SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49065; File No. SR–BSE–2003–04]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 2 and 3 to Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to the Creation of the Boston Options Exchange Regulation, LLC

January 13, 2004.

I. Introduction

On July 17, 2003, the Boston Stock Exchange, Inc. (''BSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'' or ''Exchange Act)[1] and Rule 19b–4 thereunder,[2] a proposed rule change to create a new options regulatory subsidiary, Boston Options Exchange Regulation, LLC (''BOXR''). On July 25, 2003, the Exchange amended the proposed rule change.[3] The proposed rule change, as amended, was published for comment in the **Federal Register** on August 1, 2003.[4] The Commission received one comment letter.[5] On October 10, 2003, the Exchange filed Amendment No. 2 to the proposed rule change.[6] On November 14, 2003, the Exchange filed Amendment No. 3 to the proposed rule change.[7] This order approves the proposed rule change, as amended. In addition, the Commission is approving on an accelerated basis, and soliciting comments on, Amendment No. 2 and Amendment No. 3.

II. Description of the Proposed Rule Change

The Exchange proposes to create a new, wholly-owned, options regulatory subsidiary, BOXR, and to transfer to it all of the assets and liabilities that solely support the regulation of the standardized equity options trading business of the BSE. Upon this transfer, the BSE would continue to be the self-regulatory organization (''SRO'') for BOXR and the Boston Options Exchange (''BOX''), the BSE's proposed new exchange facility for the trading of standardized equity options securities.[8] The BSE's Delegation Proposal would be effected through: (i) The addition of Chapter XXXVI to the BSE Rules of the Board of Governors (''Delegation Plan''); (ii) proposed By-Laws for BOXR; and (iii) amendments to the BSE Constitution.

A. Delegation Plan

The BSE is a founding and controlling member of BOX LLC, and has entered into various agreements with BOX LLC under which BOX LLC would operate BOX as a facility of the BSE.[9] The BSE, through BOXR, would be responsible for all regulatory functions related to the facility, and BOX LLC would be responsible for the business operations of the facility, to the extent those activities are not inconsistent with the regulatory and oversight functions of the BSE and BOXR.

The BSE would delegate specified regulatory authority to BOXR to oversee the BOX market. BOXR would conduct all necessary surveillance of the trading effected through the BOX facility, and enforce compliance by Options Participants with the BOX Rules, applicable BSE Rules, and the federal securities laws and the rules thereunder. BOXR would have regulatory oversight authority over BOX LLC and its officers, directors, agents and employees, each of whom would be required to cooperate with BOXR in the fulfillment of its regulatory obligations.[10]

1. BOXR

BOXR would be operated as a Delaware limited liability company, all of the issued shares of stock of which would be owned by the BSE. Current BSE members would retain their memberships, and thus, their ownership interests in the BSE. BOXR would be governed by the Delegation Plan, the BOXR By-Laws, and applicable BSE Rules.

2. Regulation of BOXR

As discussed above, BOXR would operate as a subsidiary of the BSE, which is a national securities exchange registered under Section 6 of the Act.[11] The BSE, as the SRO, would retain ultimate responsibility for compliance by Options Participants with the federal securities laws, the rules and regulations thereunder, and BOX Rules, as well as the BSE Rules specifically cross-referenced and incorporated by reference into the BOX Rules.[12] Pursuant to the proposed BOX Rules, Options Participants would be granted trading rights for options listed on the Exchange and traded on BOX.[13] Options Participant status would confer neither a right to participate in trading on the BSE (other than options trading on BOX), nor an entitlement to the rights and responsibilities regarding the

[1] Exchange Act Section 19(b)(1), 15 U.S.C. 78s(b)(1).

[2] Exchange Act Rule 19b–4, 17 CFR 240.19b–4.

[3] *See* letter from John Boese, Vice President, Legal and Compliance, Exchange, to Deborah Flynn, Assistant Director, Division of Market Regulation (''Division''), Commission, dated July 25, 2003 (''Amendment No. 1''). Amendment No. 1 replaces the proposed rule change in its entirety.

[4] *See* Securities Exchange Act Release No. 48229 (July 25, 2003), 68 FR 45284 (''Delegation Proposal'').

[5] *See* letter from William J. Brodsky, Chairman and Chief Executive Officer, Chicago Board Options Exchange (''CBOE''), to Jonathan Katz, Secretary, Commission, dated August 26, 2003 (''CBOE Letter'').

