May 20, 2005

***Via Facsimile (202-942-9651) and U.S. Mail***

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

Re: **SR-CBOE-2005-19 and SR-CBOE-2005-20**

Dear Mr. Katz:

This letter is a further comment for inclusion in the above-referenced proceedings. It responds to comments submitted by the Chicago Board Options Exchange ("CBOE") in the letter to you dated May 6, 2005 from CBOE's General Counsel, Joanne Moffic-Silver, Esq. By letter from my counsel to you dated May 18, 2005, I requested an extension of time to respond to and including May 24, 2005. This letter is submitted today in the event that request was not granted. In addition, it is my understanding that another commenter has asked a Delaware law firm to provide an opinion on Delaware law relevant to the issues here. It is expected that that opinion will be completed by May 27, 2005. Accordingly, I also respectfully request additional time to comment when the opinion is filed to the extent that opinion provides information relevant to the Commission's determination of the issues here to include 21 days from receipt of SR-CBOE-2005-19 Amendment No. 3 submitted on May 12, 2005 or at the minimum from the May 9, 2005 receipt of Moffic-Silver's letter.

The CBOE's letter primarily argues that the statement in my April 28, 2005 comment letter that the Chicago Board of Trade ("CBOT") as a Delaware nonstock corporation no longer exists is erroneous because the CBOT as a Delaware nonstock corporation entity continues to exist and continues to have persons deemed to be members. The CBOE's point as a technical matter is correct, but as a matter of substance it is ineffectual. It is true that the CBOT technically survived as a Delaware nonstock corporation, but substantively it is a wholly different organization in terms of its legal structure, ownership, corporate governance, and new status as a for-profit corporation. The profound organic changes to the CBOT are reflected in the facts, among others, that they involve the adoption of a "*new certificate of incorporation* and by-laws for CBOT Holdings and a *new certificate of incorporation*, by-laws and rules and regulations of

the CBOT subsidiary." (CBOT Proxy Statement and Prospectus dated February 14, 2005 at p. 61 (emphasis added).) Moreover, as explained below, although the CBOT continues to exist in name, the memberships that constituted its ownership prior to its reorganization have been extinguished and the members' former interests have been converted into stock ownership of a different entity and different and new memberships in a reconstituted subsidiary.

The CBOT's February 14, 2005 Proxy Statement and Prospectus make clear that before the restructuring the CBOT:

- was a Delaware nonstock, not-for-profit corporation, the equity ownership of which was reposed exclusively in its members; and

- held all of the outstanding shares of common stock of CBOT Holdings, Inc. which in turn held as a direct and wholly-owned subsidiary, CBOT Merger Sub, Inc., a Delaware nonstock, for-profit corporation.

Pursuant to the reorganization, CBOT Merger Sub, Inc. and CBOT merged, after which CBOT became a nonstock, *for-profit* corporation and *a subsidiary* of CBOT Holdings, Inc. In addition, pursuant to the reorganization, the CBOT subsidiary was organized along two classes of memberships, consisting of a new Class A membership held entirely by CBOT Holdings, Inc. and a series of five separate new Class B memberships distributed to former members of the former CBOT. CBOT Holdings, Inc., as the sole holder of the Class A membership, has the exclusive right to receive all distributions and proceeds upon liquidation from the CBOT subsidiary and certain limited voting rights. The Class B memberships will entitle members to certain trading rights and privileges and certain voting rights. The memberships of the former CBOT full members in the former (pre-reorganization) CBOT were extinguished by conversion of them into shares of stock in CBOT Holdings, Inc. and new Class B, Series B-1 memberships in the newly organized CBOT subsidiary.

