

CBOT.<sup>19</sup> The Exchange notes that the 1992 Agreement provides that if a CBOT Full Membership is divided into separate parts, a person must hold all of the parts to exercise on the CBOE. The Exchange states that the interpretation does not amend Article Fifth(b), rather, as noted above, the interpretation describes how the Article would apply under circumstances that were not originally contemplated when Article Fifth(b) was adopted.

Further, the Exchange represents that it has been advised by its Delaware counsel that, under Delaware state law, it is within the general authority of CBOE's Board of Directors to interpret its governing documents when questions arise as to their application in these types of circumstances, so long as the interpretation adopted by the Exchange's Board of Directors is consistent with the terms of the governing documents themselves.<sup>20</sup> The Exchange represents that the interpretations do not constitute amendments to the governing documents, and thus are not subject to the procedures that would apply if they were actually being amended.<sup>21</sup>

#### IV. Discussion

After careful review of the proposal, the comments received, and CBOE's response to the comments, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>22</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>23</sup> which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, and in

general to protect investors and the public interest, and Section 6(c)(3)(A) of the Act,<sup>24</sup> which permits, among other things, an exchange to examine and verify the qualifications of an applicant to become a member, and the natural persons associated with such applicant, in accordance with the procedures established by exchange rules.

The CBOE believes that the proposed interpretation should clarify a circumstance regarding the Exercise Right that was not originally envisioned by the CBOE and CBOT when Article Fifth(b) was adopted. The CBOE also represents that the CBOT will issue to each of its 1,402 Full Members, upon their individual request, a separately transferable interest representing the Exercise Right component of the CBOT Full Membership. Moreover, the CBOE represents that to be eligible as a CBOE exerciser member, one must hold a CBOT Full Membership, which would include one Exercise Right Privilege (representing the Exercise Right) in addition to all the other rights or privileges appurtenant to a CBOT Full Membership.

The Commission has considered the commenters' concerns about how the proposed interpretation could adversely affect the Exercise Right. In its decision to approve the proposal, the Commission is relying on CBOE's representation that the CBOT will adopt and maintain rules and procedures governing the issuance and transfer of the Exercise Right Privileges to enable the CBOE to administer the operation of the Exercise Right in a manner consistent with Exchange rules. Further, the Commission notes that CBOE has represented that both the CBOE and CBOT will provide each other with current information regarding the status of their members, including exerciser members and persons who own or lease an Exercise Right Privilege. The Commission believes that this open exchange of information regarding the Exercise Right should adequately address any concerns that the proposal will adversely affect CBOE regular membership, or any other trading rights and privileges thereof.

The Commission has also considered the commenters' concerns about the CBOT's proposed restructuring, and notes that CBOT's proposed restructuring has not yet been consummated. The Commission emphasizes that this order only approves CBOE's interpretation as it relates to the proposed changes to CBOE Rule 3.16. The Commission is not making a finding on any facts and

circumstances surrounding CBOT's proposed restructuring under Delaware law.

In addition, the Commission is not approving or disapproving the terms of the 2003 Agreement; rather, the Commission is approving a proposed rule change filed by the CBOE which interprets CBOE's rules. Further, in approving this proposal, the Commission is relying on CBOE's representation that its interpretation is appropriate under Delaware state law,<sup>25</sup> and CBOE's Opinion of Counsel that it is within the general authority of its Board of Directors to interpret Article Fifth(b) when questions arise as to its application under certain circumstances, so long as the interpretation adopted by the Exchange's Board of Directors is made in good faith, consistent with the terms of the governing documents themselves, and not for inequitable purposes.<sup>26</sup> The Commission has not independently evaluated the propriety of CBOE's interpretation under Delaware state law.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (SR-CBOE-2004-16), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50013; File No. SR-CHX-2004-02]

#### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to the Minimum Automatic Execution Threshold Size

July 14, 2004.

On February 11, 2004, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act

<sup>19</sup> The CBOE represents that, if and when the CBOT restructures and is no longer a membership organization, the CBOE will further interpret the Exercise Right to determine its application in light of the demutualization. Telephone conversation between Arthur B. Reinstein, Deputy General Counsel, CBOE, and Lisa N. Jones, Special Counsel, Division, Commission, on June 10, 2004.

<sup>20</sup> See letter from Michael D. Allen, Esq., Richards, Layton & Finger, to Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated June 29, 2004 (providing a legal opinion from Delaware counsel in connection with CBOE-2004-16) ("Opinion of Counsel").

<sup>21</sup> In its June 8th Letter, the commenters reply that, although the CBOE Board of Directors has the right to interpret changes in the CBOT membership, Article Fifth(b) requires both the CBOE member and the Exercise Right holder to decide if changes or amendments to Article Fifth(b) are permissible. Thus, the commenters believe that the CBOE Board of Directors is usurping members' rights by interpreting Article Fifth(b). See *supra* note 7.

