a DPM cannot charge a brokerage commission for orders in which it does not perform an agency function. In drafting this proposed Rule Change, CBOE believes that it would not have been practical or prudent to attempt to identify every type of agency function that would be (or would not be) subject to a brokerage commission. Such functions could be too easily subject to interpretation based on the facts and circumstances of each situation. Instead, the Exchange believes that it would be more appropriate to identify the types of order situations that should never be subject to a brokerage commission, as described above. We believe that this is what the Rule Change accomplishes. It is apparent from the Comment Letter that Citadel would prefer that

DPMs be prevented from ever charging brokerage commissions under any circumstances, but this is neither the intention of the Rule Change or of the CBOE. As such, we respectfully submit that the rule change be considered in its original form. We thank you for the opportunity to respond in this matter.

Sincerely,

James M. Flynn

cc: Elizabeth King, Associate Director, Division of Market Regulation
John Roeser, Division of Market Regulation
Ed Joyce
Joanne Moffic-Silver