

participant's quote is not (and has never been) a requirement for exchanges to trade Nasdaq issues. Moreover, the Commission has not required competitors to participate in a Nasdaq trading facility or required Nasdaq to provide access to its trading facilities to its competitors. Each of the UTP participants has independently decided whether to participate in Nasdaq's automatic execution facility. The Commission also notes that providing automatic executions—rather than operating an auction market—is not a precondition to competing in Nasdaq securities. The very essence of UTP is to permit competition among markets and market structures. Requiring one market structure for trading Nasdaq securities would defeat this purpose.

BA argued that the trading of Nasdaq securities pursuant to UTP by exchange specialists causes inconsistent application of the Firm Quote Rule, 11Ac1-1.<sup>30</sup> While compliance with the Firm Quote Rule is easier to monitor in an automatic execution environment, the Firm Quote Rule does not require market participants to be subject to automatic execution. Indeed, the Firm Quote Rule has always applied to exchange trading as well as over-the-counter trading, and exchanges must monitor and enforce compliance with the Firm Quote Rule.

BA also argued that the delay in updating quotes by human UTP exchange specialists causes UTP exchange specialists' quotes to be "not real" when compared to the quotes of Nasdaq market makers that are subject to automatic execution and electronic quote updating. The Commission notes that UTP exchange specialists must comply with the Firm Quote Rule. It may take longer to receive a fill from an exchange specialist trading pursuant to UTP and for such specialist's quote to be updated than it takes to receive a fill from a Nasdaq member that is subject to automatic execution and for the Nasdaq member's quote to be updated. This does not, however, make trading pursuant to UTP under the Plan impermissible under the Act and the rules and regulations thereunder.

## VI. Conclusion

*It is therefore ordered*, pursuant to Section 11A of the Act<sup>31</sup> and paragraph (c)(2) of Rule 11Aa3-2,<sup>32</sup> thereunder, that those amendments to the Plan detailed in Category 2, Category 3, and Category 4 above be, and hereby are, approved on a pilot basis until August

19, 2003. The Commission also has determined to continue the exemption from Rule 11Aa3-2,<sup>33</sup> regarding the dissemination of multiple BBOs from a single Plan Participant<sup>34</sup> until such time as Nasdaq is registered as a national securities exchange.<sup>35</sup>

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>36</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46719; File No. SR-CBOE-2002-41]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Relating to an Interpretation of Paragraph (b) of Article Fifth of Its Certificate of Incorporation and an Amendment to Rule 3.16(b)

October 25, 2002.

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 July 29, 2002, the Chicago Board Options Exchange, Inc. ("CBOE") 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. On September 20, 2002, the CBOE filed an amendment to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit

<sup>33</sup> 17 CFR 240.11Aa3-2.

<sup>34</sup> See 13th Amendment Notice for a more detailed discussion of the referenced exemption.

<sup>35</sup> The Commission notes that it is not continuing the exemption provided under Rule 11Ac1-2, 17 CFR 240.11Ac1-2, regarding calculation of the BBO in the 12th Amendment approval order because the 13th Amendment has converted the method of calculation of the BBO by the Plan SIP from price/time/size to price/size/time methodology consistent with Rule 11Ac1-2, 17 CFR 240.11Ac1-2.

<sup>36</sup> 17 CFR 200.30-3(a)(27).

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

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

<sup>3</sup> See letter from Arthur B. Reinstein, Deputy General Counsel, CBOE, to Elizabeth King, Associate Director, Division of Market Regulation, Commission, dated September 19, 2002 ("Amendment No. 1"). Amendment No. 1

designates the proposed rule change as filed pursuant to Section 19(b)(2) of the Act. 15 U.S.C. 78s(b)(2). The CBOE also requests that the proposed rule change be given accelerated effectiveness, pursuant to 19(b)(2) of the Act. 15 U.S.C. 78s(b)(2).

comments on the proposed rule change from interested persons, and to approve the proposed rule change, as amended, on an accelerated basis.