[6] *See* letter from John Boese, Vice President, Legal and Compliance, Exchange, to Nancy Sanow, Assistant Director, Division, Commission, dated October 10, 2003 (''Amendment No. 2''). In Amendment No. 2, the Exchange proposes to revise Section 14(e)(iii)(A) of the proposed BOXR By-Laws to state that the Options Participant representatives presented by the BOXR Nominating Committee for appointment to the BSE Board of Governors and the BOXR Board must be officers or directors of a firm approved as an Options Participant. In addition, the BSE proposes to incorporate into the BSE Constitution and the BOXR By-Laws provisions that would limit the Exchange's use of confidential information relating to the activities of Exchange members and Options Participants and develop policies and procedures to prevent disclosure of such information.

[7] *See* letter from George W. Mann, Executive Vice President and General Counsel, Exchange, to Nancy Sanow, Assistant Director, Division, Commission, dated November 13, 2003 (''Amendment No. 3''). In Amendment No. 3, the Exchange proposes to revise Section 14(e)(i) of the proposed BOXR By-Laws to state that the public representatives on BOXR Nominating Committee shall have no material business relationship with a broker, dealer, the BSE, BOX or BOXR. In addition, the BSE proposes to incorporate into Article I, Section 3 of the BSE Constitution definitions of the terms ''BOX,'' ''BOX Options Participant'' or ''BOX Participant,'' ''BOXR,'' ''BOXR Board,'' and ''BOXR Nominating Committee.''

[8] BOX would provide automatic order execution capabilities to BOX Options Participants (''Options Participants'') for standardized equity options securities listed or traded on the BSE, and would be operated by Boston Options Exchange Group, LLC (''BOX LLC''). *See* Securities Exchange Act Release No. 49068 (January 13, 2004) (SR–BSE–2002–15) (''BOX Trading Rules'').

[9] Under the Exchange Act, ''the term ''facility'' when used with respect to an exchange includes its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.'' *See* Exchange Act Section 3(a)(2), 15 U.S.C. 78c(a)(2).

[10] *See* BOX LLC Operating Agreement, Article 5, Section 5.3, Securities Exchange Act Release No. 48650 (October 17, 2003), 68 FR 60731 (October 23, 2003) (SR–BSE–2003–19).

[11] Exchange Act Section 6, 15 U.S.C. 78f.

[12] For such purposes of cross-referencing, interpreting and applying the Rules of the BSE to BOX Options Participants, any reference to ''member'' of the BSE in such cross-referenced rules is to be read as a synonym for ''Options Participant'' on BOX, whether order flow provider, market maker or both. *See* BOX Trading Rules, Chapter I, Section 2(c). For this reason, Options Participants would be statutory ''members'' of BSE.

[13] *See* BOX Trading Rules, Chapter II, Section 1(a).

governance of the BSE of a BSE Member.[14] Options Participants would not have ownership interests in the BSE, although they would have certain voting and representation rights.[15]

Pursuant to the proposed changes to the BSE Constitution, the BSE Board would be composed of the BSE Chairman, Vice Chairman and 20 governors, one of whom would represent Options Participants to provide input on the BSE Board. This governor (''Options Participant Governor'') would be nominated by the BOXR Nominating Committee [16] and must be either an officer or director of an Options Participant.[17] The BSE Board would be required to appoint the candidate presented by the BOXR Nominating Committee.[18]

While ultimately responsible, the BSE would delegate specific self-regulatory responsibilities to BOXR, pursuant to the proposed Delegation Plan. Specifically, BOXR would assume responsibility with respect to the options business of the Exchange for, among other things: (i) Interpreting rules governing the activities of Options Participants; (ii) determining regulatory and trading policies relating to the business activities of Options Participants; (iii) assuring compliance with BSE Rules, BOX Rules, the federal securities laws and rules thereunder; (iv) administering surveillance programs and systems for enforcing rules governing the conduct and trading activities of Options Participants on BOX; (v) examining and investigating Options Participants and their associated persons to determine if they have violated the BSE Rules, BOX Rules, the federal securities laws or the rules thereunder; (vi) administering the BOXR enforcement and disciplinary programs; (vii) determining whether applicants meet the requirements for an Options Participant; (viii) placing restrictions on the business activities of Options Participants and their associated persons consistent with the public interest, the protection of investors and the federal securities laws; (ix) proposing fees and charges; (x) overseeing the operation of the BOX trading facility; (xi) administering the Exchange's involvement in the national market system plans for options; and (xii) developing, administering and enforcing listing standards for securities traded on BOX.[19]

While BOXR would have extensive delegated authority to regulate and oversee the options trading business, the BSE, as the SRO, would retain the ultimate responsibility for the Rules and regulations of BOX, as well as for the operation and administration of the BSE's subsidiary, BOXR. As part of its self-regulatory responsibilities, the BSE would review disciplinary decisions of BOXR, review and ratify proposed rule changes recommended by BOXR, and direct BOXR to take action that may be necessary to effectuate the purposes and functions of the Act.[20]

