No. 95-1181

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

WILLIAM C. DUNN & DELTA CONSULTANTS, INC.,
Petitioners,

—v.—

COMMODITY FUTURES TRADING COMMISSION, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF THE FOREIGN EXCHANGE COMMITTEE, THE NEW YORK CLEARING HOUSE ASSOCIATION, THE FUTURES INDUSTRY ASSOCIATION, THE MANAGED FUTURES ASSOCIATION AND THE PUBLIC SECURITIES ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

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Pursuant to Rule 37.3 of this Court, the Foreign Exchange Committee (the "FX Committee"), The New York Clearing House Association (the "Clearing House"), the Futures Industry Association (the "FIA"), the Managed Futures Association (the "MFA") and the Public Securities

Association (the "PSA") (collectively, the "Industry Associations") respectfully submit this brief with the consent of all the parties.

Interests of *Amici Curiae*

The Industry Associations represent many of the most significant participants in foreign currency futures and options trading in the United States.

Formed in 1978 under the sponsorship of the Federal Reserve Bank of New York, the FX Committee includes representatives of major domestic and foreign commercial and investment banks and foreign exchange brokers.[1/] The objectives of the FX Committee are to (i) provide a forum for discussing technical issues in the foreign exchange and related international markets, (ii) serve as a channel of communication between those markets and the Federal Reserve and, when appropriate, to other official institutions in the United States, (iii) enhance knowledge and understanding of the foreign exchange and related international markets, (iv) foster improvements in the quality of risk management in those markets, and (v) develop recommendations and prepare issue

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1/ The members of the FX Committee are AIG Trading Corporation, Bank of America, The Bank of Boston, Bank of Montreal, The Bank of New York, The Bank of Tokyo, Ltd., Bankers Trust Company, The Chase Manhattan Bank, CIBC-Wood Gundy, Citibank, N.A., Deutsche Bank, A.G., First Bank, N.A., The First National Bank of Chicago, Goldman Sachs & Co., Lasser Marshall Inc., Manufacturers & Traders Bank, Merrill Lynch & Co., Inc., Midland Bank plc, Morgan Guaranty Trust Company of New York, Morgan Stanley & Co. Incorporated, NationsBanc-CRT, Republic National Bank of New York, Royal Bank of Canada, Swiss Bank Corporation and Tullett & Tokyo Forex International Ltd.

papers on specific market-related topics for circulation to market participants and others.

The Clearing House is an unincorporated association of eleven leading commercial banks in New York City, a majority of which are active in foreign currency trading.[2/] The Clearing House operates the Clearing House Interbank Payments System ("CHIPS"), a large-value funds transfer system that is the primary means by which international U.S. dollar payments are made and settled. CHIPS handles an average of $1.3 trillion of payments each day of which approximately 30% of the number of items and 50% of the dollar value are related to foreign exchange settlements.

The FIA is a national trade association representing the futures industry. Its members include approximately ninety of the largest futures brokerage firms, which effect more than 80% of the transactions conducted on United States futures exchanges, as well as users of the futures markets such as commercial and investment banks, commodity pool operators, commodity trading advisors, and pension, insurance and mutual fund managers. The FIA's members are active in the over-the-counter ("OTC") foreign currency markets.[3/]

[2/] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, Citibank, N.A., Morgan Guaranty Trust Company of New York, Bankers Trust Company, Marine Midland Bank, United States Trust Company of New York, Fleet Bank N.A., European American Bank and Republic National Bank of New York.

[3/] The OTC markets are separate and distinct from commodity exchanges designated by the Commodity Futures Trading Commission ("CFTC") for foreign exchange futures and options trading. Foreign currency transactions in the OTC

(continued...)

The MFA is a not-for-profit association representing the managed futures industry, including leading domestic and international managers, foreign exchange dealers, banks, commodity pool operators, commodity trading advisors, futures brokerage firms, exchanges and service providers involved in professional asset management. Its members are also active in the OTC foreign currency markets.