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

The proposed rule change consists of an interpretation of paragraph (b) of Article Fifth of the Certificate of Incorporation of the CBOE ("Article Fifth (b)") pertaining to the right of 1,402 full members of the Board of Trade of the City of Chicago ("CBOT") to become members of CBOE without having to purchase a CBOE membership (the "Exercise Right"). This provision has previously been interpreted by the CBOE, including an interpretation reflected in an agreement between the CBOE and CBOT dated September 1, 1992 (the "1992 Agreement").<sup>4</sup> The interpretation provided, among other things, that in order to become a member of the CBOE pursuant to the Exercise Right, a full member of the CBOT must be in possession of all the trading rights and privileges appurtenant to a CBOT full membership.

It has recently come to the attention of the CBOE that starting in 1999, the CBOT implemented expedited membership approval procedures applicable only to those individuals who wished to become CBOE members pursuant to the Exercise Right, but did not wish to trade as members on the CBOT itself. Under the rules of the CBOT, individuals approved for CBOT membership pursuant to these expedited procedures do not have any rights to trade as members on the CBOT, and thus the CBOE believes that these individuals do not satisfy the interpretation reflected in the 1992 Agreement as described above.

On April 17, 2002, the CBOE informed the CBOT that individuals approved for CBOT membership pursuant to these expedited procedures are not entitled to become exerciser members of the CBOE. In response, on April 22, 2002, the CBOT began advising applicants for membership on the CBOT for the purpose of becoming exerciser members of the CBOE that such individuals must complete regular CBOT membership approval procedures. All individuals exercising since that date have complied with this requirement. The CBOE represents that during the several years that CBOT's

<sup>4</sup> The CBOE believes that the 1992 Agreement and an amendment to Rule 3.16 referring to the 1992 Agreement were approved by the Commission. See Securities Exchange Act Release No. 32430 (June 8, 1993), 58 FR 32969 (June 14, 1993).

<sup>30</sup> 17 CFR 240.11Ac1-1.

<sup>31</sup> 15 U.S.C. 78k-1.

<sup>32</sup> 17 CFR 240.11Aa3-2(c)(2).

expedited membership approval procedures were in place, many individuals that were approved as CBOT members under expedited procedures did in fact exercise to become members of the CBOE. According to the CBOE, approximately 330 such individuals are currently engaged in activities as exerciser members of the CBOE. If the CBOE were now to revoke the good standing of these individuals, unless and until they are re-approved as CBOT members under regular procedures, this would be likely to impose significant hardships on these individuals and cause disruption to the CBOE's market.

To avoid these results, the CBOE now proposes a further interpretation of its prior interpretation of the Exercise Right as reflected in the 1992 Agreement to provide that each individual who would have been a member in good standing of the CBOE on April 17, 2002, pursuant to the Exercise Right, but for the fact that he or she was approved as a CBOT full member or full member delegate under expedited procedures and therefore does not possess the trading rights of a full member of CBOT, will nevertheless be recognized as a member of the CBOE in good standing, so long as that individual would possess all trading rights and privileges appurtenant to a CBOT full membership upon satisfaction of the CBOT's regular (not expedited) application process. Satisfaction of CBOT full membership would also include examination and approval requirements necessary for an individual to be in actual possession of all trading rights and privileges appurtenant to a CBOT full membership as defined in the 1992 Agreement.

Any CBOE member in good standing who subsequently ceases to be a CBOE member in good standing for any reason and who thereafter reapplies to become a CBOE member pursuant to the Exercise Right, and any other individual who applies to become a member of CBOE pursuant to the Exercise Right after April 17, 2002, will be required to satisfy all applicable CBOT application, examination and approval requirements necessary for such individual to be in actual possession of all trading rights and privileges appurtenant to a CBOT full membership as defined in the 1992 Agreement. Notwithstanding the foregoing, if a CBOE exerciser member in good standing subsequently ceases to be a member of the CBOE in good standing, and he or she reapplies to become a member of the CBOE pursuant to the Exercise Right within six months of the date he or she ceased to a CBOE exerciser member, the individual may be reinstated as a member of the CBOE

in good standing without having to satisfy the requirements of the CBOT necessary for such individual to be in actual possession of all trading rights and privileges appurtenant to a CBOT full membership as defined in the 1992 Agreement. The CBOE intends to provide a limited exception to the CBOE Rule 3.16(b). The proposed interpretation, together with a proposed amendment to CBOE Rule 3.16 (b), constitutes the proposed rule change that is the subject of this filing. Below is the text of the proposed rule change. Additions are *italicized*.

