February 26, 2007

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Attn: Ms. Nancy M. Morris, Secretary

RE: FILE NUMBER: SR-CBOE-2006-106

Thank you for your invitation to comment on the Chicago Board Options Exchange's ("CBOE's") Notice of Filing of Proposed Rule Change, and Amendment No. 1 Thereto, Relating to an Interpretation of Paragraph (b) of Article Fifth of its Certificate of Incorporation ("Proposed Rule Change").

Background

I served as Chairman of the Chicago Board of Trade from 2001 to 2003 and during that period settled a major dispute between the CBOT and CBOE. Working with my CBOE counterparts, we resolved the issues of that time with the 2001 Agreement, which was submitted to the members of each exchange and received overwhelming approval.

You should also know that I became an exerciser member of the CBOE in 1982 and for most of the next 20-25 years owned one to two CBOE memberships as well as one to two CBOT memberships. Most importantly, I was honored to have been elected by CBOE members to serve on the CBOE's nominating committee for its Board of Directors. (I do not now have any CBOE affiliation or CBOT official position, other than that of CBOT shareholder and member.)

My conclusion from these years of experience: The issues involved in this dispute have been dealt with again and again and the language of past settlement agreements is clear. CBOT members possessing all parts of a "full" membership are entitled to a full and equal share of distributions made to CBOE members. This is a contract dispute, not a rule change matter.

This letter will do four things:

1. Set forth of the clear language of past agreements.

2. Examine the CBOE's reasoning in its request for rule interpretation against the clear language of these agreements.

3. Request that the SEC disapprove the CBOE request.

4. Set forth a proposal to settle this matter.

I. Past agreements are clear.

From time to time, there have been disputes between the CBOT and the CBOE concerning the exercise right and settlements have resulted in agreements in 1992 and 2001, as well as a number of letter agreements in the years after 2001.

These agreements dealt with what would happen if the CBOT restructured, was party to a merger, sold shares to the public, and, in the letter agreements, dealt with housekeeping matters resulting from minor changes in restructuring, including use of a holding company structure, changes in governance, and slight shifts in equity allocation within the CBOT. They also dealt with how the CBOE could reduce or completely extinguish the number of CBOT exercisers.

The agreements speak for themselves and I set forth substantial portions of them to evidence their clarity and to show that this is a contract dispute, not a CBOE rules issue.

Article Fifth(b) of the CBOE's Certificate of Incorporation set forth the exercise right:

> In recognition of the special contribution made to the organization and development of the Corporation by the members of the Board of Trade. …every present and future member of said Board of Trade who applies for membership in the Corporation and who otherwise qualifies shall, so long as he remains a member of said Board of Trade <u>be entitled to be a member of the … [CBOE]</u> and …shall otherwise <u>be vested with all rights and privileges</u> and subject to all obligations of membership, as provided in the by-laws. (emphasis supplied)

Restructure of the CBOT with a division of the CBOT full membership into parts was dealt with beginning in 1992. One thing was clear: as long as a CBOT member kept all the parts together, he would continue to be eligible to exercise.

> The CBOT agrees, in its own capacity and on behalf of its members, that in the event the CBOT splits or otherwise divides CBOT Full Memberships into two or more parts, all such parts, and the trading rights and privileges appurtenant thereto, shall be deemed to be part of the trading rights and privileges appurtenant to such CBOT Full memberships and must be in the possession of an individual as either an Eligible CBOT Full Member or an Eligible CBOT Full Member Delegate in order for that individual to be eligible to be an Exerciser Member. (emphasis supplied)

As long as the parts were kept together, the CBOE agreed that:

> all Exerciser Members … have the same rights and privileges of CBOE regular membership as other CBOE Regular Members … In the event the CBOE makes a cash or property distribution, whether in dissolution, redemption or otherwise, to other CBOE Regular Members as a class, which has the effect of diluting the value of a CBOE Membership, including that of a CBOE membership under Article Fifth(b), such distribution shall be made on the same terms and conditions to Exerciser Members. (emphasis supplied)

Further, that the CBOE had to give adequate notice of distributions:

> The CBOE agrees to notify the CBOT no less than ninety (90) days prior to every offer, distribution or redemption … In order to permit Eligible CBOT Full Members and Eligible CBOT Full Member Delegates to participate in an offer, distribution or redemption … CBOE further agrees to waive all membership dues, fees and other charges and all qualification requirements.

