

ITS "Trade-Throughs" and "Locked Markets"

RULE 40. (a) Definitions

(1) An "Exchange trade-through," as that term is used in this Rule, occurs whenever a member on the Exchange initiates the purchase on the Exchange of a security traded through ITS (an "ITS Security") at a price which is higher than the price at which the security is being offered (or initiates the sale on the Exchange of such a security at a price which is lower than the price at which the security is being bid for) at the time of the purchase (or sale) in another ITS participating market center as reflected by the offer (bid) then being displayed on the Exchange from such other market center. The member described in the foregoing sentence is referred to in this Rule as the "member who initiated an Exchange trade-through."

(2) A "third participating market center trade-through," as that term is used in this Rule, occurs whenever a member on the Exchange initiates the purchase of an ITS Security by sending a commitment to trade through the System and such commitment results in an execution at a price which is higher than the price at which the security is being offered (or initiates the sale of such a security by sending a commitment to trade through the System and such commitment results in an execution at a price which is lower than the price at which the security is being bid for) at the time of the purchase (or sale) in another ITS participating market center as reflected by the offer (bid) then being displayed on the Exchange from such other market center. The member described in the foregoing sentence is referred to in this Rule as the "member who initiated a third participating market center trade-through."

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Interpretations and Policies:

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.06 Contemporaneous Commitments

The terms "Exchange trade-through" and "third market participating market center trade-through" do not include the situation where a member who initiates the purchase (sale) of an ITS security at a price which is higher (lower) than the price at which the security is being offered (bid) is another ITS participating market, sends contemporaneously

through ITS to such ITS participating market a commitment to trade at such offer (bid) price or better and for at least the number of shares displayed with that market center's better-priced offer (bid). A trade-through complaint sent in these circumstances is not valid, even if the commitment sent in satisfaction cancels or expires, and even if there is more stock behind the quote in the other market.

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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 IV 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange is a participant in the ITS Plan.⁶ Exhibit B to the ITS Plan is a model ITS Trade-Through Rule (the "Trade-Through Rule"), which provides that a member in one market should avoid initiating a trade if the trade would be executed at a price inferior to a price quoted by another ITS market center.⁷

As a remedy following a trade-through, the ITS Plan provides that (upon receipt of a valid trade-through complaint) the party that initiated the trade-through must send a commitment to trade, at the price and for the number of shares in the disseminated quotation, to satisfy the market that was traded through.

⁶ The ITS Plan was approved on a permanent basis on January 27, 1983. See Securities Exchange Act Release No. 19456 (January 27, 1983), 48 FR 4938. Signatories to the ITS Plan include the American Stock Exchange, LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the CHX, the Cincinnati Stock Exchange, Inc. (now known as the National Securities Exchange), the NASD, the New York Stock Exchange, Inc. ("NYSE"), the Pacific Exchange, Inc., and the Philadelphia Stock Exchange, Inc.

⁷ Section 8(d)(ii) of the ITS Plan requires each Participant to adopt a rule substantially the same as the Trade-Through Rule. CHX Article XX, Rule 40 is the Exchange's version of the Trade-Through Rule.

The ITS Operating Committee believes that a member should be able to avoid any trade-through liability when a member sends a commitment at the same time that it trades through the bid or offer in another market. Accordingly, based on the Commission's request for express clarification, the ITS Operating Committee has encouraged each ITS Participant, including the CHX, to expressly recognize that a trade will not be considered an inappropriate trade-through if an ITS commitment is sent contemporaneously with the execution of a trade through the bid or offer of another market center. Accordingly, the CHX is submitting proposed CHX Article XX, Rule 40, Interpretation and Policy .06.

As stated above, the Exchange believes that each ITS participant will propose a similar interpretation. As of the date of submission of this proposed rule change, the Exchange is only aware of a submission by the NYSE, containing proposed rule language identical to that proposed in this submission.

2. Statutory Basis

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of section 6(b) of the Act.⁸ The CHX believes the proposal is consistent with section 6(b)(5) of the Act,⁹ in that it is designed to promote just and equitable principles of trade, to remove impediments, and to perfect the mechanism of, a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition.

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

Written comments were neither solicited nor received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change constitutes a stated policy,

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

rule change. Telephone conversation between Kathleen M. Boege, Vice President and Associate General Counsel, CHX, and Ian K. Patel, Attorney, Division of Market Regulation, Commission, dated December 23, 2003.