The PSA is the bond market trade association representing approximately 275 securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The PSA's members include all of the primary dealers in government securities recognized by the Federal Reserve Bank of New York, as well as other securities dealers. The PSA actively represents its members in connection with all aspects of legislative and regulatory matters affecting or potentially affecting the government securities market, including the market for United States Treasury securities and mortgage-backed and non-mortgage-backed securities issued by United States government agencies and government sponsored enterprises.[4/]

[3/](...continued)
markets are bilateral, customized agreements subject to individual negotiation. In contrast, foreign exchange contracts traded on designated exchanges are largely fungible, with the price and timing of the trade being the only variables.

[4/] The volume of outstanding government securities and the daily trading volume in the government securities markets significantly exceed those of the other OTC markets. For example, the average daily trading volume in government securities, comprised of Treasury securities and mortgaged-backed and non-mortgaged-backed securities issued by United

(continued...)

Certain members of the Industry Associations have been entering into OTC foreign currency transactions with each other and other counterparties in the United States and around the world for years, with the understanding that their activities were not subject to the Commodity Exchange Act (the "CEA").

The holding of the United States Court of Appeals for the Second Circuit — that OTC foreign currency options[5/] are

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[4/](...continued)
States agencies and government sponsored enterprises, exceeds $280 billion (of which approximately $211.1 billion represents Treasury securities). The volume of outstanding government securities exceeds $4.2 trillion (of which approximately $3.4 trillion represents Treasury securities).

[5/] Foreign currency options are agreements conveying the right, but not the obligation, to buy or sell a specified amount of currency at a specified exchange rate. In entering into a foreign currency option, the purchaser and seller agree that the purchaser has the right to cause the seller either to take delivery of a particular currency from (a "put") or to deliver the currency to (a "call") the purchaser in exchange for another specified currency at an agreed upon rate (the "strike price"). In the case of a call option, for example, the purchaser will exercise the option if the option is "in the money" — that is, if the current cash market rate of exchange exceeds the strike price — because exercising the option will be a less expensive means of acquiring the relevant currency than purchasing it in the cash market. On the other hand, the purchaser will not exercise the option if the option is "out of the money" — that is, if the current cash market rate of exchange of the two currencies is less than the strike price — because the purchaser could buy the relevant currency more
(continued...)

subject to the CEA — creates significant legal uncertainty over the enforceability of a substantial volume of foreign exchange options contracts, could impose great regulatory and transactional costs on the OTC foreign currency markets and could possibly drive those OTC markets out of the United States. The ruling also may put market participants in this country, including certain members of the Industry Associations, at a disadvantage in global competition.

Indeed, many large-scale participants in foreign currency transactions, which historically have centered their business activities in the United States, could in response to the Second Circuit's decision shift the center of their foreign currency trading to their overseas offices to the detriment of the United States markets. Such a shift could result in a lessening of the liquidity of domestic foreign currency markets, which in turn could have an adverse impact on those United States businesses that engage in foreign trade and thus rely on those markets to assist their dealings in international commerce.

United States firms transacting business abroad require highly liquid OTC markets so that they can obtain the best prices for their currency purchases and sales. If the OTC foreign currency markets here in the United States were to become less liquid, those firms would likely have to shift their currency purchases and sales to more liquid financial centers offshore, such as in London, with operating hours less convenient to their business.

[5/](...continued)

cheaply in the cash market. Even so, options have realizable economic value that can increase (or decrease) as the underlying exchange rate changes prior to expiration of the option, whether or not the option is exercised or is "in the money."

For these reasons, as well as those set forth below, the issue presented in this case is of vital importance to the members of the Industry Associations and to the United States economy.[6/]

Statutory Provision Involved

This case involves the interpretation of the so-called "Treasury Amendment" to the CEA — in particular, the phrase "transactions in foreign currency." The Treasury Amendment provides:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. § 2(ii).

