

arguments concerning Amendment No. 2, including whether it is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-63 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2004-63. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2004-63 and should be submitted on or before August 9, 2005.

#### V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (File No. SR-

CBOE-2004-63), as amended, is approved, and that Amendment No. 2 thereto is approved on an accelerated basis, as a pilot program, through July 12, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Jill M. Peterson**

*Assistant Secretary*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52017; File No. SR-CBOE-2005-46]

#### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Establishment of PAR Officials

July 12, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 10, 2005, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On July 1, 2005, CBOE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend its rules relating to Designated Primary Market Makers ("DPMs"). The text of the proposed rule change, as amended, is below. Proposed new language is in italics; deletions are in brackets.

\* \* \* \* \*

<sup>14</sup> 17 CFR 200.30-3(a)(12).

<sup>15</sup> U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 replaced the original rule filing in its entirety. In Amendment No. 1, CBOE added amendments to certain Exchange Rules relating to the operation of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan") to accommodate the implementation of the proposed PAR Official Rules and other proposed rule changes described herein.

Chicago Board Options Exchange, Incorporated Rules

\* \* \* \* \*

#### Rule 6.7. Exchange Liability

(a)-(c) No Change.

\* \* \* Interpretations and Policies:

.01 Rule 7.11 governs the liability of the Exchange for claims arising out of errors or omissions of an Order Book Official or his/her assistants or clerks or a PAR Official or his/her assistants or clerks.

.02-.04 No Change.

\* \* \* \* \*

#### Rule 6.8. RAES Operations

No Change.

\* \* \* Interpretations and Policies:

.01 No Change.

.02 (a) No Change.

(b) In respect of those classes of options that have been specifically designated by the appropriate Floor Procedure Committee as coming within the scope of this sentence ("automatic step-up classes"), under circumstances where the Exchange's best bid or offer is inferior to the current best bid or offer in another market by no more than the "step-up amount" as defined below, such orders will be automatically executed on RAES at the current best bid or offer in the other market.

(i) In respect of automatic step-up classes of options under circumstances where the Exchange's best bid or offer is inferior to the current best bid or offer in another market by more than the step-up amount, or

(ii) In respect of series of option classes designated by the appropriate Floor Procedure Committee or its Chairman under circumstances where the NBBO for one of the series is crossed (e.g., 6.10 bid, 6 asked) or locked (e.g., 6 bid, 6 asked), or

(iii) In respect of specified automatic step-up classes or series of options or specified markets under circumstances where the Chairman of the appropriate Floor Procedure Committee or his designee has determined that automatic step-up should not apply because quotes in such options or markets are deemed not to be reliable, or

(iv) In respect of classes of equity options other than automatic step-up classes where the Exchange's best bid or offer is inferior to the current best bid or offer in another market by any amount, such orders will be rerouted for non-automated handling to [the DPM or OBO] a PAR workstation in the trading crowd for that class of options, or to any other location in the event of system problems or contrary routing instructions from the firm that

<sup>13</sup> Id.

forwarded the order to RAES. If the order has been rerouted to the [DPM or OBO] PAR workstation in the trading crowd, the [DPM or] OBO, or PAR Official will report the execution or non-execution of such orders to the firm that originally forwarded the order to RAES. With respect to the orders that are rerouted for manual handling pursuant to (ii) above, the appropriate Floor Procedure Committee may determine to have the orders for a particular series within a designated class of options executed on RAES notwithstanding the fact that the NBBO is either crossed or locked. Also, with respect to (ii) above, the appropriate Floor Procedure Committee may determine to have the orders rerouted for manual handling only when the CBOE RAES becomes crossed or locked as a result of applying the step-up amount.

As used in this Interpretation and Policy .02, the "step-up amount" shall be expressed in an amount consistent with the minimum trading increment for options of that series established pursuant to Rule 6.42. The appropriate Floor Procedure Committee shall determine the step-up amount in respect of specified automatic step-up classes or series of options and may vary the "step-up amount" on the basis of order size parameters. The procedures described in this Interpretation .02 shall not apply in circumstances where a "fast market" in the options that are the subject of the orders in question has been declared on the Exchange or where comparable conditions exist in the other market such that firm quote requirements do not apply.

\* \* \* \* \*

Rule 6.13. CBOE Hybrid System's Automatic Execution Feature

- (a) No Change.
- (b) Automatic Execution.
- (i)-(iii) No Change.
- (iv) Executions at NBBO: Eligible orders in classes that are multiply traded will not be automatically executed on CBOE at prices that are inferior to the NBBO and instead shall route to a [DPM's] PAR [terminal] workstation in the trading crowd or, at the order entry firm's discretion, to BART. Eligible orders received while the CBOE market is locked (e.g., \$1.00 bid-\$1.00 offered) shall be eligible for automatic execution at CBOE's disseminated quote, provided that the disseminated quote is not inferior to the NBBO.

(c)-(e) No Change.

\* \* \* \* \*

Rule 6.20. Admission to and Conduct on the Trading Floor; Member Education

(a) Admission to Trading Floor. Unless otherwise provided in the Rules, no one but a member, [or] an Order Book Official designated by the Exchange pursuant to Rule 7.3, or PAR Official designated by the Exchange pursuant to Rule 7.12 shall make any transaction on the floor of the Exchange. Admission to the floor shall be limited to members, employees of the Exchange, clerks employed by members and registered with the Exchange, service personnel and Exchange visitors authorized admission to the floor pursuant to Exchange policy, and such other persons permitted admission to the floor by the President of the Exchange.

(b)-(e) No Change.  
\* \* \* Interpretations and Policies:

- .01 No Changes.
- .02 Order Book Officials and PAR Officials may effect transactions on the floor only in the classes of option contracts to which they have been assigned and only in their capacity as Order Book Officials or PAR Officials.

.03-.10 No Change.  
\* \* \* \* \*

Rule 6.80. Definitions

- (1)-(11) No Change.
- (12) "Linkage Order" means an Immediate or Cancel order routed through the Linkage as permitted under the Plan. There are three types of Linkage Orders:

(i) "Principal Acting as Agent ('P/A') Order," which is an order for the principal account of a Market-Maker (or equivalent entity on another Participant Exchange that is authorized to represent Customer orders) reflecting the terms of a related unexecuted Customer order [for which the Market-Maker is acting as agent];

- (ii)-(iii) No Change.
- (13)-(21) No Change.