\* \* \* \* \*

### **Rule 3.16 Special Provisions Regarding Chicago Board of Trade Exerciser Memberships**

(a) *Termination of Nontransferable Memberships.* [No change]

(a) *Board of Trade Exercisers.* For the purpose of entitlement to membership on the Exchange in accordance with Paragraph (a) of Article Fifth of the Certificate of Incorporation of the Exchange ("Article Fifth(b)") the term "member of the Board of Trade of the City of Chicago" (the "CBOT"), as used in Article Fifth(b), is interpreted to mean an individual who is either an "Eligible CBOT Full Member" or an "Eligible CBOT Full Member Delegate," as those terms are defined in the Agreement entered into on September 1, 1992 (the "1992 Agreement") between the CBOT and the Exchange, *as further interpreted in accordance with that certain proposed rule change filed with the Securities and Exchange Commission as File No. SR-CBOE-2002-41*, and shall not mean any other person. In order to permit Eligible CBOT Full Members and Eligible CBOT Full Member Delegates to participate in an offer, distribution or redemption of the kind referred to in the last two sentences of Paragraph 3(a) of the 1992 Agreement, and solely for such purpose, the Exchange agrees to waive all membership dues, fees and other charges and all qualification requirements, other than those that may be imposed by law, that may be applicable to the application for membership on the Exchange of each Eligible CBOT Full Member and Eligible CBOT Full Member Delegate who wishes to exercise the Exercise Right during the period commencing on the date the Exchange gives notice to the CBOT pursuant to Paragraph 3(b) of the 1992 Agreement and ending on the date such individual participates in such offer, distribution or redemption (as the case may be); provided, however, that (i) no Exerciser Member (as defined in the

1992 Agreement) for whom dues, fees and other charges and qualification requirements are waived in accordance with the foregoing shall have any rights as a member of the Exchange other than to participate in such offer, distribution or redemption, and (ii) the membership on the Exchange of each such Exerciser Member shall terminate immediately following the time such individual participates in such offer, distribution or redemption.

\* \* \* \* \*

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

In its filing with the Commission, the 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 III 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 the proposed rule change is to provide a further interpretation of a prior interpretation of Article Fifth (b). Article Fifth (b) governs the right of all 1,402 full members of the CBOT to become members of the CBOE without having to purchase a separate CBOE membership. Article Fifth (b) has previously been interpreted on several occasions, including an interpretation made pursuant to an agreement between the CBOT and CBOE dated September 1, 1992. According to the CBOE, the 1992 Agreement states that only an individual who is an "Eligible CBOT Full Member" or an "Eligible CBOT Full Member Delegate" constitutes a CBOT member within the meaning of Article Fifth (b) and thus would be eligible to have an Exercise Right—that is, a right to be an exerciser member of the CBOE.

The 1992 Agreement defines the terms "Eligible CBOT Full Member" and "Eligible CBOT Full Member Delegate" to require in each case that the individual must be in possession of "all trading rights and privileges appurtenant to such CBOT Full Membership."<sup>5</sup> The 1992 Agreement

<sup>5</sup> According to the CBOE, the reference to "such" CBOT Full Membership describes the CBOT Full Membership owned or leased by the individual.

defines the term "all trading rights and privileges appurtenant to such CBOT Full Membership" to mean "(1) the rights and privileges of a CBOT Full Membership which entitle a holder or delegate to trade as principal and broker for others in all contracts traded on the CBOT, whether by open outcry, by electronic means, or otherwise, during any segment of a trading day when trading is authorized; and (2) every trading right or privilege granted, assigned or issued by CBOT after the effective date of this Agreement to holders of CBOT Full Memberships, as a class, but excluding any right or privilege which is the subject of an option granted, assigned or issued by CBOT to a CBOT Full Member and which is not exercised by such CBOT Full Member."

