SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57159; File No. SR-CBOE-2006-106)

January 15, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval to a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to an Interpretation of Paragraph (b) of Article Fifth of its Certificate of Incorporation

I. Introduction

On December 12, 2006, the Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change to adopt an interpretation of the rules of CBOE in response to the acquisition of the Board of Trade of the City of Chicago, Inc. ("CBOT") by Chicago Mercantile Exchange Holdings, Inc. ("CME Holdings"). On January 17, 2007, the Exchange filed Amendment No. 1 to the proposed rule change which replaced and superseded the filing. The proposed rule change, as modified by Amendment No. 1, was published for notice and comment in the Federal Register on February 6, 2007.[3] The Commission received 174 comment letters from 134 separate commenters on the proposed rule change, including comment letters from CBOT members and legal counsel to CBOT and CBOT members. The CBOE submitted its response to comments on June 15, 2007.[4] On June

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 55190 (January 29, 2007), 72 FR 5472 (SR-CBOE-2006-106) ("Notice").

4 See Letter from Michael L. Meyer, Schiff Hardin, to Nancy M. Morris, Secretary, Commission, dated June 15, 2007 ("CBOE Response to Comments").

29, 2007, CBOE filed Partial Amendment No. 2 to the proposal.[5] This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

II. Description of the Proposed Rule Change

A. Background

As compensation for the "special contribution" of time and money that the CBOT expended in the development of the CBOE in the early 1970s, an "Exercise Right" was granted to each "member of [the CBOT]" entitling him or her to become a member of the CBOE without having to acquire a separate CBOE membership.[6] This right, established in Article Fifth(b) of the CBOE Certificate of Incorporation ("Article Fifth(b)"), provides, in relevant part:

> In recognition of the special contribution made to the organization and development of the [CBOE] by the members of [the CBOT] . . . every present and future member of [the CBOT] who applies for membership in the [CBOE] and who otherwise qualifies shall, so long as he remains a member of said Board of Trade, be entitled to be a member of the [CBOE] notwithstanding any such limitation on the number of members and

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5 The CBOE submitted an opinion of counsel as Exhibit 3f to Amendment 1 to its proposal. See Letter from Wendell Fenton, Esq., Richards, Layton & Finger, to Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated January 16, 2007 ("First Opinion of Counsel"). CBOE subsequently submitted an updated legal opinion via Partial Amendment No. 2, which opines that the proposed rule change embodied in SR-CBOE-2006-106 constitutes an interpretation of Article Fifth(b), and not an amendment of Article Fifth(b), consistent with the conclusions reached in the opinion letters of Delaware counsel that CBOE submitted to the Commission in connection with CBOE rule filings SR-CBOE-2004-16 and SR-CBOE-2005-19. See Letter from Wendell Fenton, Esq., Richards, Layton & Finger, to Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated June 28, 2007 ("Second Opinion of Counsel"). The Commission believes that because Partial Amendment No. 2 raises no new or novel issues, it is technical in nature and not subject to separate notice and comment.

6 As CBOE explained in the notice of its proposal, the "special contribution" of the members of CBOT referred to in Article Fifth(b) consisted primarily of CBOT's providing the seed capital for the start-up of CBOE in the early 1970s by means of direct cash expenditures, CBOT's guarantee of a bank loan to CBOE to fund additional CBOE start-up costs, and CBOT's contribution of intellectual property. See Notice, supra note 3, 72 FR at 5473.

without the necessity of acquiring such membership for consideration or value from the [CBOE], its members or elsewhere.

Article Fifth(b) states that no amendment may be made to it without the approval of at least 80% of those CBOT members who have "exercised" their right to be CBOE members and 80% of all other CBOE members.

Since Article Fifth(b) does not define what a "member of [the CBOT]" means, on several occasions in the past, the CBOE has interpreted the meaning of Article Fifth(b), in particular the term "member of [the CBOT]," in response to changes in the ownership structure of the CBOT. On each such occasion, the CBOE and CBOT ultimately reached a mutual agreement on the particular interpretation at issue, and those interpretations are reflected in various agreements and letter agreements between CBOE and CBOT. CBOE filed these interpretations of Article Fifth(b) with the Commission, reflected in amendments to CBOE Rule 3.16(b) ("Special Provisions Regarding Chicago Board of Trade Exerciser Memberships"), as proposed rule changes pursuant to Section 19(b)(1) of the Exchange Act.[7] The Commission approved each such interpretation.

1. 1992 Agreement

In 1993, the Commission approved the CBOE's proposed interpretation of the meaning of the term "member of [the CBOT]" as used in Article Fifth(b) that was embodied in an agreement dated September 1, 1992 (the "1992 Agreement") and reflected in CBOE Rule 3.16(b).[8] The 1992 Agreement addressed, among other things, the effect on the Exercise Right of CBOT's plans to divide the membership interests of the then-existing 1,402 member-owners

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7 15 U.S.C. 78s(b)(1).

8 See Securities Exchange Act Release No. 32430 (June 8, 1993), 58 FR 32969 (June 14, 1993) (SR-CBOE-92-42).

of CBOT into parts. That interpretation provided that all such parts, together with the trading rights appurtenant thereto, must be in the possession of an individual in order for that individual to be eligible to utilize the Exercise Right.[9] CBOE Rule 3.16(b) reflects this interpretation in stating that "[f]or the purpose of entitlement to membership on the [CBOE] in accordance with… [Article Fifth(b)]… the term 'member of [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 [1992 Agreement]…."[10]

2. 2001 Agreement, as Modified By the 2004 and 2005 Letter Agreements

In connection with CBOT's proposed restructuring, CBOE took the position that the effect of such a transaction would be to eliminate entirely the concept of CBOT "membership" as it existed when the Exercise Right was created as a right held by members of CBOT, and therefore would result in the termination of the Exercise Right.[11] CBOE and CBOT eventually compromised and entered into an agreement dated August 7, 2001 ("2001 Agreement") under which CBOE agreed to interpret Article Fifth(b) such that the Exercise Right was only available to a CBOT member that held all of the trading rights of a full member of CBOT as well as the same number of shares of stock of CBOT Holdings, Inc. ("CBOT Holdings") originally issued to CBOT members in the restructuring.[12] CBOE agreed, in the 2001 Agreement, to interpret Article Fifth(b) in this way, only "in the absence of any other material changes to the structure or

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9 See 1992 Agreement, Section 2(b).

10 CBOE Rule 3.16(b). In the 1992 Agreement, an "Eligible CBOT Full Member" is defined as an individual who at the time is the holder of one of 1,402 existing CBOT full memberships ("CBOT Full Memberships"), and who is in possession of all trading rights and privileges of such CBOT Full Memberships. An "Eligible CBOT Full Member Delegate" is defined as the individual to whom a CBOT Full Membership is delegated (i.e., leased) and who is in possession of all trading rights and privileges appurtenant to such CBOT Full Membership.

11 See Notice, supra note 3, 72 FR at 5473.

12 See id.

ownership of the CBOT … not contemplated in the CBOT [restructuring]."[13]

CBOE and CBOT subsequently agreed to modify the 2001 Agreement by a Letter Agreement among CBOE, CBOT, and CBOT Holdings dated October 7, 2004 ("October 2004 Letter Agreement"), which was intended to represent the agreement of the CBOE and CBOT concerning the nature and scope of the Exercise Right following the restructuring of the CBOT and in light of the expansion of the CBOE and CBOT's electronic trading systems. The CBOE, CBOT, and CBOT Holdings entered into another letter agreement on February 14, 2005 ("February 2005 Letter Agreement") in which CBOE confirmed that CBOT's restructuring was consistent with CBOE's interpretation of Article Fifth(b) as set forth in the 2001 Agreement.

The CBOE's interpretation of Article Fifth(b) through interpretations of "Eligible CBOT Full Member" as used in CBOE Rule 3.16 were approved by the Commission.[14] As set forth in the 2001 Agreement, as amended by the letter agreements, the CBOE interprets Article Fifth(b) such that an individual is deemed to be an "Eligible CBOT Full Member" under CBOE Rule 3.16 if the individual: (1) is the owner of the requisite number of Class A Common Stock of CBOT Holdings, the requisite number of Series B-1 memberships of the CBOT, and the Exercise Right Privilege; (2) has not delegated any of the rights or privileges appurtenant to such ownership; and (3) meets applicable membership and eligibility requirements of the CBOT.[15] An individual is deemed to be an "Eligible CBOT Full Member Delegate," under that Agreement, if the individual: (1) is in possession of the requisite number of Class A Common Stock of CBOT Holdings, the requisite number of Series B-1 memberships of the CBOT, and the Exercise Right Privilege; (2) holds one or more of the items listed in (1) by means of delegation

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13 See id. at 5473-74 (citing the 2001 Agreement).

14 See Securities Exchange Act Release No. 51733 (May 24, 2005), 70 FR 30981 (May 31, 2005) (SR-CBOE-2005-19).

15 See id. at 30983 (footnote 14).

rather than ownership; and (3) meets applicable membership and eligibility requirements of the CBOT.[16]

B. CBOE's Current Proposal

1. Interpretation of Article Fifth(b)

The CBOE is again proposing an interpretation of the term "member of [the CBOT]" as used in Article Fifth(b). CBOE believes that its proposed interpretation is necessary to address the effect on the Exercise Right of the then-proposed (and now completed) acquisition of the CBOT by CME Holdings.[17] Specifically, CBOE believes that the acquisition of the CBOT by CME Holdings effected "substantial changes to the structure and ownership of CBOT, as well as to the rights represented by CBOT membership," in a way that creates a substantive ambiguity with respect to whether a person who formerly qualified under Article Fifth(b) as a "member of [the CBOT]" for purposes of the Exercise Right still possesses sufficient attributes of CBOT membership following the acquisition by CME Holdings.[18]

In response to the acquisition of the CBOT by CME Holdings, the CBOE Board of Directors found it necessary to determine whether the substantive rights of a former CBOT member would continue to qualify that person as a "member of [the CBOT]" pursuant to Article Fifth(b), as that term was contemplated when Article Fifth(b) was adopted, after the acquisition of the CBOT by CME Holdings. CBOE determined that it would not, because former CBOT

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16 See id.

17 That acquisition was accomplished by the merger of CBOT Holdings, of which CBOT was a subsidiary, with and into CME Holdings, with CME Holdings continuing as the surviving corporation and as the parent company of CBOT, as well as of its existing wholly-owned subsidiary, the Chicago Mercantile Exchange, Inc. ("CME"). CBOT Holding's shareholders approved the acquisition on July 9, 2007. See Form 8-K submitted by CME Holdings on July 9, 2007. The transaction was completed on July 12, 2007. See Form 25-NSE submitted by the New York Stock Exchange, Inc. (regarding notification of the removal of listing of CBOT Holdings).

18 CBOE Response to Comments, supra note 4, at 17.

members "lose in the CME acquisition the few remaining membership rights they retained following the [CBOT's] 2005 restructuring," such that "persons who had formerly been the full members of CBOT will simply be the holders of trading permits and will not possess any of the other rights commonly associated with membership in an exchange."[19]

Thus, CBOE's proposed interpretation concludes that, following the acquisition, there no longer are any individuals who qualify as "members of [the CBOT]" within the meaning of Article Fifth(b). Consequently, no person would qualify under Article Fifth(b) to utilize the Exercise Right to become and remain a member of CBOE without having to obtain a separate CBOE membership. This interpretation is based on CBOE's view that the concept of a member-owner of CBOT, as CBOE believes that concept was understood when Article Fifth(b) was first adopted in CBOE's Certificate of Incorporation and when it was subsequently interpreted in the 1992 Agreement, has been abolished following the restructuring of CBOT and its subsequent acquisition by CME Holdings. In this respect, the CBOE's proposal does not extinguish the Exercise Right or delete Article Fifth(b) from its Certificate of Incorporation, but rather interprets Article Fifth(b) in a manner than means no CBOT member is eligible to utilize that right following the acquisition of CBOT.

With respect to the prior agreements concerning the interpretation of Article Fifth(b) with CBOT, CBOE believes that, because the change in structure effectuated by the acquisition of CBOT by CME Holdings was not contemplated as part of the 2005 restructuring of CBOT, the acquisition constitutes a change to the ownership of CBOT that is inconsistent with a condition to the interpretation embodied in the 2001 Agreement, as amended, that there not be any change

[19] Id. at 28.

to the ownership of CBOT not contemplated in its 2005 restructuring.[20] Accordingly, CBOE believes that the 2001 Agreement, as amended, no longer governs whether and to what extent the Exercise Right will remain in existence, with the result being that CBOE and CBOT are back in the position they faced before the 2001 Agreement.[21]

With the 2001 Agreement no longer controlling, CBOE looks to the 1992 Agreement, in particular Section 3(d), which addresses the possibility that CBOT, among other things, may merge or consolidate with, or be acquired by, another entity. Section 3(d) establishes three conditions that all must be satisfied for the Exercise Right to remain available following any such transaction. Those three conditions are:

> 1. … the survivor of such merger, consolidation or acquisition ("survivor") is an exchange which provides or maintains a market in commodity futures contracts or options, securities, or other financial instruments, and …
>
> 2. the 1,402 holders of CBOT Full Memberships are granted in such merger, consolidation or acquisition membership in the survivor ("Survivor Membership"), and …
>
> 3. such Survivor Membership entitles the holder thereof to have full trading rights and privileges in all products then or thereafter traded on the survivor (except that such trading rights and privileges need not include products that, at the time of such merger, consolidation or acquisition, are traded or listed, designated or otherwise authorized for trading on the other entity but not on the CBOT) ….[22]

CBOE believes that none of these conditions are satisfied following the acquisition of CBOT by CME Holdings. Specifically, with respect to Condition 1, CBOE notes that the survivor of the acquisition (i.e., the acquiring entity that survives the transaction) is CME Holdings, which is not an exchange.[23]

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20 See Notice, supra note 3, 72 FR at 5474.

21 See id.

22 See id.

23 See id.

Further, CBOE believes that Condition 2 is not satisfied because the former 1,402 holders of CBOT Full Memberships have not been granted "membership" in the survivor.[24] Rather, CBOE's position is that there are not any holders of CBOT Full Memberships as they existed in 1992, because all of these memberships were stripped of their ownership attributes in the 2005 restructuring of CBOT.[25] Likewise, CBOE argues that CME Holdings is not an exchange and therefore is not capable of granting "membership" interests in itself to anyone.[26] CBOE further states that, even if CBOT is considered to have survived the acquisition, Condition 2 still would not be satisfied because, except for trading rights, former CBOT members no longer have most of the other rights in the surviving entity that they formerly held when they were full members of CBOT as the term "member" was commonly understood when Article Fifth(b) was adopted in 1972 and later interpreted in 1992.[27] Accordingly, following the acquisition, CBOE believes that former CBOT members will simply be the holders of trading permits and will not be granted any of the other rights commonly associated with membership in an exchange.[28]

Finally, CBOE believes that Condition 3 of Section 3(d) of the 1992 Agreement is not satisfied following the acquisition of CBOT by CME Holdings because that condition contemplates an acquisition where the surviving acquirer is an exchange, and it requires CBOT

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24 See id.

25 See id. Although CBOE has previously interpreted Article Fifth(b) to permit the Exercise Right to continue in existence following the 2005 restructuring of CBOT, subject to stated conditions, as discussed above, CBOE believes that those earlier interpretations, contained in the 2001 Agreement, as amended, are no longer controlling because those provisions applied only so long as there was no further change to the structure or ownership of CBOT not then in contemplation. See id.

26 See Notice, supra note 3, 72 FR at 5474.

27 See id. at 5475. For example, CBOE states that, following the acquisition by CME Holdings, CBOT's former Series B-1 members will be stripped, among other things, of their right to elect directors or nominate candidates for election as directors. See id.

28 See id.

members to have essentially the same full trading rights on that surviving exchange as they had on CBOT prior to the acquisition.[29] As CME Holdings is not an exchange, CBOE believes that it is not possible for CBOT members to have any trading rights on the survivor.[30] Further, CBOE believes that to be the case even if it were to look through CME Holdings to its two subsidiary exchanges, CME and CBOT.[31] CBOE states that, in respect of any new products to be introduced on CME after the acquisition, the trading rights of CBOT members will be diluted by the trading rights granted to other persons (i.e., CME members) to trade these same products, in which case the trading rights inherent in CBOT membership will be reduced from what they were prior to the acquisition.[32]

Consequently, CBOE's proposed interpretation concludes that the conditions contained in Section 3(d) of the 1992 Agreement are not satisfied following the acquisition of CBOT by CME Holdings, and that the terms of Section 3(d) therefore provide that "Article Fifth(b) shall not apply" following the acquisition. Hence, for the reasons discussed in its notice, as summarized above, CBOE's proposed interpretation is that the Exercise Right is no longer available as a means of acquiring membership in CBOE because there no longer are any individuals who qualify as "members of [the CBOT]" within the meaning of Article Fifth(b).

2. Transition Plan

In addition to its proposed interpretation of Article Fifth(b), CBOE has separately proposed a transition plan in order to avoid a sudden disruption to its marketplace as a result of no persons any longer being eligible to utilize the Exercise Right on account of the acquisition of

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29 See id.

30 See id.

31 See id.

32 See Notice, supra note 3, 72 FR at 5474.

CBOT by CME Holdings.[33] Specifically, CBOE submitted a separate proposed rule change interpreting CBOE Rule 3.19, which is a rule that authorizes the Exchange, when the Exchange determines that there are extenuating circumstances, to permit a member "to retain the member's status for such period of time as the Exchange deems reasonably necessary" to enable the member to address specified problems that caused the membership status to terminate.

Interpretation .01 to CBOE Rule 3.19, allows certain "grandfathered" Exerciser Members who had been trading on CBOE to continue to have uninterrupted access to CBOE until such time as the Commission takes action on SR-CBOE-2006-106. Under Interpretation .01 to CBOE Rule 3.19, persons who were Exerciser Members in good standing as of July 1, 2007 and who remain Exerciser Members as of the close of business on the day before the consummation of the acquisition of CBOT by CME Holdings temporarily retained their membership status, including their trading access to CBOE, for a limited period of time. Such persons were not required to hold or maintain any securities, memberships or other interests in order to maintain that status, but are required to pay a monthly access fee to the Exchange.[34] Temporary Members are required to remain in good standing and must pay all applicable fees, dues, assessments and other like charges assessed against CBOE members.

On September 4, 2007, CBOE filed a subsequent interpretation of CBOE Rule 3.19 to extend this temporary membership beyond any Commission approval of SR-CBOE-2006-106 until the earlier of: (1) the voluntary termination of a person's temporary membership; (2) any Commission approval of a subsequent proposed rule change to terminate temporary membership

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33 See Securities Exchange Act Release Nos. 56016 (July 5, 2007), 72 FR 38106 (July 12, 2007) (SR-CBOE-2007-77) and 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

34 See Securities Exchange Act Release No. 56197 (August 3, 2007), 72 FR 44897 (August 9, 2007) (SR-CBOE-2007-91) (adopting the access fee).

status; or (3) the demutualization of the Exchange.[35]

III. Comment Letters

The Commission received 174 comment letters on the proposed rule change from 134 different commenters.[36] Legal counsel for CBOT, legal counsel for CBOT Holdings, and legal counsel for the putative class of CBOT members from the Delaware litigation (collectively referred to as "CBOT") all submitted comment letters[37] in which they characterized the

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35 See Securities Exchange Act Release No. 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

36 Thirteen letters, including three letters from CBOE's legal counsel, explicitly supported the proposed rule change. See Letter from Robert H. Bloch, dated February 16, 1007 ("Bloch Letter"); Letter from Michael J. Post to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 16, 2007 ("Post Letter"); Letter from Steven G. Holtz, dated February 17, 2007; Letter from Dan Frost, dated February 19, 2007 ("Frost Letter"); Letter from Steve Fanady to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 20, 2007 ("Fanady Letter"); Letter from Lawrence J. Blum to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 25, 2007 ("Blum Letter"); Letter from Norman S. Friedland, dated February 27, 2007 ("Friedland Letter"); Letter from R. Kent Hardy to Nancy M. Morris, Secretary, Commission, dated February 27, 2007 ("Hardy Letter"); Letter from Robert Silverstein to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated February 27, 2007 ("Silverstein Letter"); Letter from Marshall Spiegel, dated April 12, 2007 (referencing attached materials); Letter from Michael L. Meyer, Schiff Hardin, to Elizabeth K. King, Associate Director, Division of Market Regulation, Commission, dated January 12, 2007 ("Schiff Hardin Letter 1"); Letter from Michael L. Meyer, Schiff Hardin, to Nancy M. Morris, Secretary, Commission, dated March 19, 2007; and CBOE Response to Comments, supra note 4. The remainder of the letters either opposed the proposal or did not clearly communicate a position.

37 See Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated December 22, 2006 ("Mayer Brown Letter 1"); Letter from Gordon B. Nash, Jr., Gardner, Carton & Douglas, to Nancy M. Morris, Secretary, Commission, dated December 22, 2006 (on behalf of the putative class members) ("Gardner Letter"); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated January 31, 2007 ("Mayer Brown Letter 2"); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated February 27, 2007 ("Mayer Brown Letter 3"); Letter from Scott C. Lascari, Drinker Biddle Gardner Carton, to Nancy M. Morris, Secretary, Commission, dated February 27, 2007 (on behalf of the putative class members); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated March 15, 2007 ("Mayer Brown Letter 4"); Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated July 9, 2007 ("Mayer Brown Letter 5"); and Letter from Charles M. Horn, Mayer, Brown, Rowe & Maw, to Nancy M. Morris, Secretary, Commission, dated August 9, 2007 ("Mayer Brown Letter 6").

proposed rule change as an attempt by CBOE to eliminate one group of Exchange members (Exerciser Members) for the benefit of another group of members (CBOE regular members), therein depriving Exerciser Members and those eligible to become Exerciser Members of a valuable property right.[38] CBOT asked the Commission to institute proceedings to disapprove CBOE's proposed rule change on the basis that the proposal is an improper use of CBOE's self-regulatory authority to resolve in its favor a private property dispute that is being litigated in the Delaware court, fails to meet the requirements of the Exchange Act, and was adopted without due process.[39]

Other commenters supplemented the concerns expressed by CBOT with criticism that the Commission lacked jurisdiction to consider the CBOE's proposal on the basis that the proposal implicated a contractual dispute subject to the jurisdiction of a state court.[40]

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38 See, e.g., Mayer Brown Letter 3, supra note 37, at 6.

39 See Mayer Brown Letter 3, supra note 37, at 1. See also Letter from Alton B. Harris, Ungaretti & Harris LLP, to Nancy M. Morris, Secretary, Commission ("Ungaretti Letter"), at 9-10 (arguing that the CBOE impermissibly and unilaterally interpreted a provision in a bilateral contract and filed this interpretation with the Commission in an attempt to invoke federal preemption). That commenter opined that the outcome of this matter could affect the future willingness of third parties to enter into contracts that may be subject to unilateral interpretation by a self-regulatory organization. See id. at 2-3.

40 See Letter from Gordon Gladstone, dated February 9, 2007; Letter from Glenn Hollander, dated February 9, 2007; Letter from Lance R. Goldberg, dated February 10, 2007 ("Goldberg Letter"); Letter from Mark Mendelson, dated February 12, 2007 ("Mendelson Letter"); Letter from John Simms, dated February 12, 2007 ("Simms Letter"); Letter from Charles W. Bergstrom to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; Letter from Mike P. Darraugh, dated February 13, 2007 ("Darraugh Letter"); Letter from Edward E. Kessler, dated February 13, 2007 ("Kessler Letter"); Letter from Stephen L. O'Bryan, dated February 13, 2007 ("O'Bryan Letter"); Letter from Mark D. Hellman to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Hellman Letter"); Letter from J. Alexander Stevens to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Stevens Letter"); Letter from Allen Mitzenmacher to Nancy M. Morris, Secretary, Commission, dated February 15, 2007 ("Mitzenmacher Letter"); Letter from Benjamin Nitka, dated February 15, 2007; Letter from Jerome Israelov, dated February 16, 2007; Letter from Susie McMurray, submitted February 16, 2007 ("McMurray Letter"); Letter from Stuart Reif to Nancy M. Morris, Secretary, Commission, dated February 16, 2007 ("Reif Letter"); Letter from Doug Riccolo, dated February 16, 2007; Letter from Burt Gutterman and Noel Moore to Nancy M. Morris, Secretary, Commission, dated February 17, 2007; Letter from Charles B. Cox III, dated February 19, 2007 ("C. Cox Letter");

Commenters also opposed the proposal as without foundation, believing that the CBOT's acquisition by CME Holdings should be irrelevant to the continued validity of the Exercise Right.[41] Other commenters argued that CBOE's proposal violates the rights of CBOT members