6/ The PSA and its members have an interest in the disposition of the instant litigation relating to whether foreign currency options are "transactions in" foreign currency because the Treasury Amendment also excludes from the CEA "transactions in" government securities. If the Court were to adopt a narrow construction of the phrase "transactions in," certain segments of the government securities market may be subjected to legal uncertainty as to the applicability of the CEA. Other segments, however, would be unaffected, including government securities options that would remain excluded from CFTC jurisdiction by virtue of the CEA's Shad-Johnson Accord amendments. 7 U.S.C. § 2a(i).

Statement of the Case

1. The OTC Foreign Currency Markets

The OTC foreign currency markets are highly evolved, sophisticated and very active. Trading is conducted twenty-four hours a day, from 6:00 a.m. Sydney, Australia time on Monday until 5:00 p.m. New York time on Friday, with exchange rate quotations available worldwide on computer screens and similar electronic devices. OTC transactions are not conducted on organized exchanges. Instead, most trading is conducted over the telephone directly with dealers or through brokers. These markets are extremely sensitive to political and financial developments around the world and around the clock.

In addition to commercial and investment banks, the most significant participants in the OTC currency markets are foreign exchange dealers and brokerage companies, corporations, money managers (including pension, mutual fund and commodity pool managers), commodity trading advisors, insurance companies, governments and central banks. Indeed, governments and businesses have historically relied upon the OTC currency markets to serve a number of their fiscal and commercial needs. For example, the Federal Reserve Bank of New York (on behalf of the United States and foreign central banks), foreign central banks and foreign governments frequently intervene in the OTC markets in an effort to implement their policies with respect to their national currencies.

The importance of the OTC currency markets to the United States economy is considerable. United States businesses and financial institutions depend on active trading in, and the orderly functioning of, the OTC currency markets. These liquid markets provide businesses with access to inter-

national markets for goods and services by providing the foreign currency necessary for transactions worldwide.

The OTC foreign currency markets also assist international businesses faced with the vagaries of global interest rate and currency volatility by providing a means of managing the risk of adverse exchange rate movements. OTC foreign currency futures and options contracts are commonly used to hedge inventories, accounts receivable or payable and contract bids denominated in a particular currency. Such contracts allow participants to shift the risk of adverse exchange rate movements to a counterparty willing to accept that risk, thereby enhancing their ability to engage profitably in international commerce.

The global significance of these OTC markets and the full scope of trading activity in this country are evident from a triennial survey conducted by twenty-six national monetary authorities and coordinated by the Bank for International Settlements ("BIS") in Basle, Switzerland. With respect to foreign currency "forwards,"[7/] this survey reports that the average daily turnover in these twenty-six countries was approximately $100 billion in April 1995, representing approximately a 70% increase over the prior three-year

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7/ The generic term "forward" is colloquially used and is used at places in this brief to refer generally to forward transactions in the OTC foreign exchange markets without regard to the regulatory status of the particular contract — *i.e.*, without regard to whether the contract is a "futures contract" or a "cash forward" contract under the CEA. As noted below, cash forwards are excluded from CEA coverage pursuant to 7 U.S.C. § 1a(11).

period.[8/] With respect to foreign currency options, the survey reports that the average daily turnover was $40 billion in April 1995, representing a 29% increase over the prior three-year period.[9/] Approximately one-half ($20 billion) of the daily turnover of OTC currency options is attributable to the United States.[10/] Collectively, the United States, United Kingdom and Japan account for more than half (56%) of all the global daily turnover in foreign exchange. The United States and United Kingdom rank top in the world, with 16% and 30%, respectively, of the global daily turnover in foreign exchange.[11/]

2. The Treasury Amendment

The CEA regulates commodity futures and options trading. *See generally Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 360-63 (1982). It requires, among other things, that all commodity futures and options trading take place on exchanges approved and regulated by the CFTC (so-called "contract markets"), unless such activities

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8/ *Compare* BIS, "Central Bank Survey of Foreign Exchange and Derivatives Market Activity 1995" at Table 1-A (May 1996); *with* BIS, "Central Bank Survey of Foreign Exchange Market Activity in April 1992" at Table 1-A (March 1993).