B. BOXR By-Laws

1. BOXR Board

Pursuant to the proposed BOXR By-Laws, the BOXR Board would consist of no fewer than seven and no more than thirteen directors, and would be composed of (i) the Chief Executive Officer (''CEO'') of the BSE (who would be considered a member for voting purposes, but not for purposes of calculating the number of Public Directors and Options Participant Directors, as defined below); (ii) at least fifty percent Public Directors; [21] and (iii) at least twenty percent, but no fewer than two, nominees of Options Participants (''Options Participant Directors'').[22]

The BSE, as the founder and sole member, would appoint the initial BOXR Board. Subsequently, the BOXR Board would be nominated by the sitting BOXR Board, subject to the nominating procedures discussed below [23] for the selection of the Options Participant Directors. The BOXR Board would be elected by the BSE Board, as the BSE is the sole shareholder of BOXR. The BSE would have the right to approve, remove, and replace any member of the BOXR Board by virtue of its status as sole shareholder, subject to the proposed BOXR By-Laws.[24] Any vacancy on the BOXR Board would be filled with a person, appointed by the BSE Board or Executive Committee, who satisfies the classification associated with the vacant seat, *i.e.*, a member of the public or a representative of an Options Participant.

The Options Participants Directors must be officers or directors of an Options Participant and must be elected by a plurality of votes cast by Options Participants, following nomination by the BOXR Nominating Committee or by petition of at least five Options Participants.[25] The BSE, as the sole member, would be required to appoint the Options Participant Directors so chosen and put forth to the BSE Board by the BOXR Nominating Committee.[26]

2. BOXR Committees

The BSE would commence BOXR operations with two committees: A BOXR Nominating Committee and a BOXR Hearing Committee, both of which would provide for Options Participant involvement in the oversight of the day-to-day operations of BOX.

a. *BOXR Nominating Committee.* The BOXR Nominating Committee would be responsible for nominating Options Participant candidates for two positions on the BOXR Board, one position on the BSE Board, and any vacant positions on the BOXR Nominating Committee (collectively, the ''available positions''), and for presenting the slate of these candidates to the BSE Board. The BOXR Nominating Committee would consist of seven members, six of whom would be elected by a plurality of the Options Participants voting by secret ballot in the annual election. The seventh would be appointed by the BOXR Board, and must be one of the BOXR Board's existing Public Directors. Of the six elected members, five would represent broker-dealer Options Participants of BOX (at least one of which would be a market maker on BOX), and one would be a representative of the public.[27]

In addition, Options Participants would be able to submit additional nominees for each of the available positions. Independent nominations for

[14] *See* BOX Trading Rules, Chapter II, Section 1(e).

[15] As discussed below, under Section 6(b)(3) of the Exchange Act, the rules of an exchange must assure that its members are fairly represented in the selection of its directors and administration of its affairs. Exchange Act Section 6(b)(3), 15 U.S.C. 78f(b)(3).

[16] *See* discussion of the proposed BOXR Nominating Committee below.

[17] *See* proposed BOXR By-Laws, Section 14(e)(3)(A), as amended by Amendment No. 2.

[18] *See* proposed changes to Article II, Section 4 of the BSE Constitution.

[19] Proposed Delegation Plan, Section 2(C).

[20] Proposed Delegation Plan, Section 2(A) and 2(D).

[21] ''Public Director'' is defined as a director who has no material business relationship with a broker or dealer, or the BSE, BOX, or BOXR. *See* proposed BOXR By-Laws, Definition (p).

[22] Proposed BOXR By-Laws, Section 4.

[23] *See* discussion of the proposed BOXR Nominating Committee below.

[24] Proposed Section 7 of the BOXR By-Laws would permit the BSE to remove any or all of the directors on the BOXR Board at any time, with cause, only if a determination is reasonably and promptly made by the BSE Board by a majority vote, that, based upon the facts known to the BSE Board at the time such determination is made that the director sought to be removed: (i) Acted in bad faith; (ii) did not act in a manner in the best interests of BOXR; (iii) engaged in conduct which was unlawful; or (iv) deliberately breached his or her duty to BOXR.

[25] *See* discussion of the proposed BOXR Nominating Committee below.

[26] Proposed Amendments to Article II, Section 4 of the BSE Constitution would require the BSE to elect the slate presented by the BOXR Nominating Committee.