It is undisputed that, from the time of the creation of the CBOE in the early 1970s until the CBOT's April 22, 2005 reorganization, the term "member of [CBOT]" in Article Fifth(b) referred to the full members of the former (pre-reorganization) CBOT. It also is undisputed that no person holds that legal status today following the reorganization because those former CBOT memberships and that former means of ownership were extinguished and converted to

something different. Accordingly, the purported "interpretation" of "member of [CBOT]" advocated by the CBOE Board literally converts the meaning of Article Fifth(b) into something new to apply to persons who have a different legal status, different rights and different interests than the members of the former CBOT prior to its reorganization. To convert the meaning of Article Fifth(b) to new persons holding different legal status, rights and interests is functionally and legally an amendment of Article Fifth(b). With reference to the terms of Section 242 of the Delaware General Corporation Law that conversion of the meaning of Article Fifth(b) would adversely "alter or change the powers, preferences, or special rights" of all non-Exercise members of the CBOE by extending the Exercise Right (and its dilutive effects) to persons who do not meet the long accepted and applied meaning of the term. As such, the purported "interpretation" is an amendment to Article Fifth(b), and, as set forth in my April 28, 2005 comment letter, may be lawfully effected only pursuant to an 80% vote of the CBOE membership.[1]

The CBOE effectively argues that its Board's purported "interpretation" is appropriate because the new persons with different legal status, rights and interests at the new CBOT subsidiary formerly were the full members of the former CBOT, and it is reasonable to permit the Exercise Right to follow them to their new legal status. There is nothing in the law, however, that declares that to be so. There is no legal right to retain a CBOE Exercise Right following reorganization of the CBOT and the corresponding change in the legal status, rights and interests of its former members.

Significantly, the CBOT's reorganization does not constitute a mere formality with respect to the functioning of the Exercise Right. Approval of the change in the meaning of Article Fifth(b) sought by the CBOE Board materially amplifies the usage and value of the

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[1] Although the contentions of the CBOE letter at page 6 are difficult to decipher, I believe the CBOE there erroneously contends that the meaning I ascribe to Article Fifth(b) is itself an "interpretation" and therefore accuses me of being "inconsistent" in my positions. To the contrary, my position is that the CBOE must live with the long-applied meaning of the terms of Article Fifth(b). The meaning I hold to is that long held and applied meaning; my position does not change that meaning and therefore is not an amendment. The CBOE, in contrast, wants to change the meaning to advance the interests of persons (the members of the former, pre-reorganization CBOT) who voluntarily extinguished the memberships that held the Exercise Rights and thus voluntarily took themselves outside the long-held meaning. That they did that cannot be questioned. Indeed, that is the precise reason the CBOE has had to file its proposed rule change under Section 19 -- because its interpretation is in fact a *material change* in the meaning of Article Fifth(b).

Exercise Right in ways not intended when it was created in 1973 and correspondingly diminishes the rights of Non-Exercise members and the value of their seats. Following the CBOT restructuring, CBOE Exercise holders have much greater legal and economic ability to utilize a CBOE membership and thus it can be expected that the number of persons exercising their rights to CBOE memberships will increase. When created in 1973, the Exercise Right had a natural impediment to its use specifically due to the facts that (1) an exerciser would not be allowed to trade on both exchanges at the same time and (2) the structure of the CBOT solely as a membership organization did not permit members to obtain value from their CBOT seat while utilizing their Exercise Rights to trade on the CBOE. Following the CBOT's reorganization, exercisers could now, for example, obtain value from their Class A shares in CBOT Holdings, Inc. by pledging them for loans or as collateral for other financial benefits or, when those shares begin to trade, shorting them against the box, while utilizing CBOE membership pursuant to the Exercise Right. This accentuates the incentive to exercise and thereby dilute the value of CBOE Non-Exercise memberships. These are but a few examples of how the CBOE's interpretation changes CBOE members' rights and interests. In short, permitting former CBOT members to carry the Exercise Right with them to the new organization adversely affects the rights and interests of CBOE Non-Exercise members.

The CBOE's assertion that there is "no evidence that any member of management or of the CBOE Board had any self-interest in any interpretation of Article Fifth(b) in response to the restructuring of the CBOT or was otherwise faced with any conflict of interest" is not accurate with my understanding of the facts. My understanding is that in 2001, 2004 and 2005, when the interpretation was agreed to with the CBOT, Exercise members of the CBOT were on the CBOE Board, and they would have had personal interest in the terms of the interpretation. My understanding is that at least one such Exercise member is Jonathan Flatow. I do not have access to the minutes of CBOE Board meetings because they are not available to me (and the CBOE as a matter of course does not provide them to members). Accordingly, I do not know what they show as to the involvement or non-involvement of Exercise members in Board deliberations or votes relating to the 2001 interpretation and agreements with the CBOT. I do not accept the CBOE's bald assertion that no conflicts existed in the absence of credible evidence to support that.

