

participant to submit an order ("N-second group"), each member of the N-second group would be entitled to share in the trade with the electronic book pursuant to the allocation algorithm described below.³⁹

Component A of the proposed allocation algorithm is an equal percentage based on the number of market participants in the N-second group. Component B of the proposed allocation algorithm is that percentage that the order or quote of each market participant in the N-second group represents relative to the total number of contracts of such orders or quotes. The final relative weighting of Components A and B would be determined by the appropriate FPC,⁴⁰ but initially, would be equal. The assigned weightings of Components A and B would be multiplied by the percentages derived for Components A and B, respectively, and then would be multiplied by the size of the incoming order.

If a DPM were eligible for an allocation by virtue of being a member of the N-second group, the DPM would be entitled to receive an allocation equal to the amount it would be entitled to pursuant to the DPM participation right established pursuant to CBOE Rule 8.87 (and Regulatory Circulars issued thereunder), discussed below. The DPM's entitlement percentage is expressed as a percentage of the remaining quantity after all public customer orders in the electronic book have been executed.

In its comment letter, ISE raises several concerns about the proposed N-second period.⁴¹ First, ISE questions whether a marketable public customer order that is received during the N-second period would receive an automatic execution against orders in the limit order book during the N-second period. The ISE also questions whether, if the incoming order trades against orders in the limit order book and the best price moves, the interest in the N-second group would be automatically cancelled.⁴²

The Commission believes that ISE's questions are answered by CBOE's amendment clarifying when a trade occurs in the context of an N-second

group transaction.⁴³ Specifically, as amended, proposed CBOE Rule 6.45A(c) indicates that a trade would occur when a market participant's quote or order interacts with the order in the book. At this point, CBOE would disseminate a trade report and decrement its disseminated quote to reflect the execution. The N-second group is relevant only to determining the appropriate allocation of the trade among market participants. According to the CBOE, the N-second period prevents millisecond priority by giving a form of parity to market participant orders submitted at virtually the same time. Moreover, because the N-second group is relevant only to the allocation of the trade, members of the N-second group would not have an opportunity to cancel trades.⁴⁴

In addition, ISE questions how a participant in the N-second group representing a customer order would be treated.⁴⁵ CBOE's amendment also clarifies that if a floor broker agent submits a customer order to buy (sell) the book, and that order is first in time (*i.e.*, ahead of all other market participants), it would have priority.⁴⁶ CBOE's amendment further clarifies that a floor broker submitting a customer order after a market participant would become part of the N-second group.⁴⁷ Floor broker handheld quoting/order entry terminals provide floor brokers with the ability to designate orders as customer orders.⁴⁸

³⁹ See Amendment No. 6, *supra* note 7.

⁴⁰ See CBOE Response Letter, *supra* note 8.

⁴¹ *Id.*

⁴² See Amendment No. 6, *supra* note 7.

⁴³ *Id.* The Hybrid System, at least temporarily, would not recognize in-crowd orders from floor broker handheld devices for purposes of allowing these orders to participate in the N-second group. To address this systems limitation, the Exchange proposes to designate in each trading crowd "Temporary Order Access Terminals" ("T-OATs") that would allow floor brokers to enter customer orders that would be eligible to participate in the N-second group. The CBOE represents that these terminals would provide to floor brokers the same functionality in terms of order entry that in-crowd market makers currently have. The CBOE also represents that these T-OATs would be reserved exclusively for the use of floor brokers holding customer orders and would be conveniently located in the trading pit such that they are readily available and easily accessible. The CBOE commits to place at least one T-OAT in each trading pit in which Hybrid is operational and further commits to provide as many T-OATs as are necessary to accommodate demand. The CBOE will provide these T-OATs for floor brokers' use until the above-mentioned Hybrid System limitation is resolved in such a manner that floor brokers have direct order entry access via floor broker workstations. The Exchange will continue to provide T-OATs until either November 28, 2003 or until the Hybrid System is capable of accepting orders from floor broker workstations, whichever occurs first. See proposed CBOE Rule 6.45A(c)(iv).

⁴⁴ *Id.*

Finally, the ISE questions the discretion given the FPC with respect to the length of the N-second interval. The Commission notes that the FPC may only shorten the length of this interval and, as represented by CBOE, any changes to the N-second interval would be announced to the membership in advance of implementation and would apply uniformly across all classes under the FPC's jurisdiction.

Accordingly, the Commission believes that this proposed algorithm is consistent with the Act and should ensure that additional market participants have an opportunity to interact with orders resting on the Exchange's electronic book.

4. Quotes Interacting with Quotes

Because Hybrid allows the simultaneous entry of quotes by multiple market makers, there may be instances where quotes become locked. If an in-crowd market maker's (including the DPM) disseminated quote were to interact with the disseminated quote(s) of another in-crowd market maker (including the DPM), resulting in the dissemination of a "locked" quote, the following would occur:

(A) The Exchange would disseminate the locked market and both quotes would be deemed "firm" disseminated market quotes.

(B) The market makers whose quotes are locked would receive a quote update notification advising that their quotes are locked.

(C) A "counting period" would begin during which market makers whose quotes are locked may eliminate the locked market.⁴⁹ Provided, however, that in accordance with subparagraph (A) above, a market maker would be obligated to execute customer and broker-dealer orders eligible for automatic execution pursuant to proposed CBOE Rule 6.13 at his disseminated quote in accordance with CBOE Rule 8.51. During the "counting period," market makers would continue to be obligated for one contract in open outcry to other market makers, in accordance with CBOE Rules 8.51 and 6.48. If, at the end of the counting

⁴⁹ For the first 60 days after a class begins trading on the Hybrid System, the length of the "counting period" for that particular class would not exceed ten seconds. For the next 60 days thereafter (*i.e.*, days 61-120) the length of the "counting period" would not exceed seven seconds in that class. Commencing on the 121st day after a class begins trading on the Hybrid System, the length of the "counting period" would not exceed four seconds in that class. Beginning April 1, 2004, all classes trading on Hybrid would be subject to a counting period not to exceed four seconds. The appropriate FPC may shorten the duration of the "counting period."

Regulatory Circular. Furthermore, this time-period would apply uniformly among all classes under the FPC's jurisdiction. See CBOE Response Letter, *supra* note 8.

³⁹ See Amendment No. 6, *supra* note . The trade occurs when the first market participant's quote or order interacts with the order in the book, not at the expiration of the N-second period.

⁴⁰ As stated above, CBOE represents that these weightings would be changed very infrequently. See CBOE Response Letter, *supra* note 8.

⁴¹ See ISE Letter, *supra* note 5.

⁴² *Id.*