This clear entitlement of CBOT exercisers to any distributions of CBOE property is repeated again and again in the 1992 Agreement:

> The CBOE agrees that a significant purpose of the Agreement is to ensure that CBOE will not make any offer, distribution or redemption to CBOE Regular Members as a class which would have the effect of diluting the rights under Article Fifth(b) of Eligible CBOT Full Members and Eligible CBOT Full Member Delegates. It is the intention of the parties that … Eligible CBOT Full Members and Eligible CBOT Full Member Delegates will have the ability to participate in every offer, distribution or redemption which would have the effect of diluting the value of CBOE regular memberships, including CBOE memberships under Article Fifth(b). (emphasis supplied)

The mutually agreed upon Q and A attached to the Agreement:

> Q. What rights are guaranteed CBOT Full Members at the CBOE?
>
> A. The Agreement guarantees that exerciser members shall have the same rights as regular CBOE members free of restrictions and discrimination except that the exerciser membership may not be transferred, leased or sold. It also guarantees that if CBOE takes action which gives CBOE Regular Members additional rights or privileges which would dilute the value of CBOE Memberships, CBOT Full Members will be given notice and opportunity to exercise and participate equally in such additional rights.

As to mergers, again the 1992 Agreement addresses this and is clear:

> The CBOE agrees that in the event the CBOT merges or consolidates with or is acquired by or acquires another entity ("other entity") and (i) the survivor of such merger, consolidation or acquisition ("survivor") is an exchange which provides or maintains a market in commodity futures contracts or options, securities, or other financial instruments, and (ii) the 1,402 holders of CBOT Full Memberships are granted in such merger, consolidation or acquisition membership in the survivor ("Survivor Membership"), and (iii) such Survivor Membership entitles the holder thereof to have full trading rights and privileges in all products then or thereafter traded on the survivor (except that such trading rights and privileges need not include products that, at the time of such merger, consolidation or acquisition, are traded or listed, designated or otherwise authorized for trading on the other entity but not on the CBOT), then the Exercise Right of Article Fifth(b) shall continue to apply and this Agreement shall continue in force and effect (with the words "CBOT Full Membership" being interpreted to mean "Survivor Membership"). (emphasis supplied)

Which brings us to the 2001 Agreement, which specifically addressed the current CBOT restructuring and to the extent that this was not completely clear before:

> WHEREAS, additional disputes have arisen between the CBOT and the CBOE regarding the Exercise Right in the context of the CBOT's proposed strategic restructuring and the expanded operation of CBOT's electronic trading system proposed to be implemented in connection therewith;

and in doing so the 2001 Agreement explicitly reaffirmed the 1992 Agreement:

> Paragraph 10. The 1992 Agreement shall remain in full force and effect, and the CBOT and CBOE hereby reaffirm all of their respective rights and obligations thereunder.

An important part of this agreement addressed how the CBOE could facilitate its own IPO: the CBOE could reduce or eliminate the number of CBOT exercisers by purchasing Exercise Right Coupons from individual CBOT members.:

> (c) "Exercise Right Coupon" means the instrument to be issued to each of the 1,402 CBOT Restructuring Transactions, which shall evidence and represent the Exercise Right and which shall, subject to satisfaction of the other conditions to being an Eligible CBOT Full Member as defined below, entitle the holder thereof to become an Exerciser Member.

As we know, this provision was used by the CBOE as recently as January, 2007 and in total about 75 coupons have been purchased, extinguishing those exercise rights. The CBOE began its purchase program after considerable delay and then essentially ended it because it did not wish to pay the price necessary to purchase more. The current dispute could be viewed as its effort to pay nothing.

Finally, the 2001 Agreement again made clear that to be an eligible exerciser all a Full Member had to do to exercise was have all the parts in "possession" (not necessarily even "owned") at the time of distribution. In other words, a CBOT member could sell parts, buy back or lease parts, and still retain the right to share equally in CBOE distributions;.

> "Eligible CBOT Full Member Delegate" has the meaning set forth in the definition of that term in the 1992 Agreement, provided that upon consummation of the CBOT Restructuring Transactions and in the absence of any other material changes to the structure or ownership of the CBOT or to the trading rights and privileges appurtenant to a CBOT Full Membership not contemplated in the CBOT Restructuring Transactions, an individual shall be deemed to be an eligible CBOT Full Member delegate if the individual (i) is in possession of (A) 25,000 shares of Class A Common Stock of the CBOT (such number being subject to anti-dilution adjustment in the event the Class A Common Stock is subject to a stock split, reverse split, stock dividend or other stock distribution made to existing shareholders, or the issuance of shares to existing shareholders at less than fair market value), and (B) one (1) share of Class B Common Stock, Series B-1, of the CBOT, and (C) one (1) Exercise Right Coupon,

> (ii) holds one or more of the items listed in (i) above through delegation rather than ownership, and (iii) meets the applicable membership and eligibility requirements of the CBOT and is deemed to be a "CBOT Full Member Delegate under the CBOT's Rules and Regulations then in effect. For the purposes of this provision, the words "in possession of" shall be deemed to include possession by ownership, lease, or, in the case of shares, by pledge or assignment agreement relating to such shares whereunder the owner of such shares is precluded from selling or transferring them during the term of such pledge or assignment agreement. (emphasis supplied)

The agreements are clear: The CBOT can restructure, become a holding company and merge, and CBOT members remain eligible to exercise into any CBOE distributions, as long as they possess the parts of membership given them in restructure. The CBOE can extinguish exercise rights by purchasing coupons from individual CBOT members. This long history of disputes and agreements shows this to be a contract matter, with clear language that should determine its outcome.