The Commission's approvals of other CBOE purported "interpretations" of Article Fifth(b) are not controlling here, as the CBOE's comment letter erroneously suggests. None of the earlier "interpretations" of the term "member of [CBOT]" concerned conversions of the meaning of the term to reach persons in new organizations holding new and different legal status, rights and interests.

The CBOE's "horns of a dilemma" argument set forth in the quotation from its Filing at pages 4-5 of its letter has never been accepted by the Commission. That argument was refuted by the arguments set forth at page13 of the Brief in Support of Motion of Marshall Spiegel for Reconsideration of the Commission's February 25, 2005 Order in SR-CBOE-2004-16, which is incorporated herein by reference. The Commission's April 18, 2005 Order denying that Motion specifically held at page 9 (Point F) that the Commission's February 25, 2005 Order did not rely on or incorporate that argument of the CBOE.

The CBOE's contention at pages 7-8 that it had "no choice" but to "provisionally" interpret Article Fifth(b) following the CBOT's restructuring is without merit. The CBOE should have held the vote required by the Articles of Incorporation for amending Article Fifth(b) to approve any interpretation before committing the CBOE to it contractually in the 2001 letter agreement with the CBOT or effectuating the unapproved interpretation after the CBOT restructuring. Moreover, contrary to its contentions, the CBOE did not have to wait for the Commission's ruling in SR-CBOE-2004-16 to make its Filing here. It had discretion to make its Filing here at any time, as the Commission's February 25, 2005 Order in SR-CBOE-2004-16 at pages 15-16 (Point E) makes clear. Footnote 49 of that Order states that the CBOE stated that it withdrew its earlier submission of the 2001 interpretation because the CBOT's demutualization plans were suspended.

The CBOE's comment letter does not provide any facts or law that rebuts the fact that it has violated and is continuing to violate Section 19 of the Securities Exchange Act by effectuating its unapproved interpretation under review here in conducting its Offer to Purchase Exercise Right Privileges. It is nothing but a *post-hoc* rationalization to try to ameliorate a knowing and purposeful violation of law and should not be countenanced. Indeed, the CBOE's letter expressly concedes that its Offer to Purchase effectuates the unapproved interpretation

under review here by expressly acknowledging that the interpretation is "integrated" into its Offer to Purchase. Moreover, the CBOE's statements at page 8 that, prior to the effectiveness of the CBOT's restructuring, it discussed with the Commission staff the concept of "provisionally" interpreting Article Fifth(b), is an admission that it knew the law did not otherwise permit it to effectuate the interpretation in advance of Commission approval.

The CBOE's comment letter, at best, effectively asks the Commission to "look the other way" when compliance with the law would otherwise be inconvenient for the Exchange's timetable for its business agenda. Its comment letter even goes so far as to contend that a violation of Section 19 is not "relevant" to the Commission's determination of the issues here. To the contrary, the CBOE and its opinion of counsel rest the validity of the interpretation on the conclusion that the CBOE is acting in good faith. A wilful violation of Section 19 has to be relevant to the assessment of good faith.

The CBOE's contention that it may effectuate the unapproved interpretation under review here because the CBOT's rules still purport to recognize the Exercise Right is frivolous. The CBOT's rules are not within the purview of Section 19 and their self-serving treatment of the Exercise Right have no bearing on the meaning of the *CBOE's* Article Fifth(b). The CBOE Board's argument at most reflects a misguided view that its job is to constantly change the meaning of Article Fifth(b)'s Exercise Right to fit it to the CBOT's unilateral changes to the its organization and rules, which the CBOT undertakes to suit its own independent business objectives. The CBOE's job should be to apply Article Fifth(b) according to its long established meaning and, if it wants to change that meaning, to conduct the vote required by its Articles of Incorporation to amend the Article.

The CBOE's letter also mischaracterizes the facts regarding the Offer erroneously to imply that the Offer is permissible because it started before the CBOT's restructuring went into effect. The CBOE originally announced on March 1, 2005 *its intention* to start its Offer, but never formally distributed any Offer materials or commenced the Offer, because on or about March 7, 2005 the effectiveness of the Commission's February 25, 2005 Order in SR-CBOE-2004-16 on which the CBOE then intended to rely in commencing its Offer was stayed. The stay ended April 18, 2005. The CBOT's reorganization went into effect April 22, 2005.