[27] Proposed BOXR By-Laws, Section 14(e).

each of the available positions would require a petition of five Options Participants. Options Participants alone would vote at the annual election, by plurality, to choose the individuals who would represent them in the available positions. Following the annual election, the successful candidates would be presented to the BSE Board by the Chairman of the BOXR Nominating Committee for appointment to their respective available positions. Pursuant to the proposed changes to the BSE Constitution, the BSE Board would be required to appoint the candidates presented by the BOXR Nominating Committee.[28]

b. *Hearing Committee.* The BOXR disciplinary process would be similar to the existing BSE disciplinary process, and would be governed by a BOXR Hearing Committee, which would be appointed by the Chairman of the Board of BOXR. The BOXR Hearing Committee would be comprised of at least one Options Participant member and such number of other members as the Chairman may deem necessary.[29]

The BOXR Chief Regulatory Officer, or his staff, would authorize the initiation of disciplinary hearings and proceedings. The BOXR Hearing Committee would conduct hearings, render decisions and impose sanctions. Decisions of the BOXR Hearing Committee would be appealable for review to the BOXR Board. Any decision of the BOXR Board subsequently would be appealable to the BSE Board, which would have discretion as to whether to hear such appeal. In addition, the BSE Board could choose to review a decision of the BOXR Board on its own motion. If the BSE Board were to not order review of a decision of the BOXR Board, or, in its discretion, were to elect not to hear an appeal of a decision of the BOXR Board, then the decision of the BOXR Board would be deemed to be the final action of the Exchange. Any decision of the BSE Board, or the BOXR Board (in cases where the BSE Board in its discretion has elected not to hear the appeal) would be ultimately appealable to the Commission. As with all BSE decisions, the Commission would have the authority to review final disciplinary sanctions imposed by BOXR or the BSE on Options Participants, including sanctions imposed for violations of BOX Rules.[30]

[28] See proposed changes to Article II, Section 4 of the BSE Constitution.

[29] Proposed BOXR By-Laws, Section 14(f).

[30] Exchange Act Section 19(d)(2), 15 U.S.C. 78s(d)(2).

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[31] In particular, the Commission believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,[32] in general, and furthers the objectives of Section 6(b)(5),[33] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, 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. Moreover, the Commission believes that the proposed rule change furthers the objectives of Section 6(b)(3) of the Act,[34] in that it assures fair representation of Options Participants in the selection of directors and the administration of the affairs of the BSE and BOXR. Finally, the Commission believes that the BSE's proposal to establish BOXR is consistent with the BSE's obligation under Section 6(b)(1) of the Act[35] to be so organized and have the capacity to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the Act, the rules thereunder, and the rules of the Exchange.

A. BOX as a Facility of the BSE

The Commission received one comment letter on the proposed rule change that strongly opposes the BSE's proposal.[36] Specifically, CBOE argues that, by seeking approval for BOX as a facility of the BSE, the BSE has improperly circumvented the exchange registration process, thereby avoiding scrutiny of BOX's ownership and governance. In CBOE's view, BOX's failure to seek registration as a national securities exchange has prevented consideration of the ''potential conflict between BOX's regulatory responsibilities and its for-profit structure, and how the Commission's jurisdiction over BOX's non-U.S. owners can be assured.''[37] CBOE supports this assertion by stating its view that had BOX ''sought registration as a national securities exchange, its principle governing document, the Operating Agreement of BOX LLC, would have been filed as an exhibit to its application,'' which would have subjected any subsequent changes to the BOX LLC Operating Agreement to the Act's Section 19(b) rule filing process. In addition, CBOE argues that, if BOX had submitted such an application, BOX would have had to assure the Commission that its members would be subject to appropriate regulation and that BOX would both be organized and have the capacity to carry out the purposes of the Act and comply with its provisions. CBOE argues that, because BOX was not required to register as a national securities exchange, BOX has been granted an unfair competitive advantage over CBOE and the other registered options exchanges.[38]

The Commission believes that the BSE's proposal that BOX be operated as its facility is properly filed under Section 19(b) of the Act and Rule 19b–4 thereunder,[39] and that BOX is not required, separate from the BSE, to register as a national securities exchange under Section 6(a) of the Act.[40] Moreover, as an SRO, the BSE is required to comply with the Act and to enforce compliance by its members and persons associated with its members with the Act.[41] Because the BSE has proposed to operate BOX as its facility, the BSE's obligations under the Act extend to its members' activities on BOX, as well as to the operation and administration of BOXR. The Commission notes that the instant rule filing relates not to the approval of

[31] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. Exchange Act Section 3(f), 15 U.S.C. 78c(f).

[32] Exchange Act Section 6(b), 15 U.S.C. 78f(b).

[33] Exchange Act Section 6(b)(5), 15 U.S.C. 78f(b)(5).

[34] Exchange Act Section 6(b)(3), 15 U.S.C. 78f(b)(3).

[35] Exchange Act Section 6(b)(1), 15 U.S.C. 78f(b)(1).

[36] *See* CBOE Letter, *supra* note 5.