\* \* \* \* \*

Rule 6.81. Operation of the Linkage

By subscribing to the Plan, the Exchange has agreed to comply with, and enforce compliance by its members with, the Plan. In this regard, the following shall apply:

- (a)-(d) No Change.
- (e) Receipt of Orders. The Exchange will provide for the execution of P/A Orders and Principal Orders if its disseminated quotation is (i) equal to or better than the Reference Price, and (ii) equal to the then-current NBBO. Subject to paragraph (c) above, if the size of a P/A Order or Principal Order is not

larger than the Firm Customer Quote Size or Firm Principal Quote Size, respectively, the Exchange will provide for the execution of the entire order, and shall execute such order in its automatic execution system if that system is available. If the size of a P/A Order or Principal Order is larger than the Firm Customer Quote Size or Firm Principal Quote Size, respectively, or if the linkage order received is not eligible to be executed automatically, the Market-Maker or the Exchange must address the order within 15 seconds to provide an execution for at least the Firm Customer Quote Size or Firm Principal Quote Size, respectively. If the order is not executed in full, the Exchange will move its disseminated quotation to a price inferior to the Reference Price.

\* \* \* \* \*

Rule 6.83. Order Protection

- (a) Avoidance and Satisfaction of Trade-Throughs.
- (1) General Provisions. Absent reasonable justification and during normal market conditions, members and the Exchange should not effect Trade-Throughs. Except as provided in paragraph (b) below, if a member or the Exchange effects a Trade-Through with respect to the bid or offer of a Participant Exchange in an Eligible Option Class and the Exchange receives a complaint thereof from an Aggrieved Party, either:

(i) the [member] party who initiated the Trade-Through shall satisfy, or cause to be satisfied, through the Linkage the Aggrieved Party in accordance with subparagraph (a)(2) below; or

(ii) if the member or the Exchange elects not to do so (and, in the case of Third Participating Market Center Trade-Through, the member or the Exchange obtains the agreement of the contra party that received the Linkage Order that caused the Trade-Through), then the price of the transaction that constituted the Trade-Through shall be corrected to a price at which a Trade-Through would not have occurred. If the price of the transaction is corrected, the [Member] party correcting the price shall report the corrected price to OPRA, notify the Aggrieved Party of the correction and cancel the Satisfaction Order.

(2) Price and Size. The price and size at which a Satisfaction Order shall be filled is as follows:

- (i) Price. A Satisfaction Order shall be filled at the Reference Price. However, if the Reference Price is the price of an apparent Block Trade that caused the Trade-Through, and such trade was not, in fact, a Block Trade, then the Member

or the Exchange may cancel the Satisfaction Order. In that case, the Member or the Exchange shall inform the Aggrieved Party within three minutes of receipt of the Satisfaction Order of the reason for the cancellation. Within three minutes of receipt of such cancellation, the Aggrieved Party may rescind the Satisfaction Order with a Reference Price of the bid or offer that was traded through.

(ii) Size. An Aggrieved Party may send a Satisfaction Order up to the lesser of the size of the Verifiable Number of Customer Contracts that were included in the disseminated bid or offer that was traded through and the size of the transaction that caused the Trade-Through. Subject to subparagraph (2)(i) above and paragraph (b) below, a Member or the Exchange shall fill in full all Satisfaction Orders it receives following a Trade-Through, subject to the following limitations:

(A) If the transaction that caused the Trade-Through was for a size larger than the Firm Customer Quote Size with respect to any of the Participant Exchange(s) traded through, the total number of contracts to be filled, with respect to all Satisfaction Orders received in connection with any one transaction that caused a Trade-Through, shall not exceed the size of the transaction. In that case, the Member or the Exchange shall fill the Satisfaction Orders pro rata based on the Verifiable Number of Customer Contracts traded through on each Participant Exchange, and shall cancel the remainder of such Satisfaction Order(s); and

(B) No Change.

(3) Change in Status of Underlying Customer Order. During the time period that a Satisfaction Order is pending at another Participant Exchange, a Member or the Exchange shall cancel such Satisfaction Order as soon as practical if (1) the order(s) for the customer contracts underlying the Satisfaction Order are filled; or (2) the customer order(s) to buy (sell) the contracts underlying the Satisfaction Order are canceled (either being a "change in status of the underlying customer order(s)"). Notwithstanding this obligation to cancel the Satisfaction Order, within 30 seconds of receipt of notification that a Participant Exchange has filled a Satisfaction Order, the Participant that sent the Satisfaction Order may reject such fill if there has been a change in status of the underlying customer order(s), provided that the status change of the customer order occurred prior to the receipt of the Satisfaction Order fill report. However, if the underlying customer order(s) has been executed against the sender of the

Satisfaction Order, the Satisfaction Order fill report may not be rejected.

(4) Protection of Customers.

Whenever subparagraph (a)(1) applies, if Public Customer orders (or P/A Orders representing Public Customer orders) constituted either or both sides of the transaction involved in the Trade-Through, each such Public Customer order (or P/A Order) shall receive:

(i) The price that caused the Trade-Through; or

(ii) The price at which the bid or offer traded through was satisfied, if it was satisfied pursuant to subparagraph (a)(1)(i), or the adjusted price, if there was an adjustment, pursuant to subparagraph (a)(1)(ii), whichever price is most beneficial to the Public Customer order. Resulting differences in prices shall be the responsibility of the [Member] party who initiated the Trade-Through.

(b) Exceptions to Trade-Through Liability. The provisions of paragraph (a) pertaining to the satisfaction of Trade-Throughs shall not apply under the following circumstances:

(1) The [Member] party who initiated the Trade-Through made every reasonable effort to avoid the Trade-Through, but was unable to do so because of a systems/equipment failure or malfunction;

(2) the Member or the Exchange trades through the market of a Participant Exchange to which [such] the Member or the Exchange had sent a P/A Order or Principal Order, and within 20 seconds of sending such order the receiving Participant Exchange had neither executed the order in full nor adjusted the quotation traded through to a price inferior to the Reference Price of the P/A Order or Principal Order;

(3) No Change.

(4) the Trade-Through was other than a Third Participating Market Center Trade-Through and occurred during a period when, with respect to the Eligible Option Class, the Exchange's quotes were Non-Firm; provided, however, that, unless one of the other conditions of this paragraph (b) applies, during any such period: (i) [Members] all parties shall make every reasonable effort to avoid trading through the firm quotes of another Participant Exchange; and (ii) it shall not be considered an exception to paragraph (a) if a Member or the Exchange regularly trades through the firm quotes of another Participant Exchange during such period;

(5)–(8) No Change.