Thereafter, on or about April 25 or 26, 2005, the CBOE commenced its Offer (by actually distributed an Offer) *for the first time* – obviously, after the CBOT's reorganization had occurred. In doing so, it specifically relied on the interpretation of "member of [CBOT]" in Article Fifth(b) under review here in order to direct it to the new shareholders of "**the requisite number of Series A shares of CBOT Holdings, Inc., the requisite number of Series B-1 shares of its trading subsidiary …, and the Exercise Right associated with such Series B-1 shares….**" (CBOT Offer to Purchase at page 1 (bold-faced type in the original).) Accordingly, the CBOE's suggestion that the Offer started at a time when it was lawful and simply spanned a time period when it became impermissible is false. The CBOE Offer thus started April 25 or 26 – after the CBOT reorganization and in knowing reliance on the unapproved interpretation.

The CBOE had clear notice of this dilemma months ago. Previously, in letters and submissions in SR-CBOE-2004-16 in November and December 2004 and February 2005, I had advised the CBOE and the Commission of the dilemma that would arise if the CBOE refrained from timely submitting the 2001 interpretation for Commission review until after the CBOT reorganization. In addition, I advised the CBOE Board of the violation of Section 19 on April 26 by letter to Chairman Brodsky with copies to the other Board members and advised the Commission of it in my April 28, 2005 comment letter in these proceedings. Further, my counsel advised the Commission's General Counsel and Director of Market Regulation of the violation in his letter to them dated May 5, 2005. Rather than refraining from a violation or stopping the conduct of the Offer in light of its known violation, the CBOE has continued the Offer and it will close on May 25, 2005.

The CBOE's letter also raises an entirely new concern – whether its decision to proceed with a violative Offer to Purchase had the Commission's advance blessing, which, if true, would appear to be entirely inconsistent with the purposes of these proceedings. Specifically, the CBOE's letter at pages 8-9 attempts to justify the commencement of the Offer to Purchase prior to any Commission approval of the interpretation under review here on the basis that the CBOE apparently had a reasonable expectation that the Commission would approve the CBOE's purported interpretation before the Offer to Purchase closes. By its terms, the Offer to Purchase closes May 25, 2005, although the CBOE also has the right to extend the period of the Offer.

Based on the experience of the related proposed rule change review proceeding SR-CBOE-2004-16 (which took many months to conclude), the CBOE could not have had a reasonable expectation on April 26, 2005, when it commenced its Offer to Purchase, or even on the date of the its comment letter, May 6, that these proceedings will be concluded before May 25, 2005. In these circumstances, such CBOE representations raise issues whether the CBOE, prior to commencing its Offer to Purchase on or about April 26, 2005, received from the Commission some sort of assurance *ex parte* that the purported "interpretation" that is the subject of these proceedings in fact *would be approved before May 25, 2005*. Such assurances would be highly irregular because at the time the Offer to Purchase commenced the period for filing of public comments had not expired and comments in fact were not filed until April 28. Underscoring the concerns about regularity is the fact that the CBOE had earlier advised me that it was in "close communication with the SEC" with respect to its Offer to Purchase, implying that the CBOE's decision to proceed with the Offer had the blessing of the SEC. (See the enclosed letter from Joanne Moffic-Silver, Esq. to Marshall Spiegel dated April 28, 2005.)[2] Further, the fact that the Commission has failed to take any appropriate action with respect to this violation – especially in light of the CBOE's lack of any valid justification for its conduct – underscores the concern that the CBOE's Offer was commenced with secret assurances from the Commission. Any secret assurances that the interpretation would be approved and, indeed, would be approved by a certain date would violate the Administrative Procedure Act and render the public comment procedure in these proceedings meaningless.

Cordially,

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Lake Forest, IL 60045

Enclosure

[2] The CBOE letter at page 8, in discussing its "provisional" interpretation theory, states that the Commission staff advised CBOE it could provisionally effectuate the interpretation provided the effectuation was "completely reversible." That advice, however, has no application to the Offer. The Offer was a voluntary act initiated by the CBOE in its discretion. It was not within the category of acts that the CBOE claims it had "no choice" but to do following the CBOT's restructuring.