[37] *Id.*

[38] *Id.*

[39] Exchange Act Section 19(b), 15 U.S.C. 78s(b) and Exchange Act Rule 19b–4, 17 CFR 240.19b–4. *See* Securities Exchange Act Release No. 42759 (May 5, 2000), 65 FR 30654 (May 12, 2000) (SR–PCX–99–39) (order approving the Pacific Exchange's proposal to operate Archipelago as an equity trading facility) (''PCX/Arca Order''). The Commission notes that Section 19(b) of the Act, and Rule 19b–4 thereunder, require that any proposed change to any material aspect of the operation of the facilities of the SRO must be filed with the Commission.

[40] Exchange Act Section 6(a), 15 U.S.C. 78f(a). *See* PCX/Arca Order, *supra* note 39.

[41] Exchange Act Section 6(b)(1), 15 U.S.C. 78f(b)(1).

BOX,[42] but to the delegation of regulatory responsibility between the BSE and its wholly-owned subsidiary, BOXR, as well as to the fair representation issues with respect to the composition of the BSE Board, the BOXR Board, and the operation of the BOXR Board committees. Consequently, the Commission believes that Section 19 of the Act[43] affords the Commission a comparable ability to determine whether the BSE's proposal is consistent with the Act as would a separate application by BOX to register as a securities exchange.

B. Fair Representation

The Commission finds that the proposed changes to the composition of the BSE Board and the proposed composition of the BOXR Board are structured in a manner that satisfies the fair representation requirements of Section 6(b)(3) of the Act.[44]

Under Section 6(b)(3) of the Act,[45] the rules of an exchange must assure that its members are fairly represented in the selection of its directors and in the administration of its affairs. The section 6(b)(3) fair representation requirement allows statutory members to have a voice in an exchange's use of its self-regulatory authority. Moreover, this statutory requirement helps to ensure that members are protected from unfair, unfettered actions by an exchange pursuant to its rules, and that, in general, an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.

1. BSE Board

As discussed above, under the proposal, the BSE Board, composed of the BSE Chairman, Vice Chairman, and 20 governors, would include one governor representing Options Participants to provide input on the BSE Board. This Options Participant Governor must be presented by the BOXR Nominating Committee, and must be either an officer or director of an Options Participant.[46] The BSE Board would be required, pursuant to the proposed amendments to the BSE Constitution, to appoint the candidate selected by Options Participants and presented by the Chairman of the BOXR Nominating Committee.[47] Moreover, as discussed below, the nominating process would allow for Options Participants to nominate additional candidates for the BSE Board on the petition of five Options Participants.[48]

The BSE Constitution would continue to require that the BSE Board include ten securities industry representatives, representing members of the BSE (one of whom would be the Options Participant Governor), and ten public representatives.[49] All of the governors, other than the Options Participant Governor, would continue to be elected to the BSE Board by a plurality of BSE members (other than Options Participants), voting in the BSE's annual election, following nomination by the BSE Nominating Committee or by independent petition of fifteen BSE members (other than Options Participants).[50]

In its comment letter, CBOE argues that the BSE's proposal does not satisfy the statutory requirement that members must be fairly represented in the governance of a national securities exchange and in the administration of its affairs. Specifically, CBOE contends that the representation of one Options Participant on the 22-person BSE Board does not satisfy the statutory requirements of fair representation. Because Options Participants would have a voice in the administration of the affairs of the BSE, and BSE members (other than Options Participants) would continue to elect ten of 22 members on the BSE Board, the Commission believes that the proposal satisfies the fair representation requirements of Section 6(b)(3) of the Act.[51]

2. BOXR Board

Pursuant to the proposal, the BOXR Board would consist of no fewer than seven nor more than thirteen directors. The composition of the BOXR Board would be: (i) The CEO of the BSE (who would be considered a member of the Board for voting purposes, but not for purposes of calculating the number of Public Directors and Options Participant Directors); (ii) at least fifty percent Public Directors;[52] and (iii) at least twenty percent, but no fewer than two, Options Participant Directors.[53]

a. *BOXR Nominating Committee.* Because the BOXR Nominating Committee is responsible for selecting Options Participant representatives for the BOXR Board, the BSE Board, and the BOXR Nominating Committee, its composition should generally reflect the composition of Options Participants (*i.e.*, the users). As discussed above, the BOXR Nominating Committee would consist of seven members, six of whom would be elected by a plurality of the Options Participants voting by secret ballot in the annual election and one of whom would be appointed by the BOXR Board and must be one of the BOXR Board's existing Public Directors.[54] Of the six elected members, five would represent broker-dealer Options Participants (at least one of which would be a BOX market maker) and the sixth would be a representative of the public. The seven members of the BOXR Nominating Committee would therefore include two representatives of the public and five representatives of the Options Participants.[55]