(9) in the case of a Third Participating Market Center Trade-Through, a Satisfaction Order with respect to the Trade-Through was not received by the

Exchange promptly following the Trade-Through. In applying this provision, the Aggrieved Party must send the Exchange a Satisfaction Order within three minutes from the time the report of the transaction that constituted the Trade-Through was disseminated over OPRA. To avoid liability for the Trade-Through, the [Member] party receiving such Satisfaction Order must cancel the Satisfaction Order and inform the Aggrieved Party of the identity of the Participant Exchange that initiated the Trade-Through within three minutes of the receipt of such Satisfaction Order (within one minute in the final five minutes of trading). The Aggrieved Party then must send the Participant Exchange that initiated the Trade-Through a Satisfaction Order within three minutes of receipt of the cancellation of the initial Satisfaction Order (within one minute in the final five minutes of trading).

(c) Responsibilities and Rights Following Receipt of Satisfaction Orders.

(1) When a Member or the Exchange receives a Satisfaction Order, that Member or the Exchange shall respond as promptly as practicable pursuant to Exchange procedures by either:

(i) specifying that one of the exceptions to Trade-Through liability specified in paragraph (b) above is applicable and identifying that particular exception; or

(ii) taking the appropriate corrective action pursuant to paragraph (a) above.

(2) If the [Member] party who initiated the Trade-Through fails to respond to a Satisfaction Order or otherwise fails to take the corrective action required under paragraph (a) within three minutes of receiving notice of a Satisfaction Order, and the Exchange determines that:

(i) There was a Trade-Through; and  
(ii) none of the exceptions to Trade-Through liability specified in paragraph (b) above were applicable; then, subject to the next paragraph, the [Member] party who initiated the Trade-Through shall be liable to the Aggrieved Party for the amount of the actual loss resulting from non-compliance with paragraph (a) and caused by the Trade-Through.

If either (a) the Aggrieved Party does not establish the actual loss within 30 seconds from the time the Aggrieved Party received the response to its Satisfaction Order (or, in the event that it did not receive a response, within four minutes from the time the Aggrieved Party sent the Satisfaction Order) or (b) the Aggrieved Party does not notify the Exchange Participant that initiated the Trade-Through of the amount of such loss within one minute

of establishing the loss, then the liability shall be the lesser of the actual loss or the loss caused by the Trade-Through that the Aggrieved Party would have suffered had that party purchased or sold the option series subject to the Trade-Through at the "mitigation price."

The "mitigation price" is the highest reported bid (in the case where an offer was traded through) or the lowest reported offer (in the case where a bid was traded through), in the series in question 30 seconds from the time the Aggrieved Party received the response to its Satisfaction Order (or, in the event that it did not receive a response, four minutes from the time the Aggrieved Party sent the Satisfaction Order). If the Participant Exchange receives a Satisfaction Order within the final four minutes of trading (on any day except the last day of trading prior to the expiration of the series which is the subject of the Trade-Through), then the "mitigation price" shall be the price established at the opening of trading in that series on the Aggrieved Party's Participant Exchange on the next trading day. However, if the price of the opening transaction is below the opening bid or above the opening offer as established during the opening rotation, then the "mitigation price" shall be the opening bid (in the case where an offer was traded through) or opening offer (in the case where a bid was traded through). If the Trade-Through involves a series that expires on the day following the day of the Trade-Through and the Satisfaction Order is received within the four minutes of trading, the "mitigation price" shall be the final bid (in the case where an offer was traded through) or offer (in the case where a bid was traded through) on the day of the trade that resulted in the Trade-Through.

(3) A Member that is an Aggrieved Party under the rules of another Participant Exchange governing Trade-Through liability (or the Exchange) must take steps to establish and mitigate any loss such Member (or the Exchange) might incur as a result of the Trade-Through of the Member's bid or offer (or an order on the Exchange's limit order book). In addition, the Member (or the Exchange) shall give prompt notice to the other Participant Exchange of any such action in accordance with subparagraph (c)(2) above.

(d) Limitations on Trade-Throughs. The Exchange and [M]embers may not engage in a pattern or practice of trading through better prices available on other exchanges, whether or not the exchange or exchanges whose quotations are traded through are Participant

Exchanges, unless one or more of the provisions of paragraph (b) above are applicable. In applying this provision:

(1) The Exchange will consider there to have been a Trade-Through if a [Member executes a] trade is executed at a price inferior to the NBBO even if the Exchange does not receive a Satisfaction Order from an Aggrieved Party pursuant to subparagraph (a)(1);

(2) The Exchange will not consider there to have been a Trade-Through if a [Member executes a] Block Trade is executed at a price inferior to the NBBO if [such Member satisfied] all Aggrieved Parties are satisfied pursuant to subparagraph (a)(2) following the execution of the Block Trade; and

(3) The Exchange will not consider there to have been a Trade-Through if a [Member executes a] trade is executed at a price inferior to the quotation being disseminated by an exchange that is not a Participant Exchange if [the Member made] a good faith effort was made to trade against the superior quotation of the non-Participant Exchange prior to trading through that quotation. A "good faith" effort to reach a non-Participant Exchange's quotation requires that a Member or the Exchange at least had sent an order that day to the non-Participant Exchange in the class of options in which there is a Trade-Through, at a time at which such non-Participant Exchange was not relieved of its obligation to be firm for its quotations pursuant to Rule 11Ac1-1 under the Exchange Act, and such non-Participant Exchange neither executed that order nor moved its quotation to a price inferior to the price of the [Member's] order within 20 seconds of receipt of that order.

\* \* \* \* \*

Rule 7.6. Duty to Report Unusual Activity

When, in the opinion of a Board Broker, PAR Official or Order Book Official, there is any unusual activity, transaction, or price change or there are other unusual market conditions or circumstances which are, with respect to any option contract in which he is acting as Board Broker, PAR Official or Order Book Official, detrimental to the maintenance of a fair and orderly market, he shall promptly make a report to a Floor Official.

\* \* \* Interpretations and Policies:

.01 To the extent unusual activity is apparent only through the inspection of trade tickets, a Board Broker, PAR Official or Order Book Official is not responsible for reporting such activity unless the trade tickets are brought to his attention.

\* \* \* \* \*

Rule 7.11. Liability of Exchange for Actions of Board Brokers, [and] Order Book Officials, and PAR Officials

(a) In no event shall the Exchange be liable to members or persons associated therewith for any loss, expense, damages or claims arising out of any errors or omissions of a Board Broker or person associated therewith. Except to the extent provided in paragraph (b) of this Rule, the Exchange's liability to members or persons associated therewith for any loss, expense, damages or claims arising out of any errors or omissions of an Order Book Official or PAR Official or the assistants or clerks of an Order Book Official or PAR Official shall be subject to the limitations set forth in paragraph (a) of Rule 6.7 and to the further limitations set forth in paragraphs (b) and (c) of this Rule.