9/ BIS, "Central Bank Survey of Derivatives Market Activity: Release of Preliminary Global Totals" at 4 (Dec. 18, 1995).

10/ Federal Reserve Bank of New York, "Central Bank Survey of Derivatives Markets Activity Results of the Survey of the United States" at Annex II, Table 5-U.S. (Dec. 18, 1995).

11/ BIS, "Central Bank Survey of Foreign Exchange and Derivatives Market Activity 1995" at Table 2-G.

fall within a statutory exclusion (such as the Treasury Amendment) or a regulatory exemption. *See* 7 U.S.C. §§ 2, 6(a) and (c), 6c(b).

In 1974, Congress substantially broadened the scope of the CEA by expanding the definition of commodity to include non-agricultural products. During Congress's consideration of the 1974 amendments, the Acting General Counsel of the Department of Treasury wrote to the Senate Committee on Agriculture and Forestry to express concern that, as a result of the proposed expansion of the CEA's scope, foreign currency transactions and transactions in other financial instruments that were then generally traded by large, sophisticated institutional participants would become subject to unnecessary regulation. *See* S. Rep. No. 1131, 93d Cong., 2d Sess. 51 (1974), *reprinted in*, 1974 U.S.C.C.A.N. 5843, 5889. The Treasury Department also expressed concern that "new regulatory limitations and restrictions could have an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors." *Id.* at 5888.

In view of these concerns, the Treasury Department urged that the proposed legislation be amended "to make clear that its provisions would not be applicable to futures trading in foreign currencies or other [specified] financial transactions." *Id.* at 5889. Congress adopted the Treasury Department's proposed statutory exclusion almost verbatim. That exclusion, which has since become known as the "Treasury Amendment," provides in relevant part:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. § 2(ii). The Senate Report offered the following explanation for including the Treasury Amendment in the CEA:

> A great deal of the trading in foreign currency in the United States is carried out through an informal network of banks and [dealers]. The [Senate] Committee believes that this market is more properly supervised by the bank regulatory agencies and that, therefore, regulation under this legislation is unnecessary.

S. Rep. No. 1131, 93d Cong., 2d Sess. 23 (1974), *reprinted in*, 1974 U.S.C.C.A.N. 5843, 5863.[12/]

3. Regulatory Exemptions

As noted above, the CEA generally requires that all commodity options be traded on contract markets designated by the CFTC, unless such trading falls within a statutory exclusion such as the Treasury Amendment or a regulatory exemption. *See* 7 U.S.C. §§ 2, 6(a) and (c), 6c(b); 17 C.F.R. § 33.3. Two regulatory exemptions — the CFTC's trade option exemption and swap exemption — could possibly render OTC foreign currency options enforceable in the absence of the Treasury Amendment's statutory exclusion. Those regulatory exemptions, however, are significantly more limited in scope than the Treasury Amendment.

[12/] Although Congress noted the regulatory supervision of banks participating in the OTC foreign exchange markets, Congress also was aware that other entities participated in that market (*see*, *e.g.*, *id.* at 5888 (referring to the "foreign exchange markets for traders and investors")), and it included in the Treasury Amendment no provision restricting the amendment to activities or participants subject to federal regulatory supervision.

The CFTC's trade option exemption is limited to option transactions offered to a "producer, processor or commercial user . . . or . . . merchant" handling the underlying commodity, who enters into the transaction "solely for purposes related to its business as such." 17 C.F.R. § 32.4. This exemption offers a limited and uncertain degree of protection to a narrow group of market participants depending on the circumstances and purpose of the transaction. Similarly, the CFTC's swap exemption is limited to enumerated transactions, including currency options, that satisfy several criteria that restrict and introduce uncertainty concerning the availability of the exemption for foreign currency option transactions. *See* 17 C.F.R. § 35.2(a)-(d).