Moreover, Options Participants have an additional opportunity to nominate other candidates. Specifically, five Options Participants may petition to add a nominee to be included on the ballot.[56] Finally, the Commission notes that Options Participants would vote to select the Options Participant nominees to the available positions on the BSE Board, the BOXR Board, and BOXR Nominating Committee from among those nominated by the BOXR Nominating Committee and by petition. The BSE, as the sole shareholder of BOXR, would be required, pursuant to its Constitution, to appoint the Options Participant nominees so selected by the Options Participants and presented to the BSE Board by the Chairman of the BOXR Nominating Committee.[57]

In its comment letter, CBOE argues that because the BSE Board would appoint the BOXR Board, Options Participants would not have the right to choose which Options Participants serve on the BOXR Board, in violation of the fair representation requirements of the Act.[58] As just discussed, however, pursuant to the proposed changes to the BSE Constitution, the BSE Board would be required to appoint the BOXR Options Participant candidates selected

[42] The BSE has filed the BOX LLC Operating Agreement and the BOX Trading Rules under separate cover. The Commission is approving both of these related filings concurrently with the instant proposal. *See* Securities Exchange Act Release Nos. 49067 (January 13, 2004) (SR–BSE–2003–19) and 49068, *supra* note 8.

[43] Exchange Act Section 19, 15 U.S.C. 78s.

[44] Exchange Act Section 6(b)(3), 15 U.S.C. 78f(b)(3).

[45] *Id.*

[46] *See* proposed BOXR By-Laws, Section 14(e)(iii)(A), as amended by Amendment No. 2.

[47] *See* proposed changes to Article II, Section 4 of the BSE Constitution.

[48] Proposed BOXR By-Laws, Section 14(e).

[49] BSE Constitution, Article I, Section I.

[50] BSE Constitution, Article II, Sections 1, 3, and 4.

[51] Exchange Act Section 6(b)(3), 15 U.S.C. 78f(b)(3).

[52] *See supra* note 20, for a definition of Public Directors.

[53] Proposed BOXR By-Laws, Section 4.

[54] *See supra* note 21, for a definition of Public Directors.

[55] Proposed BOXR By-Laws, Section 14(e).

[56] *See* proposed BOXR By-Laws, Section 14(e).

[57] *See* proposed changes to Article II, Section 4 of the BSE Constitution.

[58] See CBOE Letter, *supra* note 5.

by the Options Participants and presented to the BSE Board by the Chairman of the BOXR Nominating Committee.

Furthermore, the proposed composition of the BOXR Board would provide Options Participant representation comparable to that provided to members of PCX Equities, Inc. (''PCXE'') and the American Stock Exchange LLC (''Amex''), both of which the Commission found consistent with the Act.[59] PCXE's by-laws provide that at least twenty percent, but no fewer than two, of the directors on the PCXE board be Equity Trading Permit Holders (''ETP Holders'')[60] nominated by a nominating committee, six of seven members of which shall be ETP Holders.[61] Similarly, the Amex's constitution provides that four of the eighteen members of the Amex board of governors be floor governors proposed by either the Amex nominating committee (consisting of three floor members and two public members), or by petition of 25 regular or options principle members, and selected by a plurality of the Amex regular and options principle members voting together as a single class.[62] The Commission similarly believes that the BSE's proposal is consistent with the Act. The Commission believes further that the proposed petition process, coupled with the right to vote for their representatives, should help to ensure that Options Participants have the opportunity to be involved in the selection of their representatives for the BOXR Board, the BSE Board, and the BOXR Nominating Committee. Thus, as with the BSE Board, the fair representation requirements are satisfied.

b. *BOXR Hearing Committee.* The Commission finds that the proposed composition and authority of the BOXR Hearing Committee are consistent with Sections 6(b)(3)[63] and 6(b)(7)[64] of the Act, respectively. The BOXR Hearing Committee would include at least one Options Participant member, which should help to ensure that decisions of the BOXR Hearing Committee are made in a fair and impartial manner, as required by Section 6(b)(3) of the Act. Moreover, because aggrieved Options Participants may appeal decisions of the BOXR Hearing Committee to the BOXR Board, the BSE Board, and, ultimately, to the Commission, the Commission finds that the proposal should provide for a fair procedure for disciplining Options Participants and overseeing any denial, prohibition or limitation of membership or access to BOX or its services, in satisfaction of the standards set forth in Section 6(b)(7) of the Act.[65]

C. Proposed Delegation of Authority to BOXR

Although the BSE has delegated certain regulatory authority over BOX to BOXR, and certain operational authority over BOX to BOX LLC, the BSE, as the SRO, retains the ultimate responsibility for the operation, administration, rules, and regulation of BOX, BOXR, and BOX LLC. Pursuant to the proposed BSE Rules, the BSE must approve any proposed changes to the BOXR By-Laws and the BOX Rules, and such proposed changes must be filed by the BSE with the Commission pursuant to Section 19(b) of the Act[66] and Rule 19b–4[67] thereunder.[68] The BSE also must review disciplinary decisions of BOXR and direct BOXR to take any action that may be necessary to effectuate the purposes and functions of the Act.[69]