These provisions of the 1992 Agreement are reflected in the CBOT's rules and were adopted by the CBOT as required by the 1992 Agreement (referred to in that Agreement as the "CBOT Rule Change"). The CBOT Rule Change may not be amended without the consent of CBOE. The CBOT Rule Change has not been amended, and is currently set forth in CBOT Rules 210.00 and 221.00(g).

In 1999, without the knowledge or approval of the CBOE, the CBOT implemented certain expedited membership approval procedures applicable to those individuals who wished to become CBOT members for the sole purpose of exercising the right to become members of the CBOE pursuant to the Exercise Right, but who did not wish to be able to trade as members on the CBOT itself. Under these expedited procedures, the CBOT waived its normal application procedures and examination requirements for these individuals, and has relied on special delegated authority to approve their membership applications. Individuals approved for CBOT membership pursuant to these expedited procedures do not have any rights to trade as a member of the CBOT in any of the contracts traded on that exchange. Accordingly, such individuals cannot qualify as Eligible CBOT Full Members or Full Member Delegates for purposes of the interpretation of the Exercise Right reflected in the 1992 Agreement, and thus are not eligible to become exerciser members of the CBOE.

The CBOE did not become aware of the expedited membership approval procedures until late 2001. On April 17, 2002, the CBOE informed the CBOT that individuals approved for CBOT membership pursuant to these expedited procedures would not be

entitled to become exerciser members of the CBOE because they did not satisfy the requirements of Article Fifth(b) as it had previously been interpreted under the 1992 Agreement. In response, on April 22, 2002, the CBOT began advising individuals who apply to become members of CBOT for the purpose of exercising to be members of the CBOE that such individuals must complete regular CBOT membership approval procedures in order to be able to exercise. The CBOE believes that all individuals exercising since that date have complied with this requirement.

During the several years that the CBOT's expedited membership approval procedures were in place, many CBOT members, pursuant to the expedited procedures, exercised to become members of the CBOE. Without the CBOE having been aware of the adoption of these expedited membership procedures by the CBOT or having focused on the fact that these individuals did not meet the requirements of a valid exercise, these individuals were then approved by the CBOE as exerciser members. According to the CBOE, approximately 330 individuals who were approved as CBOT members under expedited procedures are currently engaged in conducting business as exerciser members of the CBOE. If the CBOE now refused to recognize these individuals as members of the CBOE in good standing, unless and until they are re-approved as CBOT members under procedures that give them full trading rights on the CBOT, the result would impose significant hardships on these individuals. Likewise, the CBOE believes that the removal of these individuals from the CBOE trading floor, even if only for a temporary period while they are re-approved as members of the CBOT, would be disruptive to the CBOE itself.

To avoid these harmful results, the CBOE has determined to interpret its prior interpretation of Article Fifth (b) of its Certificate of Incorporation so as to allow each individual who would have been an exerciser member in good standing of the CBOE on April 17, 2002, but for the fact that he or she was approved as a CBOT member or delegate under expedited procedures, to be recognized as a member of CBOE in good standing so long as that individual would be able to have all trading rights and privileges appurtenant to a CBOT membership, including satisfying full CBOT membership or delegate application, examination and approval requirements. Any such individual who subsequently ceases to be an exerciser member in good standing for any reason

and who thereafter reapplies to become an exerciser member, and any other individual who applies to become an exerciser member of the CBOE after April 17, 2002, as a condition of becoming an exerciser member of the CBOE, will be required to satisfy all applicable CBOT application, examination and approval requirements necessary for such individual to be in actual possession of "all trading rights and privileges appurtenant to such CBOT Full Membership" as defined in the 1992 Agreement. Notwithstanding the foregoing, if an individual who was an exerciser member of the CBOE in good standing pursuant to the first sentence of this paragraph subsequently ceases to be an exerciser member in good standing, and if the same individual reapplies to become an exerciser member of the CBOE within six months of the date he or she ceased to be an exerciser member in good standing, the individual may be reinstated as an exerciser member in good standing without having to satisfy the requirements of the CBOT necessary for such individual to be in actual possession of all trading rights and privileges appurtenant to a CBOT full membership as defined in the 1992 Agreement.