(b)(1) As used in this paragraph (b), the term "transaction" shall mean any single order or instruction which is placed with an Order Book Official or PAR Official, or any series of orders or instructions which is placed with an Order Book Official or a PAR Official at substantially the same time by the same member, and which relates to any one or more series of options of the same class. All errors and omissions made by an Order Book Official or PAR Official with respect to or arising out of any transaction shall give rise to a "single claim" against the Exchange for losses resulting therefrom as provided in this paragraph (b) and in paragraph (c), and the Exchange shall be free to assert any defense to such claim it may have. No claim shall arise as to errors or omissions which are found to have resulted from any failure by a member (whether or not the member is claiming against the Exchange pursuant to this paragraph (b)), or by any person acting on behalf of a member, to enter or cancel an order with such Order Book Official or PAR Official on a timely basis or clearly and accurately to communicate to such Order Book Official or PAR Official:

(i)-(vi) No Change.

In addition, no claim shall be allowed if, in the opinion of the arbitration panel provided for in subparagraph (3) of this paragraph (b), the member or other person making such claim did not take promptly, upon discovery of the errors or omissions, all proper steps to correct such errors or omissions and to establish the loss resulting therefrom.

(2) Absent reasonable justification or excuse, any claim by members or persons associated with members for losses arising from errors or omissions of an Order Book Official or PAR

Official, and any claim by the Exchange made pursuant to paragraph (d) of this Rule, shall be presented in writing to the opposing party within ten business days following the transaction giving rise to the claim; provided, that if an error or omission has resulted in an unmatched trade, then any claim based thereon shall be presented after the unmatched trade has been closed out in accordance with Rule 10.1 but within ten business days following such resolution of the unmatched trade.

(3)–(4) No Change.

(c) No Change.

(d) If any damage is caused by an error or omission of an Order Book Official or PAR Official which is the result of any error or omission of a member organization, then such member organization shall indemnify the Exchange and hold it harmless from any claim of liability resulting from or relating to such damage.

(e) No Change.

#### Rule 7.12 PAR Official

(a) A PAR Official is an Exchange employee or independent contractor whom the Exchange may designate as being responsible for (i) operating the PAR workstation in a DPM trading crowd with respect to the classes of options assigned to him/her; (ii) when applicable, maintaining the book with respect to the classes of options assigned to him/her; and (iii) effecting proper executions of orders placed with him/her. The PAR Official may not be affiliated with any member that is approved to act as a market maker.

(b) The PAR Official shall be responsible for the following obligations with respect to the classes of options assigned to him/her:

(i) *Display Obligation:* Each PAR Official shall display immediately the full price and size of any customer limit order that improves the price or increases the size of the best disseminated CBOE quote. For purposes of this Rule 7.12(b), “immediately” means, under normal market conditions, as soon as practicable but no later than 30 seconds after receipt (“30-second standard”) by the PAR Official. The term “customer limit order” means an order to buy or sell a listed option at a specified price that is not for the account of either a broker or dealer; provided, however, that the term “customer limit order” shall include an order transmitted by a broker or dealer on behalf of a customer.

The following are exempt from the Display Obligation as set forth under this Rule:

(A) An order executed upon receipt;

(B) An order where the customer who placed it requests that it not be displayed, and upon receipt of the order, the PAR Official announces in public outcry the information concerning the order that would be displayed if the order were subject to being displayed;

(C) An order for which immediately upon receipt a related order for the principal account of a DPM reflecting the terms of the customer order is routed to another options exchange that is a participant in the Intermarket Options Linkage Plan;

(D) The following orders as defined in Rule 6.53: contingency orders; one-cancels-the-other orders; all or none orders; fill or kill orders; immediate or cancel orders; complex orders (e.g., spreads, straddles, combinations); and stock-option orders;

(E) Orders received before or during a trading rotation (as defined in Rule 6.2, 6.2A, and 6.2B), including Opening Rotation Orders as defined in Rule 6.53(l), are exempt from the 30-second standard, however, they must be displayed immediately upon conclusion of the applicable rotation; and

(F) Large Sized Orders: Orders for more than 100 contracts, unless the customer placing such order requests that the order be displayed.

(ii) *Execution.* The PAR Official shall use due diligence to execute the orders placed in the PAR Official’s custody at the best prices available to him or her under the Rules of the Exchange.

(iii) A PAR Official shall not remove from the public order book any order placed in the book unless (A) the order is canceled, expires, transmitted through the Intermarket Options Linkage Plan, or is executed or (B) the PAR Official returns the order to the member that placed the order with the PAR Official in response to a request from that member to return the order;

(iv) *Autobook:* A PAR Official shall maintain and keep active on the PAR workstation at all times the automated limit order display facility (“Autobook”) provided by the Exchange. Only a senior trading operations official of the Exchange may determine the length of the Autobook timer for PAR Officials and a PAR Official may deactivate Autobook only with the approval of a senior trading operations official. For the purposes of this rule, a “senior Trading Operations official” is any duly appointed officer in the Exchange’s Trading Operations Division.

(c) *Compensation of PAR Officials.* The PAR Official shall be compensated exclusively by the Exchange, which shall determine the amount and form of compensation. No DPM, e-DPM, or

market maker shall directly or indirectly compensate or provide any other form of consideration to a PAR Official.

(d) *Liability of Exchange for Actions of PAR Officials.* The Exchange’s liability to members or persons associated therewith for any loss, expense, damages or claims arising out of any errors or omissions of a PAR Official or any persons providing assistance to a PAR Official shall be subject to Exchange rules, including the limitations set forth in Rule 6.7, Rule 6.7A, and Rule 7.11.

(e) *Linkage Obligations.* In connection with the performance of the PAR Official’s duties, the PAR Official shall be responsible for manually or automatically (1) routing linkage Principal Acting as Agent (“P/A”) Orders, Principal (“P”) Orders on behalf of orders in the custody of the PAR Official that are for the account of a broker-dealer (“P-BD Orders”), and Satisfaction Orders to other markets based on prior written instructions that must be provided by the DPM to the PAR Official (utilizing the DPM’s account); and (2) handling all linkage orders or portions of linkage orders received by the Exchange that are not automatically executed. When handling outbound P/A Orders, P-BD Orders and Satisfaction Orders, the PAR Official shall use due diligence to execute the orders entrusted to him/her and shall act in accordance with the prior written instructions provided by the DPM for P/A Orders, P-BD Orders, and Satisfaction Orders that the PAR Official represents. A PAR Official also shall act in accordance with CBOE rules regarding P/A, P, and Satisfaction Orders received through the Linkage.

\* \* \* Interpretations and Policies:

.01 The Exchange shall assign a PAR Official to all applicable trading stations on or before [enter date 90 days after the effective date of this rule change].

\* \* \* \* \*

#### Rule 8.51 Firm Disseminated Market Quotes

(a)–(f) No Change.

\* \* \* Interpretations and Policies:

.01–.09 No Change.