By their very nature, moreover, regulatory exemptions are subject to the CFTC's jurisdiction and regulatory discretion. Indeed, the CFTC could decide to restrict the scope of those two exemptions even further or eliminate the exemptions altogether.[13/]

4. The Proceedings Below

The CFTC brought suit in the United States District Court for the Southern District of New York against petitioners (as well as two additional corporate defendants), charging them with fraud in violation of the CEA and the CFTC's regulations in connection with foreign currency option transactions. The CFTC moved the District Court to appoint a temporary equity receiver. In response to this

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[13/] For example, the CFTC considered in 1994 narrowing the scope of its swap exemption by, among other changes, further restricting the category of participants eligible for the exemption. *See* CFTC Proposed Rules, *Section 4(c) Contract Market Transactions; Swap Agreements*, 59 Fed. Reg. 54,139, 54,150 (1994).

motion, petitioners argued that the District Court lacked subject matter jurisdiction because the Treasury Amendment deprives the CFTC of authority to regulate foreign currency options. The District Court granted the CFTC's motion, holding that it had sufficient jurisdiction to appoint a temporary receiver based on the Second Circuit's interpretation of the Treasury Amendment in *CFTC* v. *American Board of Trade, Inc.*, 803 F.2d 1242 (2d Cir. 1986). (*See* Pet. App. at 1b-6b.)[14/]

The Second Circuit affirmed the District Court's appointment of a receiver. The principal question, the Second Circuit stated, was whether the phrase "transactions in foreign currency" in the Treasury Amendment includes foreign currency options. 58 F.3d at 53 (Pet. App. at 5a). "If such options are included, then the exemption applies, and the options do not fall within the CFTC's jurisdiction." *Id.* The Second Circuit concluded, however, that it was bound by its prior decision in *American Board of Trade*, which held that the phrase "transactions in foreign currency" does not include options:

> Our reasoning [in *American Board of Trade*] was that an option was simply the right to engage in a transaction in the future, and, until this right matured, there was no exempt "transaction." The exercise of an option would constitute a "transaction in foreign currency," but the purchase or sale of the option itself would not be such a "transaction" under the Treasury Amendment.

Id. (Pet. App. at 6a).

The Second Circuit "acknowledge[d] that [its] interpretation of the phrase 'transactions in foreign currency' in

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[14/] Citations in the form of "Pet. App. at ___" are to the Appendix to the Petition for Writ of Certiorari.

American Board of Trade conflicts with that of the Fourth Circuit in *Salomon Forex, Inc.* v. *Tauber*, 8 F.3d 966 (4th Cir. 1993), [*cert. denied*, 114 S. Ct. 1540 (1994)]." *Id.* at 54 (Pet. App. at 6a). The Second Circuit nonetheless felt constrained by its earlier decision, remarking that "[w]hatever doubts [it] may have about the interpretation given the Treasury Amendment in *American Board of Trade* . . . are not grounds for [its] declining to follow it." *Id.*

Summary of Argument

The Treasury Amendment excludes from the CEA's coverage all "transactions in foreign currency . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii). As a matter of plain meaning, the phrase "transactions in foreign currency" is broad enough to include any transaction in which foreign currency is the subject matter. Regardless of whether that transaction is a spot, cash forward, future or option, so long as its subject matter is foreign currency, it is a "transaction[] in foreign currency" within the ordinary meaning of that phrase. The structure of the CEA and the Treasury Amendment taken in its entirety confirm that the phrase "transactions in foreign currency" should be construed consistent with its plain meaning.

The only issue before this Court is whether the phrase "transactions in foreign currency" includes foreign currency options. A decision by this Court that the phrase does include such options, however, does not mean that the District Court lacks jurisdiction. Although it appointed a temporary receiver, the District Court has not yet determined whether the underlying transactions were conducted on a "board of trade." If they were conducted on a "board of trade," then the transactions fall within the "unless" clause of the Treasury

Amendment, and thus are subject to the CEA despite the fact that they were "transactions in foreign currency." This action therefore should be remanded to the District Court for a determination of whether the transactions at issue were conducted on a "board of trade."

