

Commission notes that under the proposed rules, the most to which the DPM would be entitled would be either the guarantee, which is capped at 40%, or the amount to which it would be entitled pursuant to the proposed allocation algorithm, discussed above. This approach is consistent with rules previously approved by the Commission.⁶³

C. Orders on the Book

The Exchange proposes to amend CBOE Rule 7.4(a) to expand the types of orders eligible for entry into the electronic book.⁶⁴ Market participants would be permitted to place orders in the book (in those classes in which Hybrid is operational.) Proposed paragraph (a)(1) to CBOE Rule 7.4 would enable the FPC to allow all broker-dealer orders to be book eligible or, to allow orders from those broker-dealers that are not market makers or specialists to enter the book. This proposed rule also would require members submitting orders or quotes for entry into the electronic book to do so electronically and require them to comply with such format requirements as may be prescribed by the Exchange.⁶⁵

ISE contends that the proposal allows "an FPC to distinguish between broker-dealer orders and competing market maker orders on a class basis, and to decide whether one or both categories of orders may be permitted on the book and/or be eligible for automatic execution."⁶⁶ In its response, CBOE states that the Hybrid proposal does not discriminate against competing market maker orders because they are treated

floor broker, cannot exceed 40% of the original order (after relevant public customer orders have been satisfied); and Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388, 11398 (March 2, 2000) (approving International Securities Exchange's application for registration as a national securities exchange, which contains a 40% participation right for facilitating EAMs); See also Phlx 80/20 Proposal, *supra* note 61.

⁶³ See Supplementary Material .01(b) to ISE Rule 713, which states that "[i]f the Primary Market Maker is quoting at the best price, it has participation rights equal to the greater of (i) the proportion of the total size at the best price represented by the size of its quote, or (ii) sixty percent (60%) of the contracts to be allocated if there is only one (1) other Non-Customer Order or market maker quotation at the best price, forty percent (40%) if there are two (2) other Non-Customer Orders and/or market maker quotes at the best price, and thirty percent (30%) if there are more than two (2) other Non-Customer Orders and/or market maker quotes at the best price." See also PCX Rule 6.76(a)(2)(C)(iii), which states that the "LMM will be allocated a number of contracts equal to the greater of their guaranteed participation or their 'size pro rata' allocation * * *."

⁶⁴ Currently, only public customer orders are eligible for entry in the book.

⁶⁵ See Amendment No. 5, *supra* note 6.

⁶⁶ See ISE Letter, *supra* note 5.

the same way that orders for CBOE market makers who are not physically present in the trading crowd are treated.⁶⁷ In this regard, a CBOE market maker that is not physically present in the trading crowd would be eligible to receive automatic executions in that class only if all other market makers (including competing market makers) were also eligible.⁶⁸

However, a market maker who is physically present in the trading crowd would be permitted to submit one-sided quotes (also referred to as an order) or two-sided quotes.⁶⁹ These one and two-sided quotes would be treated in the same manner by the Hybrid System.⁷⁰ Such quotes would route directly to the CBOEdirect platform; would have the same participation entitlements in UMA; would be eligible to participate in the N-second group as described in proposed CBOE Rule 6.45A(c); and would be subject to proposed CBOE Rule 6.45A(d) if they locked the quote of another market maker.⁷¹ Furthermore, an in-crowd market maker would be required to be firm pursuant to the Quote Rule for a one-sided quote to the same extent he or she would be for a two-sided quote.⁷²

The Commission believes that the proposal does not unfairly discriminate against competing market makers and may enhance access to the book.

D. Firm Quotations

The Exchange proposes to amend CBOE Rule 8.51(a)(1) to clarify that in Hybrid classes, the market participant who submits a quote that is disseminated would be the responsible broker or dealer for that quote for purposes of the Exchange's rule and the Quote Rule. Proposed subparagraph (c)(1)(a)(i) to CBOE Rule 8.51 states that the firm quote requirement for customer orders would be the size disseminated to vendors. In subparagraph (a)(ii), the Exchange proposes to clarify that the firm quote requirement for broker-dealer orders would be the lesser of the size it disseminates to vendors or periodically publishes in a different manner. This proposed rule is almost identical to the CBOE's current rule, except that it provides flexibility to allow the Exchange to disseminate its broker-dealer firm quote size (rather than to periodically publish it).

In addition, CBOE proposes a change to Interpretation .10 to CBOE Rule 8.51

to clarify the timing of when an order has been presented to a responsible broker or dealer. Currently, because the trading crowd as a whole is the responsible broker or dealer, an order is considered to be presented to the responsible broker or dealer at the time it is received on a PAR station. This interpretation would remain the same for non-Hybrid classes. For Hybrid classes, an order received on a PAR station is presented to a responsible broker or dealer that is not the DPM when the order is announced to the trading crowd.⁷³ However, an order is considered presented to the DPM at the time of receipt of the order on PAR. Thus when an order is received on PAR when the disseminated quote represents the DPM and other market makers, there would be two separate times when the order has been presented for Quote Rule purposes: the order would be presented to the DPM at the time the order is received on PAR, while the order would be presented to another responsible broker or dealer when the order is announced to the crowd.

ISE argues that "the proposal changes the point at which firm quote obligations attached to orders represented by floor brokers to the time they are presented to the crowd so there is greater potential for the quote to have changed from the time the order was received at the CBOE to the time it is walked into the crowd." The Quote Rule, among other things, requires a responsible broker or dealer to execute orders presented to it by another broker-dealer, at a price at least as favorable as the responsible broker or dealer's published bid or offer. The Commission believes that CBOE's proposed rule amendment is consistent with the Quote Rule because a responsible broker or dealer in the trading crowd would not be "presented" with an order until it is announced to the crowd.

The Commission, nonetheless, has concerns about the potential for responsible brokers or dealers to improperly avoid their Quote Rule obligations. The Commission expects the CBOE to surveil not only for violations of the Quote Rule by the DPM and/or other responsible brokers or dealers, but also, for the DPM's handling

⁷³ In Amendment No. 4, the Exchange noted that market makers in the crowd have no control over PAR and no access to PAR and would be unaware that an order resides on PAR until that order is announced to them. Currently, even though a market maker may be unaware of the receipt of an order on PAR, because the disseminated quote represents the entire trading crowd, the entire crowd is deemed to receive the order upon receipt of the order on PAR. In Hybrid, each market maker has its own quote. See Amendment No. 4, *supra* note 3.

⁶⁷ See CBOE Response Letter, *supra* note 8.

⁶⁸ *Id.*

⁶⁹ See Amendment No. 6, *supra* note 7.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*