



**Joanne Moffic-Silver**  
Executive Vice President  
General Counsel &  
Corporate Secretary

Phone: 312 786-7462  
Fax: 312 786-7919  
mofficj@cboe.com

July 25, 2006

**Via Federal Express**

Nancy M. Morris  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549



**Re: Chicago Board Options Exchange, Incorporated -Request for Exemption Under Rule 608(e) of Regulation NMS Under the Securities Exchange Act of 1934 from Certain Provisions of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage Relating to the Automatic Execution of Option Transactions During Crossed Markets**

Dear Ms. Morris:

The Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") respectfully requests that the Securities and Exchange Commission ("Commission") grant a partial exemption from Rule 608(c) of Regulation NMS under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which requires the Exchange to comply with and enforce compliance by its members with the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (the "Plan").<sup>1</sup> As set forth more fully below, the Exchange seeks an exemption from liability for the satisfaction of trade-throughs under the Plan when (1) a trade-through was the result of an automatic execution by the Exchange's proposed SAL system during a time in which the disseminated market is crossed and the Exchange's disseminated price on the opposite side of the market for the incoming order at the time of receipt establishes, or is equal to, the National Best Bid or Offer ("NBBO"); and (2) when a trade-through was the result of an automatic execution when the Exchange's disseminated market is crossed, or crosses the disseminated market of another options exchange, and the Exchange's disseminated price on the opposite side of the market from the incoming order establishes, or is equal to, the NBBO.

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<sup>1</sup> The Plan is a national market system plan approved by the Commission pursuant to Section 11A of the Exchange Act, 15 U.S.C. 78k-1 and Rule 608 of Regulation NMS. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).

## **Commission's Exemptive Authority**

Rule 608(e) of Regulation NMS authorizes the Commission to issue exemptions from the provisions of Rule 608. In particular, Rule 608(e) provides:

The Commission may exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any self-regulatory organization... if the Commission determines that such exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and perfection of the mechanisms of, a national market system.

17 CFR 242.608(e). The Plan is an effective national market system plan pursuant to Rule 608 of Regulation NMS, and the Exchange is a participant in the Plan. Rule 608(e) of Regulation NMS authorizes the Commission to issue an exemption to the Exchange from Rule 608(c), which requires the Exchange to comply with and to enforce compliance by the Exchange's members with the terms of the Plan.<sup>2</sup>

## **Background**

The Exchange seeks this exemption in order to facilitate a rule change that would allow the Exchange to auction orders that are stopped (i.e. executed) at the NBBO against CBOE Market-Makers for potential price improvement even when the disseminated market for the option series in question is crossed.<sup>3</sup> CBOE would only proceed with the stop and auction if CBOE were the NBBO at the time the order was received. The purpose of the proposed rule change is to briefly auction inbound orders that would otherwise get filled at the NBBO for price improvement. The exemption is also sought to facilitate the automatic execution in option transactions when the Exchange's disseminated market is crossed with another market (i.e. \$1.05 bid, 1.00 offer), and the Exchange's disseminated price is the NBBO.

The Exchange believes that the exemption would facilitate the prompt resolution of crossed markets by permitting automatic executions when the Exchange's disseminated market is crossed by, or crosses, the disseminated market of another options exchange, and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.

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<sup>2</sup> Rule 608(c) requires each self-regulatory organization to "comply with the terms of any effective national market system plan of which it is a sponsor or a participant [, and] absent reasonable justification or excuse, enforce compliance with any such plan by its members." 17 CFR 242.608(c).

<sup>3</sup> See Securities Exchange Act Release No. 52823 (November 22, 2005), 70 FR 71565 (November 29, 2005) noticing SR-CBOE-2005-90.

## **Provisions of the Plan Requiring Exemption**

Section 8(c) of the Plan, Order Protection, generally provides that, absent reasonable justification, and during normal market conditions, members should not effect Trade-Throughs in their markets. The Plan also requires each participant to the Plan to file with the Commission uniform rules which, among other things, provide that, "[w]hen purchasing or selling, either as principal or agent, any options series of an Eligible Option Class, or when sending a Linkage Order, members of a Participant should avoid initiating a Trade-Through" unless one or more of the enumerated exceptions to Trade-Through liability contained in the Plan are applicable. In connection with this provision, the Exchange submitted, and the Commission approved, CBOE Rule 6.83, which provides that, absent reasonable justification and during normal market conditions, Exchange members should not effect Trade-Throughs unless an exception applies.

As stated above, the Exchange has proposed to permit automatic executions pursuant to proposed Rule 6.13A when the disseminated market is crossed as long as the Exchange's disseminated price on the opposite side of the market from the incoming order establishes, or is equal to, the NBBO. The Exchange also proposes to permit automatic executions when the Exchange's disseminated market is crossed by or crosses the disseminated market of another options exchange and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO. Such transactions would result in a Trade-Through. An exemption from Section 8(c) of the Plan is needed in order to permit the Exchange to automatically execute orders received and stopped when the disseminated market is crossed.

In addition, Section 4(b) of the Plan requires the Exchange to enforce compliance by its members in their use of the Linkage through the Exchange's facilities. Because the Exchange is seeking an exemption from the requirement that it enforce compliance with certain provisions of the Plan, it will necessarily need an exemption from Section 4(b) of the Plan as well.

## **Exemption Request**

In connection with the Commission's approval of the Exchange's proposed Rule 6.13A, the Exchange respectfully requests an exemption, pursuant to Rule 608(e) of Regulation NMS, from the requirement of Rule 608(c) of Regulation NMS that the Exchange comply with and enforce compliance by its members with the requirements of Section 8(c) of the Plan in the limited circumstance where a Trade-Through occurs (1) due to an automatic execution pursuant to Rule 6.13A when the disseminated market is crossed and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO and (2) as a result of an automatic execution when the Exchange's disseminated market is crossed by or crosses the disseminated market of another options exchange and the Exchange's disseminated price on the opposite side of the market for the incoming order establishes, or is equal to, the NBBO.

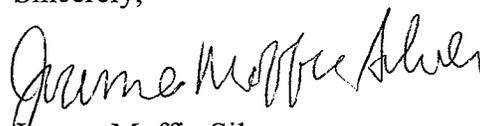
To the same extent and subject to the same limitations, the Exchange requests exemptive relief from the requirement in Rule 608(c) of Regulation NMS that the Exchange comply with Section 4(b) of the Plan by enforcing compliance by its members with the provisions of Section 8(c) of the Plan, as discussed above.

The exemption the Exchange requests satisfies the requirements of Rule 608(e) of Regulation NMS, in that the exemption is consistent with the public interest, the protection of investors, the maintenance of fair and orderly markets and the removal of impediments to, and the perfection of the mechanisms of, a national market system. Specifically, the Exchange believes that such an exemption would ultimately benefit customers, who would receive automatic executions and potential price improvement when the disseminated market is crossed.

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For the foregoing reasons, the Exchange respectfully requests that the Commission grant an exemption to the Exchange from Rule 608(c) of Regulation NMS, which requires the Exchange to comply with and enforce compliance with, section 8(c) and 4(b) of the Plan, under the terms and conditions specified above. Please feel free to contact me at 312-786-7462 or Angelo Evangelou at 312-786-7464 if you have any questions.

Sincerely,



Joanne Moffic-Silver