Argument

I.
The "Transactions in Foreign Currency" Clause of the Treasury Amendment Should Be Construed to Include All OTC Foreign Currency Transactions, Including Option Transactions.

On its face, the language of the Treasury Amendment is broad and unqualified, excluding from the CEA's coverage all "transactions in foreign currency" unless they involve sales "for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii). The Industry Associations respectfully submit that the phrase "transactions in foreign currency" encompasses all OTC foreign currency transactions, including foreign currency option transactions.

A. The Plain Meaning of the Phrase "Transactions in Foreign Currency" Includes All Transactions in Which Foreign Currency Is the Subject Matter, Including Foreign Currency Options.

"[T]he starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive." *Consumer Prod. Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). In this case, the language of the statute itself excludes from the coverage of the CEA, without limitation or qualification, all

"transactions in foreign currency," unless such transactions involve sales "for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii). As a matter of plain meaning, the phrase "transactions in foreign currency" is broad enough to encompass any transactions in which foreign currency is the subject matter. Indeed, the CEA uses the term "transaction" to define both "futures" and "options,"[15/] and the Treasury Amendment's plain language literally embraces both kinds of "transactions." When it enacted the Treasury Amendment, Congress simultaneously was conferring on the CFTC broadened jurisdiction over both commodity futures and options; Congress could have, but did not, carve out options from the unqualified term "transactions in foreign currency."

When the language of the statute is clear, as it is here, there is no need to rely on legislative history. Even if the Court were to review the legislative history of the Treasury Amendment, however, there is no "clearly expressed legislative intention to the contrary," and accordingly, the clear language of the statute must be accepted as conclusive. Far from revealing a clearly expressed legislative intention to the contrary, the legislative history of the Treasury Amendment confirms that the phrase "transactions in foreign currency" should be read broadly to encompass a wide range of transactions in the enumerated instruments, including options. For instance, the Treasury Department wrote in its letter to the Senate Committee that

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15/ Futures are "*transactions* involving contracts of sale of a commodity for future delivery," and options are "any *transaction* which is of the character of, or is commonly known to the trade as, an 'option.'" 7 U.S.C. § 2(i) (emphasis added).

> the Department is concerned that the language of the bill is broad enough to subject to regulation [by the CFTC] a *wide variety of transactions involving* financial instruments, such as puts and calls, warrants, rights, resale of installment loan contracts, repurchase options in Government securities, Federal National Mortgage Association mortgage purchase commitments, futures trading in mortgages contemplated by the Federal Home Loan Mortgage Corporation, etc. . . . [W]e do not believe it is contemplated that the bills should regulate transactions in *financial instruments of that nature*.

S. Rep. No. 1131, 93d Cong., 2d Sess. 51 (1974), *reprinted in*, 1974 U.S.C.C.A.N. 5843, 5889 (emphasis added).

The Second Circuit in *American Board of Trade* stated that foreign currency options are not transactions "in" foreign currency, but rather merely "involve" or "relate to" foreign currency, because they do not necessarily result in the actual delivery of currency. *See* 803 F.2d at 1248 ("an option to buy or sell foreign currency is not a purchase or sale of the currency itself and hence is not a transaction 'in' that currency, but at most is one that relates to the currency"). In this context, however, the semantic distinction between "in," on the one hand, and "involve" or "relate to," on the other, is meaningless. For example, Webster's New Ninth Collegiate Dictionary defines the word "in" as "indicat[ing] inclusion" and the word "involve" as "include." *See* WEBSTER'S NEW NINTH COLLEGIATE DICTIONARY 607, 637 (1987). Thus, had Congress instead used the word "involve," the meaning of the Treasury Amendment would be the same.

B. There Is No Principled Reason to Distinguish Between Foreign Currency Futures and Options.

As noted above, foreign currency options give the holder the right to purchase or sell foreign currency. Because foreign currency is the subject matter of the transactions, foreign currency options are "transactions in foreign currency." The lack of an obligation to exercise the option, and thus cause actual delivery of the foreign currency, does not change the subject matter of the option or make it a "transaction in" something other than foreign currency.