<sup>22</sup> In approving this rule, the Commission has considered the impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>23</sup> 15 U.S.C. 78f(b)(5).

<sup>24</sup> 15 U.S.C. 78f(c)(3)(A).

<sup>25</sup> Telephone conversation among Arthur B. Reinstein, Deputy General Counsel, CBOE, Katherine A. England, Assistant Director, and Lisa N. Jones, Special Counsel, Division, Commission, on July 15, 2004.

<sup>26</sup> See *supra* note at p. 5.

<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> 17 CFR 200.30-3(a)(12).

of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to eliminate the existing 100-share minimum automatic execution threshold and the rule governing the procedures by which specialists obtain permission to switch from automatic execution mode to manual execution mode. The proposed rule change was published for comment in the **Federal Register** on June 10, 2004.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange.<sup>4</sup> Specifically, the Commission finds that the proposal is consistent with the requirements of Section 6(b) of the Act,<sup>5</sup> in general, and Section 6(b)(5) of the Act,<sup>6</sup> in particular, which requires that the rule of the Exchange be designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Exchange has represented that under its current rules, a CHX specialist is required to permit its MAX system to automatically execute an unlimited number of orders for 100 shares or less at the then-prevailing national best bid or offer ("NBBO"), until the consolidated quotation stream reflects a change in the NBBO price. The CHX believes that this requirement imposes virtually unlimited liability on its specialists to fill orders at the NBBO regardless of the aggregate number shares actually available at the NBBO. The Exchange believes that this is an unintended and unwarranted consequence of automatic execution guarantees such as the Exchange's current rule and that by eliminating the 100-share minimum automatic execution threshold, specialists will have the option to act as agent for an order or manually execute the order, rather than have an order execute against him automatically at the NBBO. Thus, the Commission believes that eliminating the 100-share minimum

automatic execution threshold will give CHX specialists more flexibility in handling orders.

The Exchange has also represented that a number of CHX specialist firms have developed and are implementing a remote pricing functionality ("RFP") that permits specialists to respond to orders that are dropped for manual handling. The RFP functionality permits specialists to price individual orders. The RFP then provides the Exchange's MAX system with automated execution instructions for orders that otherwise would require further manual intervention of a CHX specialist. The Exchange believes that eliminating the 100-share minimum automatic execution threshold will grant specialists the option to handle more orders in this manner if they choose.

The Commission believes that the rule requiring specialists to guarantee automatic executions at the NBBO was one the CHX imposed on its specialists voluntarily in order to make its market more attractive to sources of order flow. The Commission believes that the business decision to potentially forego order flow by no longer requiring specialist to provide such automatic executions is a judgment the Act allows the CHX to make. The Commission notes, however, that specialists are required to handle all orders in accordance with their best execution obligations and the Commission Quote Rule<sup>7</sup> regardless of whether such orders are executed manually or automatically.

Finally, the Commission believes it is appropriate to delete the current CHX rule governing the procedures by which specialists are to obtain permission to switch from automatic execution mode to manual execution mode because the elimination of the 100-share minimum automatic execution threshold effectively permits CHX specialists to switch to manual execution mode at any time.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (File No. SR-CHX-2004-02) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>7</sup> 17 CFR 240.11Ac1-1.

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50024; File No. SR-CHX-2004-10]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Inc. Relating to Co-Specialist Assignments and Evaluations

July 15, 2004.

On February 3, 2004, the Chicago Stock Exchange, Inc. ("CHX") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change relating to co-specialist assignments and evaluations. On May 12, 2004, CHX submitted Amendment No. 1 to the proposal.<sup>3</sup>

The proposed rule change, as amended, was published for notice and comment in the **Federal Register** on May 24, 2004.<sup>4</sup> The Commission received no comment letters on the proposal.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>5</sup> and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>6</sup> Section 6(b)(5) requires, among other things, that the rules of the exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission notes that the proposed rule change, among other things, seeks to modify the co-specialist assignment and evaluation processes to shift the emphasis from evaluation questionnaire responses to execution quality data results (specifically, data on effective spread and speed of

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

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

<sup>3</sup> See letter from Ellen J. Nelly, Senior Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated May 11, 2004 ("Amendment No. 1"). Amendment No. 1 superseded and replaced the original rule filing in its entirety.

<sup>4</sup> See Securities Exchange Act Release No. 49721 (May 18, 2004), 69 FR 29592.

<sup>5</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 49793 (June 2, 2004), 69 FR 32645.

<sup>4</sup> In approving the proposal, the Commission has considered the rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).