.10 Timing of Firm Quote Obligations [in a DPM Trading Crowd]

[(a) Non-Hybrid Classes]

For purposes of determining when the firm quote obligations under Rule 8.51 attach in respect of orders received at a PAR workstation [terminal in a DPM trading crowd] and how the exemptions to that obligation provided in paragraph (e) of that Rule apply, [the responsible broker or dealer shall be deemed to receive an order, and] an order shall be deemed to be presented to the

responsible broker or dealer, at the time the order is announced to the trading crowd [received on the DPM's PAR workstation].

(b) Hybrid Classes

For purposes of determining when the firm quote obligations under Rule 8.51 attach with respect to orders received at a PAR workstation in a DPM trading crowd and how the exemptions to that obligation provided in paragraph (e) of that rule apply, the responsible broker or dealer shall be deemed to receive an order, and an order shall be deemed presented to the responsible broker or dealer

(i) At the time the order is announced to the trading crowd with respect to each responsible broker or dealer that is not the DPM for the class; and

(ii) At the time the order is received on PAR with respect to the DPM as the responsible broker or dealer.

As such, firm quote obligations for an order received on PAR may attach at two separate times for different responsible broker or dealers: at the time of receipt with respect to the DPM as a responsible broker or dealer and at the time of announcement with respect to non-DPM members of the trading crowd as responsible brokers or dealers.]

.11 No Change.

\* \* \* \* \*

Rule 8.60. Evaluation of Trading Crowd Performance

(a) The Exchange's appropriate Market Performance Committee ("Committee") shall periodically evaluate the performance of Designated Primary Market-Makers ("DPMs"), market makers, and other members both individually and collectively as trading crowds in order to determine whether they are satisfactorily meeting their market responsibilities[, including, in the case of DPMs, both market-making and agency responsibilities]. For purposes of this rule, a DPM, a market-maker, other members or a trading crowd may be referred to as a market participant ("Market Participants"). The evaluation may depend in part on the results of a survey of members administered by the Exchange, designed to assist the Committee in determining the absolute and relative performance of Market Participants. The survey may consist of a questionnaire that solicits the views of members on the performance of Market Participants in respect of (1) quality of markets, (2) extent of competition in the crowd, (3) due diligence in representing orders as agent, (4) adherence to ethical standards, (5) carrying out administrative responsibilities, and (6)

such other matters as the Exchange may deem relevant.

In addition to the survey, the Committee may also consider any other relevant information, including but not limited to statistical measures of performance and such other factors and data as the Committee may determine to be pertinent to the evaluation of Market Participants.

(b)-(g) No Changes.

\* \* \* Interpretations and Policies:

.01-.02 No Changes.

\* \* \* \* \*

Rule 8.80. DPM Defined

A "Designated Primary Market Maker" or "DPM" is a member organization that is approved by the Exchange to function in allocated securities as a Market-Maker (as defined in Rule 8.1) and is subject to the obligations under Rule 8.85 or as otherwise provided under the rules of the Exchange.], as a Floor Broker (as defined in Rule 6.70), and as an Order Book Official (as defined in Rule 7.1.) Determinations concerning whether to grant or withdraw the approval to act as a DPM are made by the Modified Trading System Appointments Committee ("MTS Committee") in accordance with Rules 8.83 and 8.90. DPMs are allocated securities by the Allocation Committee and the Special Product Assignment Committee in accordance with Rule 8.95.

Rule 8.81. DPM Designees

(a) No Change.

(b) Notwithstanding any other rules to the contrary, an individual must satisfy the following requirements in order to be a DPM Designee of a DPM:

(i)-(ii) No Change.

(iii) the individual must be registered as a Market-Maker pursuant to Rule 8.2 [and as a Floor Broker pursuant to Rule 6.71];

(iv)-(v) No Change.

Notwithstanding the provisions of subparagraph (b)(ii) of this Rule, the MTS Committee shall have the discretion to permit an individual who is not affiliated with a DPM to act as a DPM Designee for the DPM on an emergency basis provided that the individual satisfies the other requirements of subparagraph (b) of this Rule.

(c)-(d) No Change.

(e) A DPM Designee of a DPM may not trade as a Market-Maker [or Floor Broker] in securities allocated to the DPM unless the DPM Designee is acting on behalf of the DPM in its capacity as a DPM. [When acting on behalf of a DPM in its capacity as a DPM, a DPM

Designee is exempt from the provisions of Rule 8.8.]

\* \* \* \* \*

Rule 8.85 DPM Obligations

(a) Dealer Transactions. Each DPM shall fulfill all of the obligations of a Market-Maker under the Rules, and shall satisfy each of the following requirements in respect of each of the securities allocated to the DPM. To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (a)(i) through (a)[(xiii)](xiv) of this Rule and the general obligations of a Market Maker under the Rules, subparagraphs (a)(i) through (a)[(xiii)](xiv) of this Rule shall govern. Each DPM shall:

(i)-(xiii) No change.

(xiv) The DPM's account shall be used for P/A Orders and Satisfaction Orders routed by the Exchange for the benefit of an underlying customer order, and shall be used for P Orders routed by the Exchange for the benefit of an underlying broker-dealer order and to fill incoming Satisfaction Orders that result from a Trade Through that the Exchange effects. Further, the DPM shall be responsible for any charges incurred in the execution of such linkage orders.

A DPM must provide to the Exchange written instructions for routing P/A Orders, P Orders on behalf of orders in the custody of the Exchange that are for the account of a broker-dealer, and Satisfaction Orders to other markets.

(b) Agency Transactions. [Each] A DPM shall not execute [fulfill all of the obligations of a Floor Broker or Order Book Official] orders as an agent or Floor Broker in its allocated option classes. [(to the extent that the DPM acts as a Floor Broker) and of an Order Book Official under the Rules, and shall satisfy each of the requirements contained in this paragraph, in respect of each of the securities allocated to the DPM. To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b)(i) through (b)(vii) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b)(i) through (b)(vii) of this Rule shall govern.

(i) Display Obligation: Each DPM shall display immediately the full price and size of any customer limit order that improves the price or increases the size of the best disseminated CBOE quote. "Immediately" means, under normal market conditions, as soon as practicable but no later than 30-seconds after receipt ("30-second standard") by the DPM. The term "customer limit order" means an order to buy or sell a

listed option at a specified price that is not for the account of either a broker or dealer; provided, however, that the term customer limit order shall include an order transmitted by a broker or dealer on behalf of a customer. The following are exempt from the Display Obligation as set forth under this Rule:

(A) An order executed upon receipt;

(B) An order where the customer who placed it requests that it not be displayed, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were subject to being displayed;

(C) An order for which immediately upon receipt a related order for the principal account of a DPM reflecting the terms of the customer order is routed to another options exchange that is a participant in the Intermarket Options Linkage Plan;

(D) The following orders as defined in Rule 6.53: Contingency orders; one-cancels-the-other orders; all or none orders; fill or kill orders; immediate or cancel orders; complex orders (*e.g.*, spreads, straddles, combinations); and stock-option orders;

(E) Orders received before or during a trading rotation (as defined in Rule 6.2, 6.2A, and 6.2B), including Opening Rotation Orders as defined in Rule 6.53(l), are exempt from the 30-second standard, however, they must be displayed immediately upon conclusion of the applicable rotation; and

(F) Large Sized Orders: Orders for more than 100 contracts, unless the customer placing such order requests that the order be displayed.

(ii) Not remove from the public order book any order placed in the book unless (A) the order is canceled, expires, or is executed or (B) the DPM returns the order to the member that placed the order with the DPM in response to a request from that member to return the order;

(iii) Accord priority to any customer order which the DPM represents as agent over the DPM's principal transactions, unless the customer who placed the order has consented to not being accorded such priority;

(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.

(v) Act as a Floor Broker to the extent required by the MTS Committee; and

(vi) Not represent discretionary orders as a Floor Broker or otherwise.

(vii) Autobook Pilot. Maintain and keep active on the DPM's PAR workstation at all times the automated limit order display facility ("Autobook") provided by the Exchange. The appropriate Exchange Floor Procedure Committee will determine the Autobook timer in all classes under that Committee's jurisdiction. A DPM may deactivate Autobook as to a class or classes provided that Floor Official approval is obtained. The DPM must obtain such approval no later than three minutes after deactivation.]

(c)-(d) No Change.

(e) Requirement to Own Membership. Each DPM organization shall own at least one Exchange membership for each trading location in which the organization serves as a DPM. For purposes of this Rule, a trading location is defined as any separate identifiable unit of a DPM organization that applies for and is allocated option classes by the appropriate Allocation Committee. An Exchange membership shall include a transferable regular membership or a Chicago Board of Trade full membership that has effectively been exercised pursuant to Article Fifth(b) of the Certificate of Incorporation. The same Exchange membership(s) may not be used to satisfy this ownership requirement for different DPM organizations or different trading locations operated by the same DPM organization. [Each DPM shall have until May 12, 2003 to satisfy this ownership requirement, but each DPM organization must continually own at least one membership until that date.]

*A DPM organization shall be exempt from the membership requirement under Rule 8.85(e) for the period of [enter effective date of this rule change] to [enter a date 90 days from the effective date of this rule change] if the DPM organization falls out of compliance with Rule 8.85(e) because the Exchange membership used to satisfy Rule 8.85(e) was, at the time the DPM organization fell out of compliance with Rule 8.85(e), held by an individual whose affiliation with the DPM organization has been terminated as a result of the implementation of Rule 7.12.*

\* \* \* Interpretations and Policies:

.01 [The Exchange may make personnel available to assist a DPM in the DPM's performance of the obligations of an Order Book Official, for which the Exchange may charge the DPM a reasonable fee.

.02] Willingness to promote the Exchange as a marketplace includes assisting in meeting and educating market participants (and taking the time for travel related thereto), maintaining communications with member firms in order to be responsive to suggestions and complaints, responding to suggestions and complaints, and other like activities.

[.03] .02 Reserved.

[.04] .03 A DPM organization shall be deemed to own an Exchange membership for purposes of paragraph (e) of this Rule if a natural person owner of the DPM organization owns an Exchange membership that would otherwise qualify under paragraph (e) and such individual meets the following criteria: (1) Owns at least a 45% equity interest in the DPM organization; (2) maintains at least a 45% profit participation in the DPM organization; (3) is actively involved in the management of the DPM operation; and (4) maintains a constant presence on the Exchange trading floor as a primary DPM designee of the DPM organization.

\* \* \* \* \*

## II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

The purpose of this proposed rule change is to remove a DPM's obligation and ability to execute orders as an agent or Floor Broker in its allocated securities on the Exchange in any trading station. This proposed rule change also would allow the Exchange to designate an Exchange employee or independent contractor ("PAR Official") to be responsible for operating the PAR workstation in a trading station. Finally,

this proposed rule change also would implement several other amendments to conform other Exchange rules to the aforementioned changes, as detailed herein. Amendment No. 1, which supersedes the original rule filing in its entirety, proposes additional changes to certain Exchange rules relating to the operation of the Linkage Plan to accommodate the implementation of the pertinent PAR Official rules and the other proposed rule changes described herein.<sup>4</sup>

By rule, the Exchange has the authority to determine the extent to which an individual DPM must represent orders as a Floor Broker.<sup>5</sup> The Exchange's uniform practice has been to require DPMs to act as Floor Brokers for the classes of options assigned to them. Accordingly, all DPMs on CBOE presently act as both agent and principal for orders in their respective allocated securities. The Exchange has now determined that it is in the best interest of the Exchange, its members and investors to eliminate a DPM's floor brokerage duties. This change would afford DPMs the ability to concentrate their efforts exclusively on their market-making functions and would eliminate the inherent risks associated with DPMs acting as both principal and agent with respect to orders they handle and trades they make as DPMs. The Exchange also believes that the responsibility for executing agency orders at DPM trading stations should be administered by an Exchange employee or independent contractor who has no interest that might conflict with the duties owed to the customer. The following will summarize the effects this proposed rule change would have on existing Exchange rules.

#### *Agency Responsibilities*

Generally, CBOE Rules 8.80 through 8.91 govern DPMs on the Exchange, and CBOE Rule 8.85 describes the specific obligations imposed on a DPM, including the general obligation, with respect to each of its allocated securities, to fulfill all of the obligations of a Market-Maker, of a Floor Broker (to the extent that the DPM acts as a Floor Broker), and of an Order Book Official under Exchange Rules. CBOE Rule 8.85(b), in particular, describes the several Floor Broker and agency functions that a DPM must perform.<sup>6</sup>

<sup>4</sup> Exchange rules governing the operation of the Linkage Plan are set forth under CBOE Rules 6.80 through 6.85.

<sup>5</sup> See CBOE Rule 8.85(b)(v).

<sup>6</sup> This authority is delegated by CBOE Rule 8.85(b) to the Exchange's Modified Trading System Appointments Committee. Under CBOE's current Rules, it is up to the MTS Committee to decide whether and to what extent an individual DPM

Some of these functions are currently determined at the discretion of the MTS Committee. This rule change proposes to eliminate provisions providing for the DPMs' broker and agency functions and would provide that DPMs "shall not execute orders as an agent or Floor Broker in its allocated option classes." Instead, the Exchange proposes to create a new category of market participant (the "PAR Official") who will be responsible for operating the PAR workstation in the trading stations. This responsibility would include handling and executing orders that are routed to the PAR workstation.