As a practical matter, the *American Board of Trade* decision's analysis of options misapprehends the nature of options and the integrated character of the OTC foreign exchange markets. The OTC foreign currency markets are a single, integrated market, in which the same participants engage in a range of transactions including both futures[16/] and options. Like futures, options directly convey foreign exchange risk, whether or not they are exercised. The holder of an option does not need to exercise an option to profit from it. In fact, an option does not even need to be "in the money" for the holder to profit from it. The holder instead can sell the option prior to maturity at a price reflecting intervening foreign exchange movements. In addition, the distinction between options and futures is not always clear in particular transactions, and options and futures are often entered into in combination with each other.

[16/] Participants in the OTC markets routinely refer to these transactions as forwards, without regard to whether they are futures or cash forward transactions within the meaning of the CEA.

Futures and options transactions are fundamentally similar in another important respect: both are agreements to make or take delivery at a future time. The parties to both OTC futures and options transactions are not required to fulfill their obligations by delivery and, in fact, commonly do not actually deliver the underlying currency. And neither the language of the Treasury Amendment nor its legislative history suggests that the applicability of this exclusion should depend on whether (or the likelihood that) the participants in the transaction make or take actual delivery of the foreign currency. Thus, if OTC foreign exchange options fall outside the Treasury Amendment, so too must futures, a result the Fourth Circuit properly rejected in *Salomon Forex* precisely because it would render the Treasury Amendment incapable of accomplishing the very purpose for which it was enacted. *See* 8 F.3d at 976.

C. The Treasury Amendment's Exclusion Must Apply to Foreign Currency Transactions Other Than Spot and Cash Forward Transactions.

The Chicago Mercantile Exchange and the Board of Trade of the City of Chicago — two exchanges designated as "contract markets" by the CFTC — have contended that the Treasury Amendment's exclusion applies only to spot and cash forward transactions which result in actual delivery of the currency, leaving all other foreign currency transactions subject to the CEA. As the Fourth Circuit held in *Salomon Forex*, 8 F.3d at 974-78, that contention is without merit for two reasons.

1. The Structure of the CEA Confirms That "Transactions in Foreign Currency" Should Be Read Broadly.

The structure of the CEA as a whole indicates that the phrase "transactions in foreign currency" is not limited to spot and cash forward transactions. The CEA has always regulated only commodity futures and options and never spot transactions or cash forwards.[17/] The CEA applies to "accounts, agreements . . . and transactions involving . . . contracts of sale [of a commodity] for future delivery." 7 U.S.C. § 2a(ii). And the CEA's so-called "forward contract exclusion" excludes cash forward transactions from the CEA's definition of "future delivery." *See id.* § 1a(11) ("The term 'future delivery' does not include any sale of any cash commodity for deferred shipment or delivery.").

Thus, when Congress added the Treasury Amendment in 1974, if it had wanted to exclude from the CEA only spot transactions and cash forwards in foreign currencies, no amendment would have been necessary. Cash forwards were already excluded from the CEA by the "forward contract exclusion," and spot transactions were already excluded because they do not involve contracts for "future delivery" of a commodity. It is an "'elementary cannon of construction that a statute should be interpreted so as not to render one

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[17/] Although the CEA prohibits manipulation of commodity prices generally, *see* 7 U.S.C. § 13(a)(2), there is no basis even to suggest that the Treasury Amendment was enacted to circumscribe the CFTC's anti-manipulation authority with respect to cash market transactions. The complete absence in the legislative history of the Treasury Amendment of any reference (by Congress or the Treasury) to the CFTC's anti-manipulation authority belies such a suggestion.

part inoperative.'" *Mountain States Tel. & Tel. Co.* v. *Pueblo of Santa Ana*, 472 U.S. 237, 249 (1985) (quoting *Colautti* v. *Franklin*, 439 U.S. 379, 392 (1979)). Unless the Treasury Amendment is to be deemed wholly superfluous, it must be read to exclude from the CEA all OTC foreign currency transