

- The trade resulted from a verifiable disruption or malfunction of an Exchange dissemination or communication system that prevented an SBT trader from updating or canceling a quote/order for which the SBT trader is responsible, where there is Exchange documentation providing that the SBT trader sought to update or cancel the quote/order;<sup>91</sup>

- The trade resulted from an erroneous print disseminated by the underlying market that is later canceled or corrected by that underlying market, where the erroneous print resulted in a trade higher or lower than the average trade in the underlying security during the two-minute time period before and after the erroneous print by an amount at least five times greater than the average quote width for the underlying security during the time period encompassing two minutes before and after the erroneous print;<sup>92</sup>

- The trade resulted from an erroneous quote in the primary market for the underlying security that has a spread of at least \$1.00 and at least five times greater than the average quote width for the underlying security during the time period encompassing two minutes before and after the dissemination of such quote;<sup>93</sup> or

- The execution price of the trade is higher or lower than the theoretical price for the series by an amount equal to at least two times the maximum bid/ask spread allowed for the option under proposed CBOE rule 44.4, so long as such amount is \$0.50 or more (or \$0.25 or more for options priced under \$3.00).<sup>94</sup>

Upon nullification, the Help Desk promptly would notify the parties, disseminate cancellation information in prescribed OPRA format, and re-establish orders and their respective priorities on the SBT book on a best-efforts basis.<sup>95</sup>

Any determinations made under the trade nullification rule could be

though it has been taken out completely. A second SBT trader sees the "frozen" bid for 20 at 4.00 and also trades against it. In this case, the second trade could be nullified under CBOE rule 43.5(b)(1). Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Nancy Sanow, Division of Market Regulation, Commission, on February 20, 2003 ("February 20 conversation").

<sup>91</sup> See CBOE rule 43.5(b)(2).

<sup>92</sup> See CBOE rule 43.5(b)(3).

<sup>93</sup> See CBOE rule 43.5(b)(4).

<sup>94</sup> See CBOE rule 43.5(b)(5). The theoretical price of an option would be defined as the last bid/offer price, just prior to the trade, from the exchange providing the most volume in the option or, if there are no quotes for comparison, the theoretical price would be determined by two trading officials. See *id.*

<sup>95</sup> See CBOE rule 43.5(b).

appealed pursuant to chapter 19 of the Exchange's rules.<sup>96</sup>

#### G. How Trades Are Executed on CBOEdirect

##### 1. Market Orders

###### a. Market Order Processing

Non broker-dealer market orders to buy or sell options on CBOEdirect will not be automatically executed by the System at prices inferior to the best bid or offer on another national securities exchange, as those best prices are identified by the System.<sup>97</sup> In addition, the SBT System would protect a market order for a given option series by executing it against the best bid or offer only if there were a legal width market in that series.<sup>98</sup> The System would match market orders against orders at the best price in the SBT book and against the other orders behind the best price at varying prices until the order is fully executed or a legal width market no longer exists.<sup>99</sup> CBOE expects that there would be a legal width market for most series at most times—at least during an RTH session—and thus that most market orders on CBOEdirect would execute immediately.<sup>100</sup>

If there is no legal width market when the order is entered—or if the market order is not executed in full because a legal width market no longer exists—the System would hold the order (or any remaining portion thereof) in queue, send an RFQ,<sup>101</sup> and inform the originator of the market order about the order's status.<sup>102</sup> In this case, the RFQ would include the market order quantity but not whether the order was a buy or a sell.<sup>103</sup> RFQ responses would be sent to the SBT book.<sup>104</sup> The System then would execute the market order if:

- During the RFQ response time, the best quote becomes a certain prescribed percentage (as set by the appropriate

<sup>96</sup> See *id.*

<sup>97</sup> See CBOE rule 43.7.

<sup>98</sup> See CBOE rule 43.7(a)(1).

<sup>99</sup> See *id.*

<sup>100</sup> See notice, *supra* note 4, 67 FR at 31033 n.26.

<sup>101</sup> The RFQ would be sent to any SBT market maker who held an appointment in that option class and to any non-appointed SBT market maker who is quoting in that option class at the time the RFQ is sent. See CBOE rule 40.1(m).

<sup>102</sup> See CBOE rule 43.7(a)(2).

<sup>103</sup> See CBOE rule 43.7(a)(3). The only instance that an RFQ would disclose whether the intended transaction is a buy or a sell is if the SBT System generated an RFQ to remedy an order imbalance. October 23 conversation.

<sup>104</sup> See CBOE rule 43.7(a)(3). Also, market orders generally have execution priority over limit orders. However, a limit order may be executed ahead of the market order if, during the pendency of an RFQ, an order is entered on the other side of the market that satisfies the order's limit price. See CBOE rule 43.1(g).

SBT Trading Committee) of a legal width market;<sup>105</sup>

- The System receives a limit order on the same side of the market as the market order that could match the best bid or offer and at least one legal width quote has been received;<sup>106</sup> or

- A certain prescribed percentage of the SBT market makers currently providing quotes in the class (the percentage to be set by the appropriate SBT Trading Committee) respond to the RFQ with legal width markets.<sup>107</sup>

If the market order could be executed under any of the three conditions above and there is a market order on the opposite side, the System would execute the market orders with each other.<sup>108</sup>

If none of the three conditions noted above were satisfied but a legal width market existed at the end of the RFQ period, the market order would execute against the booked order with the highest priority.<sup>109</sup> However, if the System were holding a market order and the RFQ process did not yield a legal width market, the Exchange's Help Desk could solicit quotes and require a response from SBT market makers.<sup>110</sup>

###### b. Market Order Price

If a market order is executed before the RFQ process is completed under any of the three conditions set forth above, it would trade at the price of the highest priority contraside quote or order in the SBT book. However, if a market order could be executed pursuant to any of the three conditions and there were one or more market orders on the opposite side, the System would execute the market orders against each other at a price determined as follows:<sup>111</sup>

- At the middle of the best bid/offer in the SBT book, if the middle price is a price that may be entered on the System; or

- If the middle price is not a price that could be entered on the System, at the next such price that is closer to the last trade price for the series.

<sup>105</sup> See CBOE rule 43.7(a)(3)(A). CBOE has represented that it would issue an information circular regarding the designated percentage that would trigger this provision. December 5 conversation. The market order would trade with the best-priced quote or order on the SBT book.

<sup>106</sup> See CBOE rule 43.7(a)(3)(B). The market order would trade with the best priced quote or order on the SBT book. However, if no legal width market existed at the time the limit order were received, the incoming limit order would execute ahead of the market order. See *id.*; CBOE rule 43.1(g).

<sup>107</sup> See CBOE rule 43.7(a)(3)(C).

<sup>108</sup> See CBOE rule 43.7(a)(4).

<sup>109</sup> Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Michael Gaw, Division of Market Regulation, Commission, on September 25, 2002.

<sup>110</sup> See CBOE rule 43.7(b).

<sup>111</sup> See CBOE rule 43.7(a)(4).