Furthermore, pursuant to the proposed Delegation Plan, the Commission would have oversight over the premises, personnel, and records of BOXR and BOX LLC to the same extent that it currently has oversight over the premises, personnel, and records of the BSE. The books, records, premises, officers, directors, agents and employees of BOXR and BOX LLC would be deemed to be the books, records, premises, officers, directors, agents and employees of the BSE for purposes of, and subject to, oversight pursuant to the Act.[70] The books and records of BOXR and BOX LLC would be subject at all times to inspection and copying by the BSE and the Commission, and the books and records of BOX LLC would be subject at all times to inspection and copying by BOXR.[71] In addition, BOXR and BOX LLC would be required to maintain all books and records related to BOX within the United States.[72]

The Commission believes that neither Amendment No. 2 nor Amendment No. 3 significantly alters the original proposal, which was subject to a full notice and comment period, or raises any novel issue of regulatory concern. Moreover, the Commission believes that the changes made to the BSE Rules and the BOXR By-Laws strengthen and clarify the proposal.[73] Therefore, the Commission finds that granting accelerated approval to Amendment No. 2 and Amendment No. 3 is appropriate and consistent with Section 19(b)(2) of the Act.[74] Accordingly, the Commission hereby finds good cause for approving Amendment No. 2 and Amendment No. 3 to the proposal, prior to the 30th day after publishing notice of these amendments in the **Federal Register**.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 2 and Amendment No. 3, including whether the proposed amendments are 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. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. SR–BSE–2003–04. This file number should be included on the subject line if e-mail is used. To help us process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 Section, 450 Fifth Street, NW.,

[59] *See* PCX/Arca Order, *supra* note 39 and Securities Exchange Act Release No. 40622 (October 30, 1998), 63 FR 59819 (November 5, 1998) (File Nos. SR–Amex–98–32, SR–NASD–98–56, SR–NASD–98–67).

[60] An ETP Holder is an entity that has been issued a permit to effect securities transactions on the PCXE's trading facility and has status as a ''member'' of the Pacific Exchange, Inc., as that term is defined in Section 3 of the Act. Archipelago Exchange Facility Rules 1.1(m) and 1.1(n).

[61] *See* Bylaws of PCX Equities, Inc., Article III, Section 3.02. *See also* Archipelago Exchange Facility Rule 3.2, Equity Committees.

[62] The NASD must approve the floor governors, but may reject the nominees only on specific regulatory grounds. *See* Amex Constitution, Article II, Section 1.

[63] Exchange Act Section 6(b)(3), 15 U.S.C. 78f(b)(3).

[64] Exchange Act Section 6(b)(7), 15 U.S.C. 78f(b)(7).

[65] *Id.*

[66] Exchange Act Section 19(b), 15 U.S.C. 78s(b).

[67] Exchange Act Rule 19b–4, 17 CFR 240.19b–4.

[68] The BSE Board must review and ratify all proposed rule changes recommended by the BOXR Board before they are submitted to the Commission. *See* Section 2(D) of the proposed Delegation Plan.

[69] Proposed Delegation Plan, Sections 2(A)(4) and 2(A)(10).

[70] Proposed Delegation Plan, Sections 1(b) and 2(B)(1).

[71] Proposed Delegation Plan, Section 2(B)(1).

[72] Proposed Delegation Plan, Section 2(B)(2).

[73] *See supra* notes 6 and 7.

[74] Exchange Act Section 19(b)(2), 15 U.S.C. 78s(b)(2).

Washington, DC 20549–0609. Copies of such filing will also be available for inspection and copying at the principal office of the BSE. All submissions should refer to File No. SR–BSE–2003–04 and should be submitted by February 10, 2004.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[75] that the proposed rule change (File No. SR–BSE–2003–04), as amended by Amendment No. 1, be, and hereby is, approved, and Amendment No. 2 and Amendment No. 3 are approved on an accelerated basis.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 04–1115 Filed 1–16–04; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49066; File No. SR–BSE–2003–17]

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Order Approving Proposed Rule Change Establishing Fees for the Boston Options Exchange Facility and Approving the Portion of the Proposed Rule Change Relating to Linkage Fees on a Pilot Basis Until January 31, 2004

January 13, 2004.