This interpretation will provide a limited exception to the requirement of the interpretation reflected in the 1992 Agreement that all exercisers must be in possession of "all trading rights and privileges appurtenant to such CBOT Full Membership." It has the effect of "grandfathering" those individuals who were exerciser members of the CBOE in good standing on April 16, 2002, to the extent described above, notwithstanding that they were approved as members of the CBOT under expedited procedures and thus do not possess the right to trade as members on the CBOT. The CBOE represents that this interpretation will have no effect on the application of the requirements of the 1992 Agreement to individuals who were not exerciser members on April 17, 2002, and who seek to become exerciser members after that date.

## 2. Statutory Basis

The CBOE believes that the proposed rule change is consistent with and furthers the objectives of section 6(b)(5) of the Act<sup>6</sup> in particular, in that it constitutes an interpretation of and an amendment to the rules of the Exchange that are designed to promote just and equitable principles of trade, to perfect the mechanisms of a free and open

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

market, and to protect investors and the public interest.

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

The CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

No written comments were solicited or received with respect to the proposed rule change.

### III. 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.

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-2002-41 and should be submitted by November 22, 2002.

### IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of section 6(b)(5) of the Act,<sup>7</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>8</sup> Specifically, the Commission believes that this proposal, which provides a further interpretation of the Exercise Right, as provided in Article Fifth (b)

and CBOE Rule 3.16(b), should clarify that the approximately 330 exerciser members of the CBOE, who became CBOT members pursuant to the CBOT's expedited membership approval procedures, will continue to be recognized by the CBOE as exerciser members in good standing of the CBOE, so long as these exerciser members would possess all trading rights and privileges appurtenant to a CBOT membership, including satisfying full CBOT membership or delegate application, examination, and approval requirements. Further, the Commission believes that the proposal also clarifies that the CBOE will reinstate as an exerciser member in good standing any CBOE exerciser member, who became a CBOT member by the CBOT's expedited membership approval procedures and who subsequently ceases to be an exerciser member in good standing for any reason but thereafter reapplies to become an exerciser member of the CBOE, pursuant to the Exercise Right within six months of the date he or she ceased to be a CBOE exerciser member.

The Commission notes that this proposed interpretation as described above by the CBOE provides a limited exception to CBOE Rule 3.16(b), which interprets Article Fifth (b) to include "Eligible CBOT Full Member[s]" and "Eligible CBOT Full Member Delegate[s]," as defined in the 1992 Agreement between the CBOE and CBOT. The Commission believes that the proposed interpretation has no investor protection implications because all CBOE members, including exerciser members, must nevertheless comply with the requirements of the Act and CBOE rules in order to utilize their trading privileges on the CBOE floor. Also, although the CBOT granted expedited approval to these 330 individuals, the CBOE conducted a full review of these 330 members before they were permitted to trade on the CBOE. In addition, the Commission believes that refusing to recognize these certain individuals as exerciser members of the CBOE in good standing unless and until they were re-approved as CBOT members under its regular membership procedures would impose significant hardship on these individuals and cause disruption to the CBOE itself. In order to avoid such harmful results, the Commission believes that the proposed interpretation described herein and the proposed rule change are appropriate, in that the CBOE is interpreting its requirements for certain CBOT members (exerciser members) to become and remain members of the CBOE. For these

reasons, the Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice in the **Federal Register**.

*It is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-CBOE-2002-41), as amended, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to the delegated authority.<sup>10</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46727; File No. SR-CBOE-2002-44]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Incorporated To Amend Its Rules To Eliminate the "Book Indicator"

October 25, 2002.

On August 19, 2002, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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 to amend its rules to eliminate the "Book Indicator."<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on August 28, 2002.<sup>4</sup> The Commission received no comments on the proposed rule change.

The Commission has reviewed carefully the CBOE's proposed rule change and finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,<sup>5</sup> and with the requirements of section 6(b).<sup>6</sup> In particular, the Commission finds the

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</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.

<sup>3</sup> This indicator is affixed to the CBOE disseminated quotation when an order in the Exchange's book represents the best bid or offer on the Exchange.

<sup>4</sup> See Securities Exchange Act Release No. 46397 (August 21, 2002), 67 FR 55443 (August 29, 2002).

<sup>5</sup> In approving this rule proposal, the Commission notes that it has also 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).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).