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Letter from Michael J. Crilly, dated February 19, 2007 ("Crilly Letter 1"); Letter from Ronald E. Komo to Nancy M. Morris, Secretary, Commission, dated February 19, 2007 ("Komo Letter"); Letter from Thomas M. Myron to Nancy M. Morris, Secretary, Commission, dated February 19, 2007 ("T.M. Myron Letter"); Letter from Kyle A. Reed, dated February 20, 2007 ("Reed Letter"); Letter from Thomas F. Cashman to Nancy M. Morris, Secretary, Commission, dated February 21, 2007 ("Cashman Letter"); Letter from Richard Jaman, submitted February 22, 2007 ("Jaman Letter"); Letter from Lawrence D. Israel to Nancy M. Morris, Secretary, Commission, dated February 22, 2007 ("Israel Letter"); Letter from Gerald A. McGreevy, submitted February 22, 2007 ("McGreevy Letter"); Letter from David P. Baby to Nancy M. Morris, Secretary, Commission, dated February 23, 2007 ("Baby Letter"); Letter from Stephen Cournoyer to Nancy M. Morris, Secretary, Commission, dated February 24, 2007 ("S. Cournoyer Letter"); Letter from Wayne Goodman to Nancy M. Morris, Secretary, Commission, submitted February 24, 2007 ("Goodman Letter"); Letter from Cary Chubin, dated February 25, 2007 ("Chubin Letter"); Letter from John Halston, dated February 25, 2007 ("Halston Letter"); Letter from Veda Kaufman Levin, dated February 25, 2007 ("Levin Letter"); Letter from Robert J. Griffin to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Griffin Letter"); Letter from Harlan R. Krumpfes, dated February 26, 2007 ("Krumpfes Letter"); Letter from Nickolas J. Neubauer to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Neubauer Letter"); Letter from Ronald Bianchi, dated February 26, 2007 ("Bianchi Letter"); Letter from William Terman to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Terman Letter"); Letter from Robert E. Otter, dated February 27, 2007; and Letter from Paul L. Richards to Nancy M. Morris, Secretary, Commission, dated August 1, 2007 ("Richards Letter 2"). Cf. Comment Letters cited in note 36, supra (Bloch Letter, Post Letter, Friedland Letter, Frost Letter, Fanady Letter, Blum Letter (arguing that the proposal falls within the Commission's jurisdiction)).

41 See, e.g., Letter from Lawrence C. Dorf, dated February 9, 2007 ("Dorf Letter"); Goldberg Letter, supra note 40; Letter from Peter M. Todebush to Nancy M. Morris, Secretary, Commission, dated February 13, 2007 ("Todebush Letter"); Letter from Thomas M. Shuff Jr., dated February 13, 2007 ("Shuff Letter"); Letter from Norm Friedman, dated February 16, 2007 ("N. Friedman Letter"); C. Cox Letter, supra note 40; Crilly Letter 1, supra note 40; Ungaretti Letter, supra note 39; Letter from Brian Cassidy, dated February 20, 2007 ("Cassidy Letter"); Letter from Gregory J. Ellis, dated February 20, 2007 ("Ellis Letter"); Letter from Paul R.T. Johnson, Jr. to Nancy M. Morris, Secretary, Commission, submitted February 20, 2007 ("Johnson Letter"); Reed Letter, supra note 40; Letter form Michael E. Stone, submitted February 22, 2007 ("Stone Letter 1"); Letter from Robert C. Sheehan, Electronic Brokerage Systems, LLC, to Nancy M. Morris, Secretary, Commission, dated February 23, 2007 ("Sheehan Letter"); Letter from Carolyn J. Davis to Nancy M. Morris, Secretary, Commission, dated February 24, 2007; Goodman Letter, supra note 40; Letter from David G. Northey, M&N Trading, submitted February 24, 2007 ("Northey Letter"); Letter from Kevin A. Ward, submitted February 24, 2007; Chubin Letter, supra note 40; Halston Letter, supra note 40; Letter from Michael E. Stone, dated February 25, 2007 ("Stone Letter 2"); Letter from Edward A. Cox and Cynthia R. Cox to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("E. Cox Letter"); Krumpfes Letter, supra note 40; Letter from John L. Pietrzak to Nancy M. Morris, Secretary, Commission, dated February 26, 2007 ("Pietrzak Letter"); Letter from Robert Salstone to Nancy M. Morris, Secretary,

with respect to the Exercise Right and violates the agreements between the CBOT and CBOE,[42] and complained about the economic impact of the proposed rule change on CBOT members,

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Commission, dated February 26, 2007.

[42] See Letter from Peter W. Aden, dated February 9, 2007; Dorf Letter, supra note 41; Letter from Michael C. Rothman, dated February 9, 2007 ("Rothman Letter"); Goldberg Letter, supra note 40; Letter from Clint Gross, dated February 11, 2007 ("Gross Letter"); Letter from Richard D. Lupori, dated February 12, 2007; Mendelson Letter, supra note 40; Letter from Adam Rich to Nancy M. Morris, Secretary, Commission, dated February 12, 2007 ("Rich Letter"); Simms Letter, supra note 40; Letter from Frank J. Aiello to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; Darraugh Letter, supra note 40; Letter from Michael Forester to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; Letter from Richard Friedman, dated February 13, 2007 ("R. Friedman Letter"); Letter from Ronald F. Grossman, dated February 13, 2007 ("Grossman Letter"); Kessler Letter, supra note 40; Letter from Robert T. O'Brien to Nancy M. Morris, Secretary, Commission, dated February 13, 2007; O'Bryan Letter, supra note 40; Shuff Letter, supra note 41; Todebush Letter, supra note 41; Letter from Arthur Arenson to Nancy M. Morris, Secretary, Commission, dated February 14, 2007; Letter from Michael Floodstrand to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Floodstrand Letter"); Hellman Letter, supra note 40; Letter from Pat Hillegass, dated February 14, 2007; Letter from Michael D. Morelli to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("Morelli Letter"); Letter from Ira S. Nathan, dated February 14, 2007 ("Nathan Letter"); Letter from Glenn Beckert, dated February 15, 2007 ("Beckert Letter"); Letter from John V. Grimes, dated February 15, 2007 ("Grimes Letter"); Mitzenmacher Letter, supra note 40; Letter from Thomas E. Nelson to Nancy M. Morris, Secretary, Commission, dated February 15, 2007 ("Nelson Letter"); Letter from Young Chun, dated February 16, 2007 ("Chun Letter"); N. Friedman Letter, supra note 41; McMurray Letter, supra note 40; Reif Letter, supra note 40; Letter from Howard Tasner, dated February 16, 2007; Letter from Kelly A. Caloia to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Mark Feierberg, dated February 18, 2007 ("Feierberg Letter"); Letter from J. Patrick Hennessy to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Alan Matthew to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Nicholas M. McBride to Nancy M. Morris, Secretary, Commission, dated February 18, 2007; Letter from Richard H. Woodruff to Nancy M. Morris, Secretary, Commission, dated February 18, 2007 ("Woodruff Letter"); C. Cox Letter, supra note 40; Crilly Letter 1, supra note 40; Komo Letter, supra note 40; T.M. Myron Letter, supra note 40; Letter from Patrick H. Arbor to Nancy M. Morris, Secretary, Commission, dated February 20, 2007 ("Arbor Letter"); Letter from John T. Brennan, dated February 20, 2007; Letter from Karl G. Estes to Nancy M. Morris, Secretary, Commission, dated February 20, 2007 ("Estes Letter"); Johnson Letter, supra note 41; Letter from Patrick A. Walsh, dated February 20, 2007 ("Walsh Letter"); Jaman Letter, supra note 40; Letter from Ronald G. Lindenberg to Nancy M. Morris, Secretary, Commission, dated February 21, 2007; McGreevy Letter, supra note 40; Baby Letter, supra note 40; Sheehan Letter, supra note 41; Letter from Bryan Cournoyer to Nancy M. Morris, Secretary, Commission, submitted February 24, 2007 ("B. Cournoyer Letter"); S. Cournoyer Letter, supra note 40; Goodman Letter, supra note 40; Northey Letter, supra note 41; Letter from Joyce Selander, submitted February 24, 2007; Chubin Letter, supra note 40; Letter from Neil Esterman, dated February 25, 2007 ("Esterman Letter"); Letter from Terry Myron, dated February 25, 2007; Letter from Martin Flaherty, dated February 25, 2007; Levin Letter, supra note 40; Letter from John F. McKerr, Celtic Brokerage, Inc., to Nancy M. Morris, Secretary, Commission, dated February 25, 2007 ("McKerr Letter"); Griffin Letter,

especially the fact that the CBOE's proposal would prohibit CBOT members from sharing in the CBOE's anticipated demutualization.[43] The main points raised by the comment letters, as well as the Commission's findings, are discussed below.

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supra note 40; Krumpfes Letter, supra note 40; Neubauer Letter, supra note 40; Letter from Sondra Brewer Pfeffer to Nancy M. Morris, Secretary, Commission, dated February 26, 2007; Bianchi Letter, supra note 40; Terman Letter, supra note 40; Letter from Judy Anne Parrish, dated February 27, 2007 ("Parrish Letter"); Letter from James Ryan, dated February 27, 2007; Letter from Rose G. Schneider, dated February 27, 2007 ("Schneider Letter"); Letter from Michael J. Crilly to Nancy M. Morris, Secretary, Commission, dated August 17, 2007 ("Crilly Letter 2"); Letter from Gary V. Sagui, Templar Securities LLC, to Nancy M. Morris, Secretary, Commission, dated August 20, 2007; and Letter from Paul L. Richards to Bill Brodsky, Chairman, CBOE, dated August 31, 2007.

[43] See Dorf Letter, supra note 41; Goldberg Letter, supra note 40; Mendelson Letter, supra note 40; Rich Letter, supra note 42; Simms Letter, supra note 40; R. Friedman, Letter, supra note 42; Grossman Letter, supra note 42; Floodstrand Letter, supra note 42; Nathan Letter, supra note 42; Beckert Letter, supra note 42; Grimes Letter, supra note 42; Nelson Letter, supra note 42; Letter from Erskine S. Adam, Jr. to Nancy M. Morris, Secretary, Commission, dated February 16, 2007; Chun Letter, supra note 42; Letter from Angelo Dangles, dated February 18, 2007; Feierberg Letter, supra note 42; Woodruff Letter, supra note 42; C. Cox Letter, supra note 40; Crilly Letter 1, supra note 40; Komo Letter, supra note 40; Arbor Letter, supra note 42; Ellis Letter, supra note 41; Estes Letter, supra note 42; Letter from Jay Homan, dated February 20, 2007; Walsh Letter, supra note 42; Cashman letter, supra note 40; McGreevy Letter, supra note 40; Stone Letter 1 and 2, supra note 41; Baby Letter, supra note 40; Richards Letter 2, supra note 40; Levin Letter, supra note 40; Letter from Robert M. Geldermann, dated February 26, 2007; Letter from Stephen R. Geldermann, dated February 26, 2007; Neubauer Letter, supra note 40; Parrish Letter, supra note 42; Schneider Letter, supra note 42; and Letter from Nancy Williams, dated February 27, 2007 ("Williams Letter").

Some commenters noted that the right to exercise to trade on the CBOE was priced into their CBOT memberships when they initially purchased them. See Rothman Letter, supra note 42; Goldberg Letter, supra note 40; Gross Letter, supra note 42; Williams Letter; Cassidy Letter, supra note 41; Johnson Letter, supra note 41; Walsh Letter, supra note 42; Letter from Robert Berry, dated February 21, 2007; Cashman Letter, supra note 40; Jaman Letter, supra note 40; McGreevy Letter, supra note 40; B. Cournoyer Letter, supra note 42; Chubin Letter, supra note 40; C. Cox Letter, supra note 40; Terman Letter, supra note 40; and Richards Letter 2, supra note 40. Cf. Hardy Letter, supra note 36 (noting that at some points in time a CBOE membership cost more than a CBOT membership, thus undercutting the argument that the CBOT membership reflected a premium for its attendant CBOE access right).

One commenter, a self-described founding member of CBOE, argued that the documents presented to the CBOT board of directors at the meeting where it decided to spin-off the CBOE do not mention equity rights to be retained in CBOE by CBOT members; rather, access rights, liquidation rights in CBOE in case of failure, and how to get back the initial investment of $750,000 were the main topics of discussion. See Blum Letter, supra note 36. The commenter notes that the $750,000 was eventually repaid to CBOT. See also Hardy Letter, supra note 36 (also noting that the $750,000 was repaid). One commenter argued that CBOT could have given each of its members a free seat on the CBOE if an equity position was desired, but instead they

IV. Discussion and Commission Findings

Before turning to the specific questions under consideration, it is appropriate to review the obligations that the Exchange Act imposes on the Commission in reviewing SRO proposed rule changes and the manner in which the Commission carries out those obligations. The Exchange Act specifically requires an exchange to file with the Commission all proposed rules and any proposed changes in, additions to, or deletions from its rules.[44] As noted below, "rules" of an exchange are defined broadly to include, in this case, interpretations of CBOE's Certificate of Incorporation.[45] Once an exchange files a proposed rule change with the Commission, the Exchange Act requires the Commission to approve any such proposed rule change if it finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the exchange.[46] Alternatively, if the Commission cannot so find, it must disapprove the rule proposal.[47] The Exchange Act requirements for Commission action are not conditioned upon the absence of issues arising under other federal or state laws.

The Commission considers proposed rule changes in accordance with the requirements applicable to national securities exchanges under Section 6 of the Exchange Act. In addition, because Section 6(b)(1) of the Exchange Act requires exchanges to enforce compliance by its

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chose to grant access through the Exercise Right. See Hardy Letter, supra note 36.

44 See 15 U.S.C. 78s(b)(1).

45 See infra note 70 and accompanying text.

46 See 15 U.S.C. 78s(b)(2). Section 19(b) of the Exchange Act requires the Commission to approve a proposed rule change or institute proceedings to determine whether the proposed rule change should be disapproved "[w]ithin thirty-five days of the date of publication of notice of the filing of a proposed rule change… or within such longer period as the Commission may designate up to ninety days of such date… or as to which the self-regulatory organization consents." Id. The CBOE consented to an extension of time for the Commission to consider its filing. See Item 6 of Amendment No. 1 to CBOE's Form 19b-4 filing, dated January 17, 2007.

47 See 15 U.S.C. 78s(b)(2).

members and persons associated with its members with the provisions of the Exchange Act, the Commission considers whether proposed rule changes are consistent with all other Exchange Act provisions and Commission rules adopted thereunder. Further, Sections 6(b)(1) and 19(g)(1) of the Exchange Act[48] require exchanges to comply with their own rules; as noted below, those rules are defined by the Exchange Act to include the exchange's certificate of incorporation and its bylaws.[49] Thus, the Commission cannot approve a proposed rule change if the exchange has failed to complete all action required under, or to comply with, its own certificate of incorporation or bylaws.

With respect to CBOE's proposal, the Commission has carefully reviewed the proposed rule change, all comment letters and attachments thereto, and the CBOE's response to the comment letters, and finds that, as a matter of federal law, the proposed rule change is consistent with the requirements of the Exchange Act, in particular Section 6 of the Exchange Act[50] and the rules and regulations applicable to a national securities exchange.[51]

In particular, the Commission finds that the proposed rule change is consistent with: (1) Section 6(b)(1) of the Exchange Act,[52] which requires the Exchange to be organized and have the capacity to comply, and to enforce compliance by its members and persons associated with its members, with, among other things, the rules of the Exchange; (2) Section 6(b)(5) of the Exchange Act,[53] which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade and not be unfairly discriminatory; (3) Section

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48 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78s(g)(1), respectively.

49 See infra note 70 and accompanying text.

50 15 U.S.C. 78f(b).

51 In approving this rule, the Commission has considered the impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

52 See 15 U.S.C. 78f(b)(1).

53 See 15 U.S.C. 78f(b)(5).

6(b)(8) of the Exchange Act,[54] which requires that the rules of the Exchange not impose any burden on competition that is not necessary or appropriate in the furtherance of the purposes of the Exchange Act; (4) Section 6(c)(3)(A) of the Exchange Act,[55] which permits, among other things, an exchange to examine and verify the qualifications of an applicant to become a member, in accordance with the procedures established by exchange rules; and (5) Section 6(c)(4) of the Exchange Act,[56] which prohibits the Exchange from decreasing the number of memberships below the number of memberships in effect on May 1, 1975.[57] The Commission also finds that the proposed rule change complied with the requirements of Section 19(b) of the Exchange Act,[58] was complete and properly filed, and provided all of the requisite information specified in Form 19b-4.[59]

While we make these findings under the Exchange Act based on the record now before us, we discuss below possible reactions by the CBOE or the Commission to the eventual decision in a lawsuit now pending in Delaware state court. Depending upon that outcome, it may be appropriate for CBOE and the Commission to take further actions in light of the state court's findings and to assess whether they affect CBOE's compliance with the federal securities laws.[60]

A. The Commission Has Jurisdiction to Consider the CBOE's Proposed Rule Change

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54 See 15 U.S.C. 78f(b)(8).

55 See 15 U.S.C. 78f(c)(3)(A).

56 See 15 U.S.C. 78f(c)(4).

57 See infra Section IV.C. (discussing the Commission's findings in greater detail).

58 15 U.S.C. 78s(b).

59 See infra Section IV.C.2 (discussing the completeness of CBOE's proposed rule change on Form 19b-4).

60 See infra note 115.

Various commenters challenged the Commission's jurisdiction over the CBOE's proposed rule change, arguing that the Commission should not consider or approve the CBOE's proposal because the filing implicates a contractual dispute arising under state law and therefore is subject to the jurisdiction of a state court.[61] In particular, CBOT notes that the proposed rule change relates to a pending dispute in the Delaware court involving matters that are governed by state law, including the interpretation of private contracts between CBOE and CBOT involving a property right and claims regarding the proper exercise of authority and fiduciary obligations on the part of CBOE's Board of Directors.[62] CBOT expressed its view that the Commission's authority to consider the proposed rule change under the federal securities laws does not preempt the authority of the state court to determine whether the CBOE's actions comported with state corporate, fiduciary, and contract law.[63]

Accordingly, CBOT and certain commenters have asked the Commission to either disapprove the proposal or defer consideration of the proposed rule change until after the Delaware court has adjudicated the state law issues.[64] CBOT suggests that, since the state

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61 See Comment Letters cited in note 40, supra (questioning the Commission's jurisdiction over the proposed rule change).

62 See Mayer Brown Letter 3, supra note 37, at 6. Specifically, CBOT argues that CBOE's Board of Directors violated its fiduciary duty towards Exerciser Members and violated prior contractual agreements between the CBOE and CBOT by submitting a proposal that has the effect of not affording Exerciser Members equal treatment in the anticipated CBOE demutualization. See id. at 9-10.

63 See id. at 11.

64 See Gardner Letter, supra note 37, at 2; Mayer Brown Letter 1, supra note 37, at 1, 3-4; Mayer Brown Letter 2, supra note 37, at 1; Mayer Brown Letter 3, supra note 37, at 6-7, 10-11; Mayer Brown Letter 6, supra note 37, at 1-2. According to CBOT, the central question in the Delaware litigation – the status of the Exercise Right in light of CBOE's proposed demutualization and the acquisition of CBOT by CME Holdings – is fundamentally a state law question because it concerns an interpretation of the CBOE Certificate of Incorporation, which is treated as a contract under Delaware law. See Mayer Brown Letter 3, supra note 37, at 10.

See also, e.g., Kessler Letter, supra note 40; Reed Letter, supra note 40; Cashman Letter, supra note 40; McKerr Letter, supra note 42; and Letter from Marshall Spiegel, dated March 19, 2007

court's decision may inform the Commission's resolution of the proposed rule change, it may be more efficient for the Commission to defer its consideration of the proposal until after the Delaware litigation is resolved.[65] For similar reasons, CBOT claims that the proposed rule change is not a proper subject of SRO rulemaking because it does not implicate issues under the federal securities laws.[66]

The Commission believes the proposed rule change is a proper subject of SRO rulemaking and implicates issues under the federal securities laws. While the proposed rule change may relate to issues that are implicated in a lawsuit pending in Delaware court, it is also a proposal by a self-regulatory organization ("SRO") to interpret its rules. Section 19(b)(1) of the Exchange Act[67] requires CBOE to file with the Commission any proposed changes to, or interpretations of, its rules. Accordingly, the Exchange Act unambiguously places CBOE's proposal firmly within the Commission's authority and responsibility. Furthermore, the Commission is obligated to consider CBOE's proposal, as the Exchange Act does not give the

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(all requesting that the Commission wait for the Delaware court to rule before acting on the CBOE's proposal). One commenter urged the Commission to wait until the Delaware court decides the issue on the basis that if the Delaware court finds bad faith on the part of the CBOE Board under state law, then the proposed rule change will have been improperly filed. See Ungaretti Letter, supra note 39, at 5-6.

65 See Mayer Brown Letter 1, supra note 37, at 3-4. CBOT notes that, although the Commission has jurisdiction to review proposed rule changes to ensure that they are consistent with the Exchange Act, the Commission previously has indicated that it does not interpret state law to determine whether a rule change is also consistent with state laws. See Mayer Brown Letter 1, supra note 37, at 3; Mayer Brown Letter 5, supra note 37, at 5-6.

66 See, e.g., Mayer Brown Letter 5, supra note 37, at 5 ("In sum, this controversy, and the Proposed Rule Change, have nothing to do with 'membership issues', and everything to do with the ownership issues before the Delaware court."); Mayer Brown Letter 2, supra note 37, at 1 ("The Proposed Rule Change has no legitimate securities regulatory or self-regulatory purpose."); and Mayer Brown Letter 3, supra note 37, at 6-7

67 15 U.S.C. 78s(b)(1).

Commission authority to defer consideration of a proposed rule change that has been properly filed.[68]

As a federal law matter, Congress has given the Commission jurisdiction over SROs and has required "[e]ach self-regulatory organization [to] file with the Commission, in accordance with such rules as the Commission may prescribe, copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such self-regulatory organization…."[69] The "rules of a self-regulatory organization" include, among other things, "the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding to the foregoing, of an exchange… [and] the stated policies, practices, and interpretations of such exchange…."[70] Rule 19b-4(b) under the Exchange Act defines the term "stated policy, practice, or interpretation" broadly to include:

> (1) any statement made generally available to the membership of the SRO, or to a group or category of persons having or seeking access to facilities of the SRO, that establishes or changes any standard, limit, or guideline with respect to the rights, obligations, or privileges of such persons, or
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> (2) the meaning, administration, or enforcement of an existing SRO rule.[71]

Accordingly, because the CBOE's Certificate of Incorporation and the CBOE's interpretation thereof constitute "rules" of the Exchange, the Exchange Act clearly establishes

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68 The Commission notes that the pending lawsuit has been stayed pending Commission action on this proposed rule change. See CBOT Holdings, Inc. et al. v. Chicago Board Options Exchange Inc., et al., Memorandum of Opinion, decided August 3, 2007 (Del. Ch.) ("Memorandum of Opinion"); see also Letter Opinion, dated October 10, 2007 (denying Plaintiffs' Motion to Lift Stay to Allow for Filing of a Third Amended Complaint and the Commencement of Discovery).

69 15 U.S.C. 78s(b)(1).

70 See Sections 3(a)(27) and 3(a)(28) of the Exchange Act; 15 U.S.C. 77c(a)(27) and (28).

71 See 17 CFR 240.19b-4(b).

that CBOE's proposed rule change, an interpretation of Article Fifth(b) of its Certificate of Incorporation, was the proper subject of a rule filing under Section 19(b)(1) of the Exchange Act. Indeed, Section 19(b)(1) of the Exchange Act[72] requires CBOE to file with the Commission any proposed changes to, or interpretations of, its Certificate of Incorporation.

In compliance with Section 19(b)(1), CBOE filed its proposed interpretation of its Certificate of Incorporation with the Commission on December 12, 2006. Once CBOE filed this proposed rule change, Section 19(b)(2) of the Exchange Act[73] required the Commission to publish notice of the proposed rule change and either approve it or institute proceedings to determine whether the proposed rule change should be disapproved.[74] Accordingly, the Commission has the obligation under the Exchange Act to consider and affirmatively dispose, by either approving or disapproving, of the CBOE's proposal. The existence of a contractual dispute arising under state law subject to pending litigation in state court does not in any way displace or supplant the Commission's jurisdiction to consider a proposed rule change submitted by an SRO.[75]

Moreover, Article Fifth(b), which entitles "members of [the CBOT]" to be members of the CBOE, implicates several important Exchange Act issues. First, by its terms, this provision of the CBOE's Certificate of Incorporation relates to membership on the Exchange. The

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72 15 U.S.C. 78s(b)(1).

73 15 U.S.C. 78s(b)(2).

74 The CBOE consented to an extension of time for the Commission to consider its filing. See Item 6 of Amendment No. 1 to CBOE's Form 19b-4 filing, dated January 17, 2007.

75 CBOE asserts that the proposed rule change was not an attempt to undercut the Delaware court's authority to resolve the litigation initiated by the CBOT and the putative class, because, at the time the proposed rule change was filed, the Delaware litigation dealt only with the valuation issues arising from the CBOE demutualization, whereas the proposed rule change addresses the impact of the change in the CBOT corporate structure on the eligibility to be, and remain, an Exercise Member. See Schiff Hardin Letter 1, supra note 36, at 2; and CBOE Response to Comments, supra note 4, at 17-18.

Exchange Act clearly establishes the Commission's oversight responsibility with regard to matters of exchange membership,[76] which includes access to trading on the exchange. For example, Section 6(b)(2) of the Exchange Act requires that "[s]ubject to the provisions of subsection (c) . . ., the rules of the exchange provide that any registered broker or dealer or natural person associated with a broker or dealer may become a member of such exchange . . . "[77] Section 6(c) of the Exchange Act further specifies when a national securities exchange may deny membership to, or condition the membership of, a registered broker or dealer.[78] An exchange's rules are also required, among other things, to provide a fair procedure for the denial of membership to any person seeking membership and the prohibition or limitation by the exchange of any person's access to services offered by the exchange.[79] Further, the Commission has authority under Sections 19(d) and (f) of the Exchange Act to, among other things, review denials of membership by a national securities exchange.[80]

Second, the Exchange Act manifests a strong federal interest in the governance of national securities exchanges.[81] Section 6(b)(3) of the Exchange Act requires the rules of the

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76 CBOE notes that state courts have previously recognized the Commission's exclusive authority over membership rules and membership decisions, including CBOE's interpretations of Article Fifth(b), and have noted that the Commission's authority preempts direct judicial consideration of exchange membership issues. See CBOE Response to Comments, supra note 4, at 6-8; Schiff Hardin Letter 1, supra note 36, at 5-6. CBOE opined that the preeminence of federal law with respect to membership issues is critical to avoid having inconsistent standards imposed on exchanges by competing judicial authorities, which CBOE believes would undermine the federal regulatory scheme. See CBOE Response to Comments, supra note 4, at 8-10.

77 15 U.S.C. 78f(b)(2).

78 See 15 U.S.C. 78f(c).

79 See 15 U.S.C. 78f(b)(6).

80 See 15 U.S.C. 78s(d) and (f), respectively.

81 See, e.g., Securities Exchange Act Release No. 48946 (December 17, 2003), 68 FR 74678 (December 24, 2003) (SR-NYSE-2003-34) (approving NYSE's governance proposal to establish a new board of directors composed wholly of independent directors; an advisory board of executives that would be representative of the exchange's various constituencies; independent board committees with specific oversight authority for compensation, audit functions, the

exchange to assure "a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall. . . not be associated with a member of the exchange, broker, or dealer."[82] By giving members a voice in the governance of an SRO, this requirement "serves to ensure that an exchange is administered in a way that is equitable to all market members and participants,"[83] and helps to preserve the integrity of an exchange's self-regulatory functions. Effective governance of an exchange is also important to an exchange's ability to satisfy the requirement under Section 6(b)(1) of the Exchange Act that an exchange be organized and have the capacity to carry out the purposes of the Exchange Act and to comply and enforce compliance with the Exchange Act, the rules and regulations thereunder, and exchange rules.[84]

The CBOE's interpretation of Article Fifth(b) affects who is entitled to be a member of the CBOE. Because of the role that CBOE members have in the governance of the Exchange, including the election of the CBOE Board of Directors,[85] the Commission has an interest in who

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nominations process and regulatory matters; and an autonomous regulatory unit that would report directly to the regulatory oversight committee).

82 15 U.S.C. 78f(b)(3). The Exchange Act requires that at least one director be representative of issuers and investors because of the public's interest in ensuring the fairness and stability of significant markets. See id.

83 Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70882 (December 22, 1998) (S7-12-98).

84 See, e.g., Securities Exchange Act Release No. 21439 (October 31, 1984), 49 FR 44577 (November 7, 1984) (SR-CBOE-84-15 and SR-CBOE-84-16). This order instituted proceedings to disapprove two CBOE proposals to change certain of its rules related to governance. The first proposal would have increased the number of floor directors on the Board of Directors. The Commission subsequently disapproved this proposal because it could not find that it was consistent with the Act, particularly Sections 6(b)(1), 6(b)(3), and 6(b)(5). See Securities Exchange Act Release No. 22058 (May 21, 1985), 50 FR 23090 (May 30, 1985) (SR-CBOE-84-15 and SR-CBOE-84-16). The second proposal provided that, in the event there is more than one candidate for Chairman of the CBOE Executive Committee, the Chairman would be elected by a plurality of CBOE members voting at an annual meeting of the membership. This proposal was later approved. See id.

85 See CBOE Constitution, Section 6.1.

is entitled to be a member of the Exchange, because it affects how the Exchange is governed and how it fulfills its regulatory responsibilities consistent with Section 6(b) of the Exchange Act.

B. Compliance with Its Own Rules

National securities exchanges are required under Sections 6(b)(1) and 19(g)(1) of the Exchange Act to comply with their own rules.[86] In this case, commenters and the CBOT present two questions of the CBOE's compliance with its rules, which are (1) whether the CBOE should have treated the rule as an amendment instead of an interpretation and (2) whether the Board of Directors of the CBOE breached duties under state law when approving the proposed rule. We begin with a discussion of the way the Commission evaluates arguments such as these in the course of reviewing a proposed SRO rule and then turn to the two specific issues the CBOT and commenters present.

Both of the issues concerning the CBOE's compliance with its own rules raise state law questions. Typically, the Commission does not consider matters outside the scope of the federal securities laws, except to the extent that consideration of a matter of state law is necessary to inform a Commission finding on a federal matter arising under the Exchange Act. Generally, the analysis of whether an SRO has complied with its own rules is straightforward and does not require consideration of disputed areas of state law. For instance, the question might involve whether an SRO complied with requirements relating to a particular time period or some other readily ascertainable procedural step. In those cases, the Commission has a straightforward task in determining whether the SRO complied with its own rules. Other cases, however, might present a more nuanced question of compliance that turns on a difficult or novel issue of state law. In those cases, the Commission generally looks for expert guidance and reaches a decision

[86] 15 U.S.C. 78f(b)(1) and 78s(g)(1).

based on the submissions and sufficiency of the basis of the action of the SRO. However, the Commission is not the final arbiter on questions of state law. If an authoritative decision by a court reaches a conclusion about the relevant state law in a dispute concerning the SRO's actions that differs from the position the Commission relied on, the Commission expects the SRO promptly to propose changes to its rules necessary to comply with the outcome of any such litigation.

In other words, when a proposed rule change raises a difficult or novel question of SRO compliance with its certificate of incorporation or bylaws, the Exchange Act requires the Commission to determine whether the SRO has so complied, even though the question of compliance turns on the interpretation and application of state law. In that situation, the Commission relies on the conclusions of experts or other authorities as to the content and application of state law.[87]

1. Interpretation vs. Amendment of Article Fifth(b)

CBOT argues that CBOE deviated from its own rules and procedures in failing to obtain the necessary vote when it "amended" Article Fifth(b) to eliminate the property right created therein.[88] In response, CBOE states that a vote of its membership was not necessary because the proposed rule change constituted an interpretation of, rather than an amendment to, Article Fifth(b), and thus is not subject to a vote pursuant to the terms of Article Fifth(b).[89] Based on the record before it, the Commission agrees with CBOE.

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87 Cf. Fed. R. Civ. P. 44.1 (in determining foreign law, a court may consider any relevant material or source).

88 See Mayer Brown Letter 3, supra note 37, at 26 and 33. CBOT notes that the terms of Article Fifth(b) require an 80% class vote to amend that provision. See id. at 26.

89 See CBOE Response to Comments, supra note 4, at 19-20 and 22-23.

The proposal interprets who qualifies as a "member of [the CBOT]" under Article Fifth(b) in light of circumstances external to the proposed rule change (i.e., CBOT's decision to be acquired by CME Holdings). CBOT argues that the proposed rule change is an unreasonable interpretation[90] that violates CBOE's Certificate of Incorporation and breaches the 1992 Agreement because it is based on the faulty premise that, following the acquisition by CME Holdings, former CBOT members will no longer be "members" within the meaning of Article Fifth(b).[91] Rather, CBOT asserts that its former members continue to qualify as "CBOT Full Members" and continue to have all the same trading rights they had in the past.[92] In addition, CBOT argues that the provisions in the 1992 Agreement regarding the effect of a potential merger involving CBOT do not adversely affect the continued availability of the Exercise Right in this case.[93] CBOT believes that members of CBOT after the acquisition continue to hold sufficient indicia of CBOT membership to qualify for CBOE membership under Article Fifth(b).[94]

In particular, CBOT points out that the CBOT itself did not merge with any entity and

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90 One commenter criticizes the CBOE's proposal on the basis that it ignores the CBOT's "reasonable alternative interpretation." See Ungaretti Letter, supra note 39, at 9. The Commission, however, is not required to find that the interpretation proposed is the most reasonable, but only that the one proposed is consistent with the Exchange Act.

91 See Mayer Brown Letter 3, supra note 37, at 34. CBOT also notes CBOE's (now expired) arrangement with the Intercontinental Exchange ("ICE") when ICE was attempting to acquire the CBOT in which ICE and CBOE would have paid $665.5 million to compensate, in part, for the loss of the Exercise Right. See Mayer Brown Letter 5, supra note 37, at 2. CBOT believes that this arrangement undercut CBOE's claim that after the acquisition by CME Holdings, the Exercise Right will have no value and the rights of Eligible CBOT Full Members will be extinguished. See id. The Commission disagrees. An offer of settlement in which compensation is to be paid does not necessarily suggest that the underlying matter in dispute has any particular validity or value. An offer to settle a disputed matter has value it its own right, for example the savings associated with the avoidance of protracted legal proceedings and the ability to bring a dispute to a final conclusion.

92 See Mayer Brown Letter 3, supra note 37, at 34-36.

93 See id.

94 See id. at 37.

will survive the transaction with CME Holdings.[95] CBOT affirms that the acquisition by CME Holdings is "precisely the kind of transaction that CBOE has already agreed would have no effect on the Exercise Right under the 1992 Agreement."[96] CBOT asserts that as part of its 2005 restructuring it split full memberships into three components: the Exercise Right Privilege, a Series B-1 membership, and stock in CBOT Holdings, and possession of all three components qualifies a person as an "Eligible CBOT Full Member" within the meaning of the 1992 Agreement (therefore qualifying such person for the Exercise Right).[97] CBOT argues that the Exercise Right should survive because the only change after the acquisition by CME Holdings is that "the 27,338 shares of Class A common stock of CBOT Holdings that Exercise Right holders held before the merger was consummated will be converted into 8,217.80 shares of CME Holdings Class A common stock."[98]

In response, CBOE argues that the concept of a CBOT "member" was eliminated by the acquisition of CBOT, and the only reason persons had continued to qualify as "members" of CBOT for purposes of Article Fifth(b) after CBOT's restructuring is because under the 2001 Agreement, CBOE interpreted Article Fifth(b) so that persons would qualify as "members" of CBOT if they held all of three specified interests in CBOT and CBOT Holdings following CBOT's restructuring.[99] CBOE points out that Article Fifth(b) was designed to recognize

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95 See id. at 35. Rather, CBOT Holdings (of which CBOT is a subsidiary) was acquired by CME Holdings.

96 See id.

97 See id. at 36.

98 See id. at 34.

99 See CBOE Response to Comments, supra note 4, at 26 and 29. The Commission notes that there is support for this position in the Memorandum of Opinion: "The CBOE agreed, albeit with some reluctance, that the restructuring of the CBOT into CBOT Holdings would not render the Exercise Right inapplicable, a circumstance that would likely have been the case if a provision under the parties' agreement in 1992 had been strictly interpreted." Memorandum of Opinion, supra note 68, at 3.

contributions made by CBOT members in their capacities as owners, and so an ownership stake in CBOT is essential to the definition of "member."[100] However, after the CME/CBOT transaction, the concept of CBOT "members" as originally contemplated in Article Fifth(b) no longer exists because CBOT is now owned by CME Holdings.[101] Similarly, after the acquisition, persons who were former members of the CBOT only hold trading permits and no longer possess any of the other rights commonly associated with membership in an exchange.[102] In particular, according to CBOE, a former CBOT member no longer has a right to elect directors, the right to nominate candidates for director, or the right to amend or repeal the bylaws of CBOT.[103] In addition, CBOE notes that one of the conditions in the 1992 Agreement for Exercise Rights to continue after an acquisition is that "the survivor" entity of any merger be an exchange, a condition that is no longer satisfied since the survivor of the transaction is not an exchange, but rather a holding company.[104] CBOE states that ownership of shares of CME Holdings is not enough to support Exercise Right eligibility because the interpretation of Article Fifth(b) embodied in the 2001 Agreement was that "persons remain 'members' of CBOT only if they continue to hold all of three specified interests in CBOT and CBOT Holdings following the 2005 demutualization of CBOT – namely, one Class B, Series B-1 membership in CBOT, one [Exercise Right Privilege] and 27,338 shares of Class A stock of CBOT Holdings."[105] However, as CBOE notes, after CBOT is acquired by CME Holdings, "there no longer will be any persons who could hold all three of these interests – because CBOT Holdings Class A stock will cease to

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100 See CBOE Response to Comments, supra note 4, at 26-27.

101 See id. at 26.

102 See id. at 28.

103 See id.

104 See id.

105 Id. at 29.

exists and instead will be converted into either cash or shares of CME Holdings."[106] Further, CBOE notes that the 2001 Agreement states that the provisions applicable to the Exercise Right would continue to apply only "in the absence of any other material changes to the structure or ownership of the CBOT...not contemplated in the CBOT [restructuring]."[107]

Additionally, in response to the assertion that issues raised in the proposed rule change are governed by state contract law, CBOE responds that the 1992 Agreement was not a contract in which new rights were created, but was rather an interpretation serving to clarify the term "Exercise Member" and what is required to qualify as such.[108] Specifically, according to CBOE, any contractual grant of exercise rights that added or detracted from those afforded by Article Fifth(b) would have represented an amendment of Article Fifth(b), which under its own terms would have required an affirmative vote of at least 80% of Exercise Members and CBOE Seat Owners, voting as separate groups.[109] Thus, CBOE concludes that, since no vote was taken, the 1992 Agreement cannot be construed as a contractual source of new exercise rights, and, at most, must be construed to be a mutually shared interpretation of Article Fifth(b).

The Commission believes that the record provides a sufficient basis on which the Commission can find that the CBOE complied with its own Certificate of Incorporation in determining that the proposed rule change is an interpretation of, not an amendment to, Article Fifth(b).[110] After considering the materials on this issue submitted by both the CBOE and CBOT, the Commission is persuaded by CBOE's analysis of the difference between "interpretations" and "amendments." In particular, the Commission notes that the CBOT's

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106 CBOE Response to Comments, supra note 4, at 29.

107 Id. at 27.

108 See id. at 13-15.

109 See id.

110 See 15 U.S.C. 78f(b)(1).

letter of counsel was based on an error of fact with respect to the composition of the CBOE Board at the time of the interpretation of Article Fifth(b), and, in fact, the CBOE's Board of Directors was composed of a majority of disinterested public directors at the time. This issue is discussed below.[111]

In approving this proposal, the Commission is relying on the CBOE's representation that its approach is appropriate under Delaware state law. The Commission is also relying on CBOE's letter of counsel that concludes that the Board's interpretation of Article Fifth(b) does not constitute an amendment to the CBOE's Certificate of Incorporation and that it is within the general authority of the CBOE's 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.[112] Without opining on the merits of any claims arising solely under state law, the Commission finds that CBOE has articulated a sufficient basis to support its proposed rule change and for the foregoing reasons finds that it is consistent with the Exchange Act.

Further, the Commission agrees that the actions of the CBOT necessitated CBOE's interpretation of Article Fifth(b) to clarify whether the substantive rights of a former CBOT member would continue to qualify that person as a "member of [the CBOT]" pursuant to Article

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111 See infra note 120 (citing to CBOT's opinion letter from Frederick H. Alexander, Morris, Nichols, Arsht & Tunnell LLP, to Erik R. Sirri and Elizabeth K. King, Division of Market Regulation, Commission, dated August 20, 2007) and note 124 (citing to CBOE's opinion letter from Michael D. Allen, Richards, Layton & Finger, to Nancy M. Morris, Secretary, Commission, dated August 31, 2007).

112 See Second Opinion of Counsel, supra note 5, at 5. The Commission's evaluation of CBOE's interpretation of Delaware law rests solely on the materials in the record before it.

Fifth(b) in response to changes in the ownership of the CBOT.[113] While CBOE could have interpreted Article Fifth(b) in any number of ways following that transaction, its proposed interpretation is one that the Commission may find, and herein has found, to be consistent with the Exchange Act. In particular, the Commission finds that CBOE's proposed interpretation is consistent with Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, because the proposal interprets CBOE's rules fairly and reasonably with respect to eligibility for the Exercise Right following the acquisition of CBOT by CME Holdings.[114]

Except to the extent necessary to make these findings under the Exchange Act, the Commission is not purporting to decide a question of state law. Rather, the Commission's approval of the CBOE's proposal under federal law leaves undisturbed any aspects arising solely under state law for the consideration and disposition by the competent state authorities. The currently pending Delaware state court action may result in authoritative decisions on some of the issues we have addressed and could make some of the conclusions reached here infirm. If that occurs, the Commission expects CBOE to propose appropriate amendments to its rules. Should CBOE fail to take the required steps, the Commission has the authority to act.[115]

2. Independence of CBOE Directors Voting on the Matter

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113 See CBOE Response to Comments, supra note 4, at 24.

114 15 U.S.C. 78f(b)(5). See also Securities Exchange Act Release No. 51733 (May 24, 2005), 70 FR 30981, 30983 (May 31, 2005) (SR-CBOE-2005-19) (finding CBOE's proposal to be consistent with Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, because it interpreted CBOE's rules fairly and reasonably with respect to the eligibility of a CBOT full member to become a member of the CBOE following the CBOT's restructuring).

115 See, e.g., Section 19(c) of the Exchange Act; 15 U.S.C. 78s(c) (authorizing the Commission to abrogate, add to, and delete from exchange rules as necessary or appropriate to conform those rules to the requirements of the Exchange Act).

When filing a proposed rule change with the Commission, an SRO is required to state that the proposal was validly approved pursuant to the SRO's governing documents.[116] If the CBOE Board's action in approving the proposal for filing with the Commission was invalid, the consequence would be that the CBOE's proposal would not satisfy the Exchange Act requirements, specified in Form 19b-4, regarding the necessity of valid approval by the SRO's governing body to authorize the filing of the proposal with the Commission.

CBOT argues that the proposal was approved by a conflicted board of directors that had a financial interest in the status of the Exercise Right.[117] Further, CBOT argues that, while the CBOE Board of Directors may interpret the CBOE Certificate of Incorporation "in good faith, consistent with the terms of [Article Fifth(b)], and not for inequitable purposes,"[118] in this particular instance, the CBOE Board "acted in bad faith, for inequitable purposes, inconsistently with the clear terms of the CBOE Charter, and in breach of its fiduciary duties" and was "dominated by members with personal financial interests in expropriating the rights of CBOT members."[119]

The Commission notes that the CBOT submitted an opinion of counsel opining that the CBOE Board breached its fiduciary duties in determining to extinguish the rights of Exerciser

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116 See Item 2 of Form 19b-4 (requiring an SRO to "[d]escribe action on the proposed rule change taken by members or board of directors….") and General Instruction E (specifying that the Commission will not approve a proposal before the SRO has completed all action required to be taken under its governing documents with respect to the submission of such proposal to the Commission).

117 See Mayer Brown Letter 3, supra note 37, at 11.

118 Id. (citing CBOE's Second Opinion of Counsel).

119 Id. One commenter asserts that if the CBOT's allegations are correct that the CBOE Board of Directors lacked corporate authority in filing the proposed rule change in so much as they acted in bad faith and for inequitable purposes, then the issue of whether the proposal had the requisite corporate authority is a central question that can only be resolved by the Delaware state court. See Ungaretti Letter, supra note 39, at 7.

Members.[120] That opinion letter concludes that "[a] majority of the directors serving on the CBOE Board and interpreting Article Fifth(b) are either regular members of CBOE (who stand to benefit financially from the proposed rule change) or are affiliated with, or beholden to, such regular members."[121] Specifically, the opinion letter notes that "11 of the 23 members of the CBOE Board" are regular CBOE members or affiliated with or employed by such members.[122] Together with the Chairman and CEO of CBOE, the letter opines that "12 of CBOE's 23 Board members are not independent" with respect to the decision on how to treat Exerciser Members.[123] The letter also criticized the CBOE Board's failure to appoint a special committee to interpret Article Fifth(b), as it had done before CBOT announced its planned acquisition, in connection with the determination regarding how to treat Exerciser Members in connection with CBOE's planned demutualization.[124]

CBOE responds to the CBOT's comment by stating that it is based on factual errors with respect to the CBOE Board's deliberations.[125] CBOE affirms that its Board of Directors followed deliberative procedures designed to ensure that the interpretation of Article Fifth(b) was considered and agreed upon by directors who did not have a personal or financial interest in the

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120 See Letter from Frederick H. Alexander, Morris, Nichols, Arsht & Tunnell LLP, to Erik R. Sirri and Elizabeth K. King, Division of Market Regulation, Commission, dated August 20, 2007 ("Morris Nichols Opinion Letter") (originally submitted as an appendix to a comment letter to File No. SR-CBOE-2007-77 from Jerrold E. Salzman, Skadden, Arps, Slate, Meagher & Flom LLP, dated August 20, 2007).

121 See id. at 3-4.

122 See id. at 4.

123 See id.

124 See id.

125 See CBOE Response to Comments, supra note 4, at 15-23. See also Letter from Michael D. Allen, Richards, Layton & Finger, to Nancy M. Morris, Secretary, Commission, dated August 31, 2007 ("Richards Layton August Opinion Letter") (originally submitted as an appendix to a comment letter to File No. SR-CBOE-2007-77 from Patrick Sexton, Associate General Counsel, CBOE, dated August 31, 2007).

issue and who were not subject to improper influence from those who might have such an interest.[126] Specifically, according to CBOE, although interested directors were permitted to participate in the general discussion of the interpretation, the disinterested public directors' vote was conducted independently under procedures that ensured that the vote was free from any undue influence.[127]

CBOE also responded to the Morris Nichols Opinion Letter by submitting a subsequent opinion letter from its own counsel.[128] In particular, the CBOE's opinion letter states that, contrary to the Morris Nichols Opinion Letter's assertion that the CBOE Board was composed of 23 members, 12 of whom had a material interest in the interpretation, the CBOE Board in fact had a majority of disinterested directors at the time of the December 21, 2006 meeting of the CBOE's Board of Directors when the Board considered the proposed rule change.[129] Specifically, the opinion letter states that the Board was comprised of 21 members, 11 of whom had no membership interest in CBOE, possessed no right to acquire a membership interest in CBOE, and had no affiliation with an entity that owned any CBOE membership (i.e., they were CBOE's "Public Directors").[130] The opinion letter notes that an additional director was an Exerciser Member (the "Exerciser Director"), and therefore did not have a personal interest in favor of regular full CBOE members.[131]

In an affidavit provided by CBOE's General Counsel, CBOE affirms that at the December 21, 2006 meeting of the CBOE's Board of Directors, seven of the Public Directors

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126 See CBOE Response to Comments, supra note 4, at 19-20.

127 See id. at 19-22. See also Richards Layton August Opinion Letter, supra note 125.

128 See Richards Layton August Opinion Letter, supra note 125.

129 See id. at 2.

130 See id.

131 See id. at 3.

were present (in person or by telephone).[132] The four Public Directors who were members of a Special Committee of the Board that previously had been convened to consider certain issues related to CBOE's planned demutualization were present at the meeting but recused themselves from the discussion and vote on the proposed interpretation.[133] In a separate meeting, all seven Public Directors voted unanimously in favor of the interpretation.[134] Following the separate meeting of the Public Directors, the entire CBOE Board met to discuss the interpretation.[135] At that time, six Industry Directors were present and voted unanimously in favor of the interpretation, one of whom was an Exerciser Member.[136] The seven Public Directors also voted in favor of the proposal.[137] The remaining three Industry Directors abstained from the vote.[138] In addition, the Chairman of the Board was present and voted for the proposal.[139]

Accordingly, the opinion letter notes that "a majority of the members of the Board voting when the full Board considered the Exercise Right Interpretation were also Public Directors or Exerciser Directors" and the proposed interpretation was unanimously approved by the seven voting Public Directors, who also had met and unanimously approved the proposal in closed session, as well as the one Exerciser Director and the remaining six voting directors.[140]

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132 See Affidavit of Joanne Moffic-Silver, dated August 30, 2007, at 1-2 (originally submitted as an appendix to a comment letter to File No. SR-CBOE-2007-77 from Paul E. Dengel, Schiff Hardin LLP, dated August 30, 2007) ("Moffic-Silver Affidavit").

133 See id. at 2. See also Richards Layton August Opinion Letter, supra note 125, at footnote 3.

134 See Moffic-Silver Affidavit, supra note 132, at 2.

135 See id.

136 See id.

137 See id.

138 See id.

139 See id.

140 See Richards Layton August Opinion Letter, supra note 125, at 3.

CBOT also asserts that the proposal is inconsistent with the requirements of Section 6(b)(3) of the Exchange Act, which requires fair representation of CBOE members in the administration of the exchange's affairs, because the fact that the proposal would eliminate the Exercise Right without compensation demonstrates per se that Exerciser Members were not represented in the administration of CBOE's affairs.[141] However, in response, CBOE notes that the presence of an Exerciser Member representative on CBOE's Board demonstrates that CBOE provided fair representation to Exerciser Members in satisfaction of Section 6(b)(3) of the Exchange Act.[142]

The Commission believes that the CBOE has adequately responded to these commenters' contentions, and believes, based on the record before it, that the CBOE Board's approval of the interpretation filed in this proposed rule change was proper and that the CBOE has provided a sufficient basis on which the Commission, as a federal matter under the Exchange Act, can find that the CBOE's proposed rule change was properly authorized and validly filed. In this regard, the Commission approved CBOE's rules establishing the composition of its board of directors, including the number of public directors.[143] In 2002, the Commission found that CBOE's proposal to increase the number of public directors from 8 to 11 is consistent with the requirements of Section 6(b)(5) of the Exchange Act "because it is designed to promote just and equitable principles of trade and to protect investors and the public interest by increasing public representation on the Exchange's Board and certain committees so that the Board and those committees will be balanced between industry (member) and public directors."[144]

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141 See Mayer Brown Letter 3, supra note 37, at 19.

142 See Richards Layton August Opinion Letter, supra note 125, at 2.

143 Section 6.1(a) of CBOE's Constitution defines "public directors" as persons who are not members and who are not broker-dealers or persons affiliated with broker-dealers.

144 See Securities Exchange Act Release No. 46718 (October 24, 2002), 67 FR 66186 (October 30,

The Commission is persuaded by CBOE's letter of counsel affirming that, at the time of the CBOE Board's consideration of the Exercise Right interpretation, a majority of the CBOE Board was disinterested and independent.[145] The Commission is relying on the CBOE's representations and its letter of counsel, which conclude that a majority of the CBOE Board's directors during the consideration of the interpretation did not have a personal interest to favor the regular CBOE members, which, counsel concludes, entitles the Board to the presumption of the business judgment rule.[146]

C. Additional Concerns Expressed by the CBOT and Commenters

As stated above, the Commission herein finds that CBOE's proposed interpretation of Article Fifth(b) is consistent with the Exchange Act. In particular, the Commission would like to address CBOT's contentions that: (1) due process was not given; (2) the proposal does not comply with the requirements of Form 19b-4; (3) the proposal unfairly discriminates among classes of CBOE members by revoking the memberships of a defined group for reasons that do not apply to all CBOE members or potential members; (4) the proposal fails to allocate fairly fees and dues by increasing the value of one group's CBOE membership and forcing another group to purchase new memberships at an added cost; (5) the proposal does not promote free and open markets because it reduces the number of members of the CBOE and therefore negatively impacts liquidity and depth of the markets; (6) the proposal places an unnecessary burden on competition by eliminating the membership rights of current Exerciser Members and eligible Exercise Members and thus reduces the number of people who are able to trade on the Exchange;

2002) (SR-CBOE-2002-48).

145 See Richards Layton August Opinion Letter, supra note 125, at 3.

146 See id. at 2-3.

and (7) that the proposal is inconsistent with Section 6(c)(4) of the Exchange Act.[147] The CBOT also argues that the proposal is an unreasonable interpretation and breach of contract under state law.[148] Each of these points is addressed in turn, below.

1. Due Process and Sufficiency of Notice

CBOT contends that there were failures of due process in the CBOE Board's approval of the proposal.[149] In particular, CBOT believes that CBOE did not provide Exerciser Members or eligible Exercise Members sufficient notice or an opportunity to be heard "at a meaningful time" prior to filing the proposal with the Commission, which consequently deprived CBOT members of valuable property rights without due process.[150]

In response, CBOE notes that it has complied with the requirements of the Exchange Act in proposing its interpretation of Article Fifth(b) and believes that there is no basis to argue that the fulfillment of its filing obligations under the Exchange Act constitutes a deprivation of due process.[151]

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147 See Mayer Brown Letter 3, supra note 37, at 17-26. CBOT's contention that the proposal was improperly adopted in so far as CBOE failed to comply with its own rules in promulgating the proposed rule change is addressed above. See supra Section IV.B.

148 See Mayer Brown Letter 3, supra note 37, at 34.

149 See Mayer Brown Letter 3, supra note 37, at 27-34. See also Stevens Letter, supra note 40. CBOT argues that CBOE, as a state actor endowed with quasi-governmental authority, was obligated to set rules that provide fair procedures when taking actions that deny membership or limit a person's access to the services of the Exchange. See Mayer Brown Letter 3, supra note 37, at 27-29.

150 See Mayer Brown Letter 3, supra note 37, at 30-34. CBOT notes that CBOE stated in its Form 19b-4 submission that it did not solicit or receive comments on the proposed rule change, and uses this fact to support its contention that the CBOE's process for consideration of the proposal was flawed. See id. at 32. Item 5 of Form 19b-4 directs an SRO to summarize any written comments it may have received on a proposal prior to filing such proposal with the Commission. The requirement to solicit written comments, however, is not a prerequisite to filing a proposal with the Commission. Rather, the act of filing a proposal with the Commission initiates a public notice and comment procedure in which the Commission provides notice of and solicits comments on an SRO's proposed rule change.

151 CBOE Response to Comments, supra note 4, at 18 (footnote 28).

The Commission is not persuaded that the CBOE should be considered a government actor subject to constitutional due process requirements in the context of its decision to file with the Commission a proposed rule change pursuant to Section 19 of the Exchange Act. Even if the CBOE were found to be a state actor when proposing an interpretation of its rules, we do not believe that the CBOE, in fulfilling its filing obligations, has deprived CBOT members of any process they are due. Based on the record before it, the Commission finds that the CBOE has satisfied all requirements prerequisite to filing a proposed rule change with the Commission and in so doing has complied with the applicable requirements of the Exchange Act, which are designed to provide interested parties with notice and an opportunity to express their views. CBOE filed its proposal with the Commission and the Commission then promptly published it for notice and comment in the Federal Register. The proposal was posted on the Commission's Web site as well as the CBOE's Web site. This process, required by the Exchange Act, provided the public with a meaningful opportunity to be heard and afforded an opportunity for interested persons to alert the Commission to facts or reasons that may indicate why a proposed rule change may not satisfy the requirements for a proposed rule change under Section 19(b) of the Exchange Act. If in fact the Commission believes that a proposal may not be consistent with the Exchange Act and the rules and regulations thereunder applicable to the exchange, the consequence would be that the Commission would institute disapproval proceedings and, if the proper findings were made, would not allow an SRO to proceed with its proposal. In the present case, the Commission does not believe that any commenters have raised facts or reasons indicating that the CBOE's proposal is not consistent with the Exchange Act and the rules thereunder applicable to CBOE.

The Commission is confident that the public and all affected entities have received ample notice of CBOE's proposed rule change, and commenters, including the CBOT members, have availed themselves of this opportunity to provide their views to the Commission.[152] Further, because CBOE filed its proposal in December 2006, a full six months before CBOT Holdings shareholders voted on the acquisition, and CBOE granted the Commission an extension of time to consider the proposal, affected entities were put on notice of the CBOE's position and were afforded an extended opportunity to be heard before the Commission considered the proposal.

Finally, the Commission disagrees with the CBOT's argument that CBOE was required to provide due process to the Exerciser Members prior to filing the proposal with the Commission pursuant to Section 19(b), because CBOE's act of filing a rule change for Commission consideration does not deprive the Exerciser Members of property interests requiring prior due process.[153] The CBOT argues that "the CBOT members who hold Exercise Rights are holding a valuable property interest with an ascertainable pecuniary value" and that the "value of an Exercise Right is also reflected in the total value of a CBOT Full Membership, which in itself is fully transferable."[154] In essence, the CBOT appears to argue that the CBOE has deprived the Exerciser Members of a valuable property right simply by filing the proposal with the Commission for consideration pursuant to the Exchange Act.[155]

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152 As noted previously, the Commission received 174 comment letters on this proposal from 134 different commenters. See supra note 36 and accompanying text.

153 See, e.g., Mathews v. Eldridge, 424 U.S. 319, 332 (1976) (noting that "procedural due process imposes constraints on governmental decisions which deprive individuals of "liberty" or "property.")

154 Mayer Brown Letter 3, supra note 37, at 30.

155 See id. (stating that "the Proposed Rule Change affects the current value of the Exercise Rights and the CBOT memberships regardless of whether the Merger ever occurs.")

This argument is not persuasive. Any diminution of the value of the CBOT memberships is not a deprivation of a property interest that would compel the provision of due process by the CBOE. The proposal is simply that, a proposal. At the time it was filed with the Commission, it had not taken effect. Further, the proposal could not take effect before the provisions of Section 19(b) of the Exchange Act had been satisfied, which, in this case, include a determination by the Commission that the proposed rule change complies with the requirements of the Exchange Act. Although the rule filing might have caused a decreased value in an Exercise Right, in the way the filing of litigation can affect a company's stock price, the rule filing process mandated by the Exchange Act affords due process. Therefore, the CBOE did not deprive the Exerciser Members of any due process that would warrant additional process in advance of CBOE's filing a proposed rule change with the Commission.

2. Completeness of CBOE's Form 19b-4 Submission

Item 3(b) in Form 19b-4 requires the SRO to "explain why the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization."[156] CBOT argues that the proposed rule change is inconsistent with the requirements of the Exchange Act because Item 3 of CBOE's Form 19b-4 submission was incomplete.[157] In response, CBOE states that it satisfied the requirements of Form 19b-4 by providing a detailed history behind the proposed interpretation, explained the need for the interpretation, stated the purpose served by the interpretation, and noted why the interpretation is fair and reasonable.[158] Furthermore, CBOE submits that it provided a full explanation in Item 3 of why its proposed interpretation is consistent with the Exchange Act and then simply stated the

156 See Item 3(b) in Form 19b-4.

157 See Mayer Brown Letter 3, supra note 37, at 17; Mayer Brown Letter 5, supra note 37, at 6-7.

158 See CBOE Response to Comments, supra note 4, at 23-24.

conclusion in Section II.A(2) of the Notice.[159] The Commission finds that the proposed rule change was complete and properly filed in that it provided all of the requisite information specified in Form 19b-4.

3. Unfair Discrimination

CBOT argues that the proposed rule change discriminates among classes of CBOE members (i.e., Exerciser Members vs. "regular" CBOE full members) by impermissibly applying "different membership rules to Regular [CBOE] Members and Exerciser Members without justification…."[160] In response, CBOE states that equal treatment is not required in this case because it is not relevant to the validity of the proposed interpretation whether persons who previously would have qualified as Exerciser Members will not be treated the same as regular members under the interpretation.[161] According to CBOE, the argument that Exerciser Members are entitled to the same treatment as regular CBOE members presumes that persons are still eligible to become and remain Exerciser Members, and is consequently flawed because the CBOT/CME transaction resulted in no persons being eligible to remain Exercise Members.[162]

In other words, CBOE asserts that its proposed interpretation does not "terminate" or "extinguish" the Exercise Right for persons who otherwise would be entitled thereto. Rather, it is the actions of the CBOT that has resulted in no persons being able to qualify as "members"

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159 See id.

160 See Mayer Brown Letter 3, supra note 37, at 18.

161 See CBOE Response to Comments, supra note 4, at 30-32.

162 See id. at 30-32. In addition, CBOE notes that Exerciser Members and regular CBOE members were treated differently in one respect – Exerciser Members were not permitted to transfer their CBOE Exercise Membership. See id. at 30.

of the CBOT for purposes of Article Fifth(b).[163] In addition, CBOE notes that the proposal does not delete Article Fifth(b) or the Exercise Right contained therein, but rather addresses whether anyone will continue to be eligible to utilize that right after the acquisition of CBOT by CME Holdings.[164] CBOE notes that the express terms of Article Fifth(b) state that the Exercise Right will remain available for a person only for "so long as he remains a member of [CBOT],"[165] and, as explicitly contemplated in the 1992 Agreement, CBOE believes that CBOT was well aware that the consequence of a merger or acquisition of the CBOT might be to eliminate the eligibility of persons to utilize the Exercise Right.[166]

The Commission believes that the CBOE's proposed interpretation of Article Fifth(b) is consistent with Section 6(b)(5) of the Exchange Act,[167] which requires, among other things, that exchange rules not be unfairly discriminatory. The CBOE is interpreting an existing rule that allows certain persons to become members without buying a seat on the exchange. These persons must satisfy all other prerequisites to membership.[168] Article Fifth(b) only relates to members of the CBOT. It entitled such members to membership on CBOE under certain circumstances, which have been interpreted over many years by CBOE, including specifically in the 1992 and 2001 Agreements, which addressed the status of Exerciser Members in the event that significant changes in the ownership structure of the CBOT occurred. The interpretation proposed by the CBOE applies equally to all persons similarly situated.

4. Allocation of Fees and Dues/ Economic Impact of Proposal

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163 See id. at 24.

164 See id. at 24-25.

165 See id. at 25.

166 See id.

167 15 U.S.C. 78f(b)(5).

168 See, e.g., CBOE Rule 3.3 (Qualifications and Membership Statuses of Member Organizations).

CBOT argues that the proposal fails to provide for a reasonable allocation of dues, fees, and other charges in that it could have the effect of increasing the value of a CBOE membership while requiring former Exerciser Members to "pay twice" for access to CBOE.[169] Further, CBOT argues that the proposal will result in a windfall enrichment of regular CBOE members in connection with CBOE's proposed demutualization.[170] Additionally, one commenter argued that the potential economic impact of the proposal presented a reason for the Commission to disapprove the proposed rule change.[171]

In response, CBOE states that former Exerciser Members have no claim to any value derived from their former rights for which they no longer qualify.[172] According to CBOE, the value of the Exercise Right was lost, not because of action taken by the CBOE, but rather because of the CME's acquisition of CBOT.[173]

The Commission notes that the CBOE's proposed rule change does not propose any new or modified fees, dues, or other charges. Further, the Commission is not required to consider the potential effect on the value of a CBOE or CBOT membership that arises as a consequence of the CBOE's proposed rule change. Section 6 of the Exchange Act does not establish standards regarding the impact of exchange rules on the value of an exchange's membership or the value of a membership in a separate entity.

5. Market Impact

169 See Mayer Brown Letter 3, supra note 37, at 22.

170 See Mayer Brown Letter 3, supra note 37, at 25. See also Ungaretti Letter, supra note 39, at 11.

171 See Ungaretti Letter, supra note 39, at 2 and 10.

172 See CBOE Response to Comments, supra note 4, at 32.

173 See id.

CBOT argues that the proposed rule change will adversely affect the liquidity and depth of CBOE's market because it would reduce the number of CBOE members as Exerciser Members lose their ability to trade on the CBOE.[174] In response, CBOE notes that the proposal contemplates that CBOE will provide temporary interim trading access to allow former Exerciser Members to continue to have uninterrupted access to CBOE in order to avoid a sudden disruption to CBOE's market.[175] The CBOE has since filed its temporary membership plan for former Exerciser Members, which will become operative following today's approval of the interpretation.[176] In addition, CBOE believes that a negative impact on the quality of CBOE's markets is unlikely, given the number of people who currently provide liquidity as market makers on CBOE's market.[177]

The Commission agrees. The CBOE's proposed temporary membership plan was filed on September 13, 2007 under Section 19(b)(3)(A) and was immediately effective upon filing. The Commission did not, and is not today, approving that proposed rule change. This temporary membership plan, however, does preserve the status quo in existence prior to the acquisition of CBOT by CME Holdings with respect to those individuals that had utilized the Exercise Right to trade on the CBOE. Because of these temporary memberships, the Commission believes that its approval of this proposed rule change will not impact the quality

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174 See Mayer Brown Letter 3, supra note 37, at 24-25. See also Ungaretti Letter, supra note 39, at 11-12; Morelli Letter, supra note 42; Crilly Letter 1, supra note 40; Cashman Letter, supra note 40; Israel Letter, supra note 40; Chubin Letter, supra note 40; Esterman Letter, supra note 42; Pietrzak Letter, supra note 41; Bianchi Letter, supra note 40; Todebush Letter, supra note 41; Richards Letter 2, supra note 40; and Crilly Letter 2, supra note 42.

175 See CBOE Response to Comments, supra note 4, at 33.

176 See Securities Exchange Act Release No. 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

177 See CBOE Response to Comments, supra note 4, at 33.

or fairness of CBOE's market and is, therefore, consistent with Section 6(b)(5) of the Exchange Act.[178]

6. Burden on Competition

CBOT asserts that the proposal imposes an unnecessary burden on competition, which CBOE has failed to justify, because it drastically reduces the number of people who are able to trade on CBOE.[179] CBOE's position is that the effect on the Exercise Right is a consequence of former CBOT members' approval of the acquisition of CBOT by CME Holdings, in which case the failure to qualify as a "member of [the CBOT]" under Article Fifth(b) is a self-imposed consequence of substantial changes to the structure and ownership of the CBOT.[180]

The Commission agrees that the CBOE's proposal does not impose an inappropriate burden on competition, and is therefore consistent with Section 6(b)(8) of the Exchange Act.[181] In particular, following Commission approval of CBOE's proposal, CBOE's existing full members, as well as former Exerciser Members who access the Exchange pursuant to temporary memberships, will continue to have uninterrupted access to CBOE's markets. Accordingly, the Commission believes that CBOE will continue to accommodate a membership pool that provides for vigorous competition on CBOE's markets. Furthermore, CBOE's proposal is an application of existing rules and interpretations to a new set of facts arising from the CME's acquisition of CBOT. Accordingly, the Commission finds that CBOE's proposed interpretation does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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178 15 U.S.C. 78f(b)(5).

179 See Mayer Brown Letter 3, supra note 37, at 24.

180 See CBOE Response to Comments, supra note 4, at 33.

181 15 U.S.C. 78f(b)(8).

7. The Proposed Interpretation is Consistent with Section 6(c)(4) of the Exchange Act

One commenter urged the Commission to disapprove the proposal on the basis that it would violate Section 6(c)(4) of the Exchange Act,[182] which requires that an exchange not "decrease the number of memberships in such exchange" below the number of memberships "in effect on May 1, 1975."[183] CBOE argues that the proposed interpretation does not "terminate" or "extinguish" the Exercise Right for persons who otherwise would be entitled thereto, and therefore it has not taken any action that would violate Section 6(c)(4) of the Exchange Act.[184] Rather, CBOE states, that it is the actions of the CBOT to enter into the CME Holdings acquisition that has resulted in no persons being able to qualify as "members of the [CBOT]" for purposes of Article Fifth(b).[185]

The Commission finds that the proposed rule change is not an attempt on the part of CBOE to decrease the number of CBOE memberships in violation of Section 6(c)(4) of the Exchange Act. Rather, CBOE's proposal was to address the status of the Exercise Right following the acquisition of CBOT by CME Holdings.

In addition, the CBOE's temporary access plan allows former Exerciser Members to maintain their temporary memberships on CBOE and continue, on an uninterrupted basis, to have access to CBOE's markets. To change or terminate its temporary access plan, CBOE would be required to file a proposed rule change with the Commission and any such proposal would have to be consistent with the Exchange Act, including Section 6(c)(4) thereof.

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182 15 U.S.C. 78f(c)(4).

183 See Ungaretti Letter, supra note 39, at 12.

184 See CBOE Response to Comments, supra note 4, at 33.

185 See id.

Even if the Commission were to view the CBOE's proposal as an effort on the part of CBOE to decrease the number of exchange memberships below the 1975 level, the Commission finds that the number of CBOE memberships in effect on November 2, 2007 exceeds the number of CBOE memberships in effect in 1975. Specifically, the CBOE has represented that as of June 30, 1975,[186] the number of CBOE memberships was 1,025.[187] CBOE has represented that the number of CBOE memberships in effect on November 2, 2007 was 1,179.[188] The 222 Temporary Members are "members" under Section 3(a)(3) of the Exchange Act with the same rights "to effect transactions on [the CBOE] without the services of another person acting as broker."[189] Accordingly, the current number of CBOE memberships exceeds the number of CBOE memberships in effect in 1975 for purposes of Section 6(c)(4) of the Exchange Act.

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186 CBOE has informed the Commission that it is unable to locate historical records from May 1, 1975, but has located financial statements from June 30, 1975 that contain a full count of memberships then in effect. See Letter from Joanne Moffic-Silver, General Counsel, CBOE, to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 2, 2007.

187 See id. Of those, 774 were transferable memberships and 251 were exerciser memberships. See id. Cf. Letter from Peter B. Carey to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 9, 2007 (arguing that the number of CBOE memberships in 1975 should include all 1,402 exerciser memberships both active and inactive). Under the Exchange Act, a "member" of a national securities exchange is defined as a person permitted to effect transactions on an exchange without the services of another person acting as broker. See 15 U.S.C. 78c(a)(3)(A). Thus, only those persons who affirmatively exercised their rights under Article Fifth(b) to trade on CBOE would have been considered members of the CBOE because only those persons were permitted to effect transactions on the exchange without the services of another person acting as broker.

188 See Letter from Joanne Moffic-Silver, General Counsel, CBOE, to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 2, 2007, at 2. Of those, 930 are transferable memberships, 222 are temporary members (i.e., former Exerciser Members), and 27 are CBOE Stock Exchange permits. See id.

189 See 15 U.S.C. 78c(a)(3)(A). See also Securities Exchange Act Release Nos. 56016 (July 5, 2007), 72 FR 38106 (July 12, 2007) (SR-CBOE-2007-77) and 56458 (September 18, 2007), 72 FR 54309 (September 24, 2007) (SR-CBOE-2007-107).

Accordingly, based on the record before us, the Commission finds that the proposal is consistent with Section 6(c)(4) of the Exchange Act and does not constitute an effort by CBOE to decrease the number of CBOE members.

V. Pending State Court Litigation

The Commission wants to emphasize the limited nature of our position on the state law issues we have addressed. The Commission is aware of the state court litigation between the CBOE and members of the CBOT and the state court's decision to stay the litigation until the Commission acts on the CBOE rule proposal. We stress that our consideration of the state law questions in this matter should in no way prejudice or affect the state court's consideration of those questions. As we explained, the state law questions played a role in our analysis of the federal law considerations the Commission is charged with deciding under the Exchange Act. To carry out our responsibilities under the Exchange Act (and also to avoid an endless cycle of our deference to the state court on the state law issues and the state court's deference to us on the federal law issues) we have proceeded to review the CBOE rule proposal. Our decisions about state law matters, however, are only those required to serve as a basis for carrying out our Exchange Act responsibilities.

We also recognize that our review of the CBOE proposed rule involves procedures different from those the state court uses in the pending litigation. This review process is not a forum to litigate state law issues that may arise regarding an SRO's rule proposal. Rather, our review of a proposed rule of an SRO employs public notice and comment, the receipt of written submissions from the SRO and the public, and the possibility of a proceeding to determine whether it should be disapproved. To this process, we bring familiarity with SROs and their rules and extensive knowledge and experience with the relevant provisions of the Exchange Act.

The state court applies the range of procedures used in traditional adversarial litigation, including discovery, rules of evidence, witnesses, cross-examination, motions, and the like. It has deep and specialized knowledge of Delaware corporate law.

The state court thus is free to find the relevant facts and determine and apply the relevant state law in its normal fashion without according weight to our evaluation of the state law questions, which was done employing different procedures and for different purposes.[190] And, as we have explained, if the state law decision calls into question the basis on which our decision here with respect to these state law issues or any other relevant state law issues was made, we would expect CBOE to respond appropriately, or we will act on our own as necessary.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[191] that the proposed rule change (SR-CBOE-2006-106), as amended, be, and hereby is approved.

By the Commission.

Nancy M. Morris
Secretary

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190 The Delaware court discussed possible ways in which the Commission's jurisdiction and the court's state law authority might interact. As the court emphasized, the court "has jurisdiction to consider the 'economic rights' issues by the Complaint because those claims emerge from and are governed by state contract or fiduciary duty law." See Memorandum of Opinion, supra note 68, at 29. The court also noted that "even if it turns out that the SEC's mandate requires that CBOT Full Members be excluded from trading on the CBOE," then "it does not ineluctably follow that, in these unique circumstances, they are also divested of whatever economic (or contractual) rights they hold as a result of that status." Id. at note 48. We agree with the Delaware court and welcome its expert determination of these issues.

191 15 U.S.C. 78s(b)(2).