

that day (up to the time of the transaction in question) to determine which exchange provides the most volume. If CBOE is the volume leader, it will use volume figures from the exchange with the next highest volume level.

(b) This Interpretation expires upon final approval of SR-CBOE-2001-04 or December 1, 2003, whichever occurs earlier.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

On September 29, 2003, the Commission granted partial accelerated approval on a pilot basis of a provision of CBOE's proposed obvious error rule that allows for the adjustment and nullification of trades resulting from verifiable disruptions or malfunctions of Exchange systems.³ According to CBOE, while approval of this section provides a degree of relief to market makers and Designate Primary Market Makers ("DPMs") who, through no fault of their own, execute trades electronically based on erroneous prices, it does not provide any protection against transactions executed at obviously erroneous prices that are not the result of Exchange systems disruptions. The purpose of this proposal, therefore, is to request accelerated approval, of new temporary Interpretation .03 to CBOE Rule 6.25, which is substantially similar to the

SBT trade nullification rule (CBOE Rule 43.5) provision relating to obvious pricing errors, as described below.⁴

Proposed Interpretation .03 to CBOE Rule 6.25 will allow for the adjustment or nullification of trades when 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 CBOE Rule 8.7(b)(4), provided the amount is \$0.50 or more or \$0.25 or more for options priced under \$3. For purposes of this Interpretation, the Theoretical Price of an option is defined as the last bid (offer) price, just prior to the trade, from the exchange providing the most volume in the option with respect to an erroneous bid (offer) entered on the Exchange. If there are no quotes for comparison purposes, then the Theoretical Price of an option is as determined by two Trading Officials. CBOE will look to the volume figures for that day, up to the time of the transaction in question, to determine which exchange provides the most volume. If CBOE is the volume leader, it will use volume figures from the exchange with the next highest volume level.

The Exchange represents that approval is both necessary and justified for several reasons. First, as indicated above, the Commission has already approved a substantially similar rule provision in the context of CBOE's SBT. The SBT rules were published for comment and the Commission received no negative comments. Second, and most important, the rule is necessary from a protective standpoint: trades executed at obviously erroneous prices can have extreme financial ramifications on a market maker and the inability to seek relief for obvious errors imposes a form of strict liability trading upon participants. The Exchange is not requesting relief from errors that do not qualify as obvious, and readily accepts that in some instances the cost of doing business means that market makers must honor trades executed at inaccurate prices. CBOE believes that requiring a market maker to honor trades executed at prices that are not even remotely close to theoretical value, will have nothing but a chilling effect and cause those market participants to stop quoting or reduce their sizes. CBOE notes that both the International

Securities Exchange ("ISE") and Pacific Exchange ("PCX") have "clearly erroneous" rules, and CBOE represents that the obvious pricing component that it proposes herein is much more restrictive than either of those Exchanges' rules. According to CBOE, this means that the same trade executed on CBOE and ISE or PCX could be nullified or adjusted on the PCX or ISE while it would stand on CBOE. Accordingly, CBOE believes that competitive forces necessitate this proposal.

The Exchange requests approval of this Interpretation on a temporary basis until the earlier of final Commission approval of File No. SR-CBOE-2001-04 or December 1, 2003. The procedural requirements necessary for implementation of CBOE Rule 6.25 (i.e., Sections (b)-(e)) were approved by the Commission on a pilot basis on September 29, 2003 and will be utilized to implement proposed Interpretation .03.

2. Statutory Basis

By providing for the adjustment or nullification of trades executed at clearly erroneous prices, the Exchange believes the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.⁵ Specifically, the Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,⁶ which requires that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

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

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

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

CBOE did not solicit or receive written comments on the proposed rule change.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and

³ See Securities Exchange Act Release No. 48556 (September 29, 2003), 68 FR 57716 (October 6, 2003), (File No. SR-CBOE-2001-04). The Exchange's proposed obvious error rule, CBOE Rule 6.25, defines six instances that qualify as "obvious errors" and hence are subject to adjustment or nullification. The Commission approved on a temporary basis until December 1, 2003 the following sections of CBOE Rule 6.25: (a)(3) and (b)-(e). The following sections of CBOE Rule 6.25 have not yet been approved: (a)(1), (2), (4)-(6) and Interpretations .01 and .02.

⁴ The Commission approved CBOE Rule 43.5 as part of the Exchange's screen-based trading ("SBT") rules. See Securities Exchange Act Release No. 47628 (April 3, 2003), 68 FR 17697 (April 10, 2003) (File No. SR-CBOE-2000-55). CBOE represents that SBT rules have no application to trading that is not effected through the SBT.

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).