II. CBOE Proposed Rule Change

The CBOE submission ignores the clear language of these numerous agreements and instead focuses upon straws.

In year 2000 the CBOE made the weak argument that the exercise right was lost because the CBOT changed its state of incorporation from Illinois to Delaware. Unfortunately, in today's dispute the CBOE is again trying to avoid years of agreements and understandings by focusing on equally weak "form over substance" issues like the holding company issue, governance issues, etc.

The CBOE submission bases its series of technical "gotchas" by arguing that the 2001 Agreement is no longer valid because acquisition by the CME was not contemplated in 2001 ("the present acquisition of CBOT by CME … was not contemplated as part of the original restructuring of CBOT"). But the 2001 Agreement explicitly reaffirmed the 1992 Agreement that addressed mergers and consolidations; merger between the CBOT and CME has been talked about for at least 30 years. Consequently, this attempt to eliminate the 2001 Agreement and the subsequent letter agreements from the CBOT/CBOE history of agreements must be rejected, as a CME transaction like this has been contemplated since 1992 and before.

The CBOE's need to "delete" the 2001 Agreement and the following letter agreements shows how weak its arguments are. As to the "holding company" issue, i.e., that a holding company is not an exchange, the various letter agreements following the

2001 Agreement recognized that the holding company structure was not material to the exchange issue (the CBOT itself is a holding company).

The CBOE also argues that CBOT changes in governance, petition rights, etc., etc., following a merger are also issues that extinguish the exercise right. Again, such minor changes occurred throughout the CBOT restructuring and again were validated by the 2001 Agreement and subsequent letter agreements.

The CBOE even makes the argument that CBOT members will no longer have "full trading rights" because the new CME/CBOT entity may introduce new products that previous CME members may also trade along with the CBOT members (i.e., the new product trading rights will not be exclusive to former CBOT Full members). This is a weak and false argument for many reasons, one being that the CBOT throughout its history has introduced new products with access shared by full and other membership categories.

Following a merger with the CME, a CBOT member can continue to have all the parts held originally and have the same trading privileges. This has been recognized throughout in the explicit language of the agreements as what matters and the CBOE arguments are transparent attempts to circumvent this.

III. SEC Action Requested

My discussion of these agreements is intended to show that what is involved here is an effort by the CBOE to scrap previous commitments to benefit CBOE members. It is clearly not simply a "Proposed Rule Change" and is completely unlike a rulemaking or interpretative activity. Evidently, the CBOE believes that the SEC will favor the CBOE in its contract dispute. Accordingly, I ask that the SEC disapprove, or abstain from considering this Proposed Rule Change as it is a transparent attempt to turn a contract dispute into an SEC matter. .

IV. Proposal for Settlement

Strictly speaking, this letter should end with my request that the SEC disapprove or not rule on the CBOE request and I understand that the proposal below is not within the SEC's purview.

I am offering the proposal here as (1) this will be a widely read forum and (2) to show there is a straightforward way for the CBOE to extinguish exercise rights while honoring years and years of agreements.

Once again, however, my conclusion from years of experience is that the issues involved today have been dealt with repeatedly and the language of the past settlements is

clear. CBOT members possessing all parts of a "full" membership are entitled to an equal share of distributions made by the CBOE to CBOE members.

Despite that conviction, I am offering this proposal to resolve the current dispute and let the members of each exchange move forward, instead of spending years and years in wasteful, costly and endless litigation, with the possible result of substantial losses in stock market value if the situation is ever resolved.

Article 5(b) both sets forth the exercise right and the means by which the exercise right can be changed and/or extinguished:

> No amendment may be made with respect to this paragraph (b) of Article Fifth without the prior approval of not less than 80% of (i) the members of the Corporation admitted pursuant to this paragraph (b) and (ii) the members of the Corporation admitted other than pursuant to this paragraph (b), each such category of members voting as a separate class.

Proposal: In accordance with the 80% amendment process, each class of CBOT and CBOE members voting separately is asked to approve the ending of the exercise right based upon the purchase of C shares by the CBOE for a payment to be made half in cash paid from CBOE IPO proceeds and half in CBOE shares valued at the IPO price.

The procedure above could settle the matter without further litigation and appeals therefrom because this is a procedure set forth in Article 5(b) and the 2001 Agreement's creation of C shares. The 80% majority requirement should be viewed as a positive in that it ensures that this compromise is acceptable to each membership.

The total amount of the payment would be a subject of negotiation, such that it would be acceptable to each class. I believe there is a payment amount that would meet the approval of the separate memberships. The CBOE would have the benefit of making payment only if and when an IPO takes place.

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Once again, thank you for your consideration.

Very truly yours,

Nickolas J. Neubauer