

as amended. This order approves the proposed rule change, as amended, and issues notice of, and grants accelerated approval to, Amendment No. 3.

## II. Description of the Proposed Rule Change

Pursuant to the Linkage Project and Facilities Management Agreement ("Agreement"),<sup>7</sup> the Linkage Participants, including the Exchange, are required to file a proposed rule change with the Commission to provide the Options Clearing Corporation ("OCC") with limited liability with respect to the members' use of the Linkage. The CBOE represents that it filed this proposed rule change to fulfill its obligation under the Agreement. The CBOE proposes to adopt Interpretation .04 to CBOE Rule 6.7 to limit the liability for the OCC with respect to CBOE members' use of the Linkage.

## III. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>8</sup> and, in particular, the requirements of Section 6(b) of the Act<sup>9</sup> and the rules and regulations thereunder. The Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,<sup>10</sup> which requires, among other things, that the rules of the Exchange be designed to foster cooperation and coordination with persons engaged in regulation, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission believes that this proposed rule change, as amended, should foster cooperation and should promote a relationship between the CBOE and the OCC that is conducive to the effective operation of the Linkage.

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> for approving Amendment No. 3

prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. In Amendment No. 3, the CBOE proposes to eliminate a provision from proposed Interpretation .04 to CBOE Rule 6.7 that characterized Linkage as a facility or service of the Exchange for purposes of Exchange Rule 6.7. The Commission believes that removing this provision makes the CBOE's rules consistent with the rules of some of the other Exchanges recently approved by the Commission.<sup>12</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-2003-22 and should be submitted by November 6, 2003.

## V. Conclusion

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change, as amended, (File No. SR-CBOE-2003-22) is approved, and Amendment No. 3 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>7</sup> Linkage Project and Facilities Management Agreement (January 30, 2003).

<sup>8</sup> In approving this proposed rule change, as amended, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</sup> See Exchange Act Release Nos. 48530 (September 24, 2003), 68 FR 56357 (September 30, 2003) (SR-ISE-2003-15), and 48531 (September 24, 2003), 68 FR 56370 (SR-Phlx-2003-43).

<sup>13</sup> *Id.*

<sup>14</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48600, File No. SR-CBOE-2003-44]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the Chicago Board Options Exchange, Inc., To Amend a Rule Regarding Nullification and Adjustment of Transactions

October 7, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 7, 2003, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is granting accelerated approval of the proposed rule change, which will be in effect on a temporary basis.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to amend its obvious error rule, CBOE Rule 6.25, on a pilot basis. Proposed new language is *italicized*.

\* \* \* \* \*

Rule 6.25 Nullification and Adjustment of Electronic Transactions

(a)-(e) No Change.

Interpretations and Policies.....

*.03 (a) Trades may be adjusted or nullified 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 Rule 8.7(b)(4), so long as such amount is \$0.50 or more or \$0.25 or more for options priced under \$3. For purposes of this subparagraph, the Theoretical Price of an option is 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 use the volume figures for*

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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.

\* \* \* \* \*

## 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.<sup>3</sup> 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

<sup>3</sup> 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.

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

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

<sup>4</sup> 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.

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.<sup>5</sup> Specifically, the Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,<sup>6</sup> 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

<sup>5</sup> 15 U.S.C. 78f(b).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-2003-44 and should be submitted by November 6, 2003.

#### IV. Commission's Findings and Order Granting Accelerated Approval on a Pilot Basis

After careful review, the Commission finds that proposed Interpretation .03 to CBOE Rule 6.25 is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>7</sup> In particular, the Commission finds that the proposed Interpretation is consistent with the requirements of Section 6(b)(5)<sup>8</sup> of the Act, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principals of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade is such that execution of a trade at that particular price indicates that an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether such an "obvious error" has occurred should be based on specific and objective criteria

<sup>7</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

and subject to specific and objective procedures. The Commission believes that CBOE's proposed Interpretation .03 to CBOE Rule 6.25 establishes such specific and objective criteria for determining when a trade may involve an "obvious price error," and thus may be adjusted or nullified in a fair and non-discriminatory manner. The Commission notes that if there are no quotes for comparison, CBOE has specified that trading officials may determine the Theoretical Price, which would then be used to adjust or nullify transactions resulting from an obvious price error.

The Commission finds good cause, pursuant to Section 6(b)(5)<sup>9</sup> and Section 19(b)<sup>10</sup> of the Act, to accelerate approval of Interpretation .03 to CBOE Rule 6.25 on a pilot basis, prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that the provisions of the proposal are substantially similar to CBOE's SBT obvious price error rule, CBOE Rule 43.5(b)(5), which the Commission has approved.<sup>11</sup> The Commission also notes that it has recently approved "obvious error" rules for ISE and PCX that provide procedures for the nullification or adjustment of a trade.<sup>12</sup> Furthermore, the provisions of the proposed rule change would be in effect on a temporary basis until the earlier of approval of File No. SR-CBOE-2001-04 or December 1, 2003, whichever occurs earlier. Finally, the Commission notes that the procedures to implement Interpretation .03 to CBOE Rule 6.25 were adopted on a pilot basis in Securities Exchange Act Release No. 48556.<sup>13</sup> The Commission finds, therefore, that granting accelerated approval of the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**, is appropriate and consistent with Section 6(b)(5)<sup>14</sup> of the Act.

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that Interpretation .03 to CBOE Rule 6.25, as set forth in the proposed rule change be

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 15 U.S.C. 78s(b).

<sup>11</sup> See Securities Exchange Act Release No. 47628 (April 3, 2003), 68 FR 17697 (April 10, 2003) (File No. SR-CBOE-00-55).

<sup>12</sup> See Securities Exchange Act Release No. 48538 (September 25, 2003), 68 FR 56858 (October 2, 2003) (File No. SR-PCX-2002-01); and Securities Exchange Act Release No. 48097 (June 26, 2003), 68 FR 39604 (July 2, 2003) (File No. SR-ISE-2003-10).

<sup>13</sup> See *supra* note 3.

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> 15 U.S.C. 78s(b)(2).

and hereby is approved on an accelerated basis. Interpretation .03 to CBOE Rule 6.25 specifies that the Interpretation will expire upon final Commission approval of File No. SR-CBOE-2001-04 or December 1, 2003, whichever occurs earlier.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48606; File No. SR-NASD-2003-134]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. To Amend Rule 4710 To Allow Nasdaq National Market Execution System Order Entry Firms To Automatically Internalize in SuperMontage

October 8, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 22, 2003, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by Nasdaq. On September 26, 2003, Nasdaq amended the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to amend Rule 4710 to allow the Nasdaq National Market Execution System ("NNMS" or "SuperMontage") to automatically

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter from Thomas P. Moran, Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated September 25, 2003 ("Amendment No. 1"). In Amendment No. 1, Nasdaq expands upon the purpose of the proposed rule change.