I. Introduction

On November 14, 2003, the Boston Stock Exchange, Inc. (''BSE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change that would establish fees for the Exchange's options trading facility, Boston Options Exchange (''BOX'').[3] On November 20, 2003, the Exchange's rule proposal was published for comment in the **Federal Register**.[4] No comment letters were received on the proposal. This order approves the proposed rule change and approves the portion of the proposed rule change relating to linkage fees on a pilot basis until January 31, 2004.

II. Description of Proposal

In conjunction with its proposal to operate a new options facility—BOX—the BSE proposes a fee schedule relating to the BOX market.

A. BOX Trading Fees

The BSE proposes to establish trading fees related to the BOX market. The fees would apply to Public Customers,[5] broker-dealers, and Market Makers.[6]

1. Per Contract Fees

Executions of Public Customer orders would not be subject to a trading fee. Executions of orders for broker-dealer proprietary accounts and BOX Market Maker accounts would be charged a $0.20 per contract trade execution fee, or a $0.40 per contract fee for trades against an order that BOX's automatic trading system (''Trading Host'') filters to prevent trading through the NBBO, pursuant to the NBBO filter procedures set forth in Chapter V, Section 16(b) of the BOX Rules. The BSE proposes to assess the $0.40 per contract fee to Market Makers as an incentive for Market Makers to post competitive quotations, and to broker-dealers for the cost of providing a service that is not available to broker-dealers on other exchanges. In addition, executions on behalf of broker-dealer proprietary accounts and BOX Market Maker accounts would be charged any passed-through licensing fees for Exchange Traded Funds (''ETFs''), if applicable. At BOX's launch, the only applicable surcharge on ETFs would be a $0.10 per contract fee for options on the Nasdaq 100 (''QQQ'').

2. Alternative Trading Fees: BOX Minimum Activity Charge

The pricing model proposed for Market Makers includes a Minimum Activity Charge (''MAC'') for each class to which a Market Maker is appointed. The MAC would vary depending on the total trading volume across all options exchanges, as determined by the Options Clearing Corporation (''OCC'') clearing data,[7] in a particular class, and would be equal to approximately $0.20 times the number of contracts equaling 1% of the total industry-wide volume. As noted above, the per contract trading fee for a Market Maker is $0.20 per contract. If the total per contract trading fees for a Market Maker in a given month do not exceed the total MAC for all classes for which that Market Maker holds appointments, that Market Maker would be charged the total MAC, rather than the trading fee. Thus, if a Market Maker's monthly trading activity is low, the MAC may be applicable. If, however, a Market Maker's total trading fees exceed the MAC, the Market Maker would pay the trading fees.

The MAC would not be applied during the first three calendar months following BOX's launch. Subsequently, the MAC would be ''indexed'' to BOX's overall market share as determined by OCC clearing volumes. Specifically, at the beginning of each calendar month, BOX would calculate its market share for the previous month (market share equals the total BOX traded volume divided by the total OCC cleared volume for the classes that BOX has listed). If BOX's overall market share is less than 10%, BOX would reduce the MAC applicable to each Market Maker as follows: (1) If BOX's market share were less than 5%, the MAC would be 33.3% of the full MAC; and (2) if BOX's market share were between 5% and 10%, the MAC would be 66.7% of the full MAC.

3. Volume Discounts

The Exchange would provide certain volume discounts if a Market Maker's average daily volume in a given month exceeds certain thresholds.

B. Other Fees

1. InterMarket Linkage

The Exchange is proposing on a pilot basis, until January 31, 2004,[8] fees for trades executed via the InterMarket Linkage (''Linkage''). These Linkage fees include charges to Options Participants, such as a $0.40 per contract charge for a trade in the BOX market, that is

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[75] Exchange Act Section 19(b)(2), 15 U.S.C. 78s(b)(2).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 49068 (January 13, 2004).

[4] *See* Securities Exchange Act Release No. 48787 (November 14, 2003), 68 FR 65477 (November 20, 2003).

[5] A Public Customer is a person that is not a broker or dealer in securities. *See* BOX Rules, Chapter I, Sec. 1(a)(50).

[6] A Market Maker registered with the Exchange is vested with the rights and responsibilities specified in Chapter VI of the BOX Rules.

[7] For purposes of determining the MAC for each options class listed by BOX, the options classes listed by BOX would be divided into six classes, based on the total trading volume of each class across all U.S. options exchanges as determined by OCC data. The classifications would be adjusted at least twice annually (in January and July, based on the average daily volume for the preceding six month period). If exceptional events or news occur in a given class, the Exchange may review the MAC level for that class at anytime. The BSE would file a proposed rule change with the Commission regarding any changes to its fees, including the MAC, pursuant to section 19 of the Act. 15 U.S.C. 78s.

[8] If the BSE seeks to extend the pilot period for the effectiveness of these fees, the BSE would file a proposed rule change pursuant to Section 19(b) of the Act. 15 U.S.C. 78s(b).