The PAR Official would be an Exchange employee or independent contractor designated by the Exchange to be responsible for (i) operating the PAR workstation; (ii) when applicable, maintaining the customer limit order book for the assigned option classes;<sup>7</sup> and (iii) effecting proper executions of orders placed with him or her. The PAR Official would be prohibited from having an affiliation with any member that is approved to act as a market maker on the Exchange.

#### *Other Affected Rules*

Other Exchange rules also must be amended to allow the Exchange to reassign agency responsibilities and obligations from the DPM to the PAR Official, as detailed below.

**Display Obligation.** Currently, under CBOE Rule 8.85(b)(i), the DPM is required to immediately display the full price and size of any eligible customer limit orders when such orders represent buying or selling interest that is at a better price than the best disseminated CBOE quote.<sup>8</sup> Because the DPM no longer would be operating the PAR workstation or executing orders as agent, the Exchange proposes to shift the display obligation in its entirety from the DPM to the PAR Official in such trading crowds.<sup>9</sup> Accordingly, the PAR Official would be required to

should be required to act as a Floor Broker. CBOE Rule 8.85(b)(v), captioned "Agency Transactions," provides that each DPM is required to "act as a Floor Broker to the extent required by the MTS Committee." This concept is echoed in the general statement of a DPM's agency responsibilities as set forth in the first sentence of CBOE Rule 8.85(b): "Each DPM shall fulfill all of the obligations of a Floor Broker (to the extent that the DPM acts as a Floor Broker) \* \* \*"

<sup>7</sup> This provision will not apply to option classes that are on the CBOE's Hybrid System.

<sup>8</sup> See CBOE Rule 8.85(b)(i); see also Exchange Act Release No. 51063 (January 21, 2005); 70 FR 4165 (January 28, 2005) (SR-CBOE-2004-35) (order approving the display obligation).

<sup>9</sup> The display obligation set forth in CBOE Rule 8.85(b)(i) would be moved to proposed rule 7.12(b)(i) and also would include the various exceptions to the display obligation that are currently applied to the DPM obligation.

maintain and keep active the Exchange's automated limit order display facility, Autobook, on the PAR workstation.

**Due Diligence Responsibility.** Under the proposed rule, the PAR Official would be required to use due diligence to execute the orders at the best prices available to him or her under the rules of the Exchange.

**Public Order Book Responsibilities.** In addition to maintaining a responsibility to book eligible orders, the PAR Official also would be prohibited from removing booked public customer orders unless (A) the order is cancelled, expires, transmitted in accordance with Intermarket Option Linkage ("Linkage") obligations, or is executed or (B) the PAR Official returns the order to the member that placed the order with the PAR Official in accordance with a request from that same member.

**Linkage Obligations.** As the DPM would no longer be executing agency orders, this responsibility, and any associated Linkage obligations that previously were handled by the DPM would now fall upon the Exchange. As an employee (or independent contractor) of the Exchange, the PAR Official would be responsible for handling Linkage orders in the option classes appointed to him or her.

Specifically, a PAR Official would have the means to (1) utilize a DPM's account to route Principal Acting as Agent ("P/A") Orders, Principal ("P") Orders on behalf of orders in the custody of the PAR Official that are for the account of a broker-dealer ("P-BD Orders"), and Satisfaction Orders to away markets based on prior instructions that must be provided by the DPM to the PAR Official and (2) handle all Linkage orders or portions of Linkage orders received by the Exchange that are not automatically executed. The PAR Official also would have the means to utilize the DPM's account to fill Satisfaction Orders that result from a Trade Through<sup>10</sup> that the Exchange effects. Because the Linkage Plan requires that P/A orders be submitted for the account of a market maker,<sup>11</sup> the PAR Official must be able to utilize the DPM's account to fulfill the Linkage obligations imposed by CBOE rules.

CBOE Rule 8.85(a) would be amended to require a DPM to make available its account to the PAR Official for the purpose of enabling the PAR Official to satisfy certain Linkage-related obligations. CBOE Rule 8.85(a) also would be amended to obligate the DPM to provide the PAR Official with written

<sup>10</sup> See CBOE Rule 6.80(19).

<sup>11</sup> See Linkage Plan Section 2(16)(a); see also CBOE Rule 6.80.

instructions for routing P/A Orders, P-BD Orders, and Satisfaction Orders to other markets.<sup>12</sup> These written instructions should also include direction as to how the PAR Official should handle responses to Linkage Orders, as provided under CBOE Rule 6.81(d).<sup>13</sup>

Finally, when handling outbound P/A Orders, P-BD Orders, and Satisfaction Orders, the PAR Official shall use due diligence to execute the orders entrusted to him/her and act in accordance with the prior written instructions provided by the DPM for P/A Orders, P-BD Orders, and Satisfaction Orders that the PAR Official represents and act in accordance with CBOE rules regarding P/A, P, and Satisfaction Orders received through the Linkage.

**Compensation of PAR Official.** As an Exchange employee or independent contractor, the PAR Official's compensation would be determined and paid solely by CBOE. No DPM, e-DPM, or market maker would be permitted to directly or indirectly compensate or provide any other form of consideration to a PAR Official.

**Liability of the Exchange for Actions of PAR Officials.** The Exchange's liability for the actions of PAR Officials would be limited in the same manner as currently provided under existing Exchange rules, including, but not limited to, CBOE Rules 6.7 (Exchange Liability), 6.7A (Legal Proceedings Against the Exchange and its Directors, Officers, Employees, Contractors or Agents), and 7.11 (Liability of Exchange for Actions of Board Brokers, Order Book Officials and PAR Officials).

**Firm Disseminated Market Quotes.** Interpretation and Policy .10 to CBOE Rule 8.51 currently provides that, in the case of an order received at PAR workstations in DPM trading crowds, the DPM's firm quote obligation attaches at the time the order is received on the PAR workstation, regardless of whether the DPM is actually aware of the order at that time. This provision is a direct consequence of the fact that the DPM currently represents such orders in its capacity as a Floor Broker from the moment such orders are received on the PAR workstation. However, because the DPM no longer would be operating the

PAR workstation if the proposed rule change were approved, Interpretation and Policy .10 to CBOE Rule 8.51 would be modified such that the firm quote obligation would attach, when a DPM is the responsible broker or dealer, at the same time those obligations attach with respect to each other responsible broker or dealer—that is, when the order is announced to the trading crowd by the PAR Official.

**Rules Relating to RAES Operations.** Under CBOE's established procedures, in accordance with Interpretation and Policy .02(b)(iv) to CBOE Rule 6.8 (RAES Operations), a RAES-eligible order routed electronically to CBOE will not be automatically executed if the CBOE's disseminated quote is inferior to the NBBO by more than the step up amount and instead will be rerouted to the PAR workstation for non-automated handling. On the assumption that the DPM will always be responsible for representing such orders as a Floor Broker, the language of that Interpretation and Policy calls for the order to be "rerouted \* \* \* to the DPM or OBO \* \* \*" <sup>14</sup> In order to make this Interpretation and Policy consistent with the proposed rules that would assign the PAR workstation operation to the PAR Official, Interpretation and Policy .02(b)(iv) to CBOE Rule 6.8 would be revised to provide that a RAES-eligible order will be rerouted to "a PAR workstation in the trading crowd," without identifying the DPM as the particular crowd participant necessarily responsible for the order.

**Rules Relating to CBOE Hybrid System's Automatic Execution Feature.** Several other provisions within CBOE Rules also use terminology that presumes that, in a crowd with a DPM, only the DPM will be operating the PAR workstation. CBOE Rule 6.13(b)(iv) (CBOE Hybrid System's Automatic Execution Feature), in particular, in describing how orders in multiply traded options are routed to avoid automatic execution at prices inferior to the NBBO, states that such orders will be routed to "the DPM's PAR terminal." To make CBOE Rule 6.13 consistent with the proposed rules relating to the introduction of the PAR Official on the Exchange, CBOE Rule 6.13 would be amended to eliminate the suggestion that the DPM would always be responsible for the operation of the PAR workstation.

**DPM Membership Ownership Requirement.** CBOE Rule 8.85(e) provides that each DPM organization shall own at least one Exchange

membership for each trading location in which the organization serves as a DPM. In the interest of fairness and to ensure that the implementation of this proposed rule change does not unduly burden Exchange members, CBOE proposes the adoption of a three-month grace period to the membership ownership rule for those DPM organizations who may fall out of compliance solely because the Exchange membership previously being used to satisfy CBOE Rule 8.85(e) was, at the time the DPM organization fell out of compliance with CBOE Rule 8.85(e), held by an individual whose affiliation with the DPM organization has been terminated as a result of the implementation of CBOE Rule 7.12. This grace period would expire three months after the date on which this rule change is deemed effective by the Commission.

**Duty to Report Unusual Activity.** CBOE Rule 7.6 also will be require a PAR Official to report to a Floor Official any unusual activity, transactions, or price changes or other unusual market conditions or circumstances with respect to the PAR Officials appointed option classes, that may be detrimental to the maintenance of a fair and orderly market.

**General DPM Rules.** There are also other Exchange rules relating to DPMS that must be amended to reflect the fact that DPMS will not always be operating the PAR workstation or executing orders as agent with respect to their allocated option classes. These changes are reflected in the proposed rule text set forth above in Part I.

#### *Implementation*

Finally, to ensure a smooth and orderly transition from DPMS to PAR Officials of the responsibility for operating PAR workstations and executing agency orders, the Exchange proposes to implement this rule change to all applicable trading stations over a ninety day period from the effective date of this rule change. During this ninety-day transition period, any DPM who continues to operate the PAR workstation in its trading crowd would continue to be subject to the same agency obligations as currently provided under CBOE Rule 8.85(b), except that, upon the approval of this rule change eliminating CBOE Rule 8.85(b), these obligations instead would be reflected in a Regulatory Circular.

#### 2. Statutory Basis

Because the proposed rule change would refine and enhance Exchange members' ability to meet certain regulatory requirements, the Exchange believes that the proposed rule change

<sup>12</sup> CBOE intends to file with the Commission a request for an exemption from the obligation to adhere to the provisions of the Linkage Plan that require the market maker through whom the P/A Order is routed to be functioning as the agent with respect to that order.

<sup>13</sup> CBOE Rule 6.81(d) specifically addresses the situations in which (1) a CBOE member does not receive a response to a P Order or P/A Order within 20 seconds of sending the order or (2) a Participant Exchange cancels a CBOE member's response to a P Order or P/A Order.

<sup>14</sup> For equity classes on CBOE, the DPM currently serves as the Order Book Official, or OBO.

is consistent with Section 6(b)<sup>15</sup> of the Act in general, and furthers the objectives of Section 6(b)(5)<sup>16</sup> in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest.

#### *B. Self-Regulatory Organization's Statement on Burden on Competition*

This proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others*

The Exchange neither solicited nor received comments with respect to the proposed rule change.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, as amended, or

(B) Institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2005-46 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2005-46. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2005-46 and should be submitted on or before August 9, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>17</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

[FR Doc. E5-3828 Filed 7-18-05; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52021; File No. SR-CBOE-2005-50]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change to Modify the Designated Primary Market-Maker Participation Entitlement for Orders Specifying a Preferred DPM

July 13, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 29, 2005, the Chicago Board Options

Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. In addition, the Commission is granting accelerated approval of the proposed rule change.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The CBOE proposes to modify the Designated Primary Market-Maker ("DPM") participation entitlement for orders specifying a Preferred DPM. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

#### Rule 8.87 Participation Entitlements of DPMs and e-DPMs

(a) Subject to the review of the Board of Directors, the MTS Committee may establish from time to time a participation entitlement formula that is applicable to all DPMs.

(b) The participation entitlement for DPMs and e-DPMs (as defined in Rule 8.92) shall operate as follows:

(1) Generally.

(i) To be entitled to a participation entitlement, the DPM/e-DPM must be quoting at the best bid/offer on the Exchange.

(ii) A DPM/e-DPM may not be allocated a total quantity greater than the quantity that the DPM/e-DPM is quoting at the best bid/offer on the Exchange.

(iii) The participation entitlement is based on the number of contracts remaining after all public customer orders in the book at the best bid/offer on the Exchange have been satisfied.

(2) Participation Rates applicable to DPM Complex. The collective DPM/e-DPM participation entitlement shall be: 50% when there is one Market-Maker also quoting at the best bid/offer on the Exchange; 40% when there are two Market-Makers also quoting at the best bid/offer on the Exchange; and, 30% when there are three or more Market-Makers also quoting at the best bid/offer on the Exchange.

(3) Allocation of Participation Entitlement Between DPMs and e-DPMs. The participation entitlement shall be as follows: If the DPM and one or more e-DPMs are quoting at the best bid/offer on the Exchange, the e-DPM participation entitlement shall be one-half (50%) of the total DPM/e-DPM entitlement and shall be divided equally

<sup>15</sup> 15 U.S.C. 78f(b).

<sup>16</sup> 15 U.S.C. 78f(b)(5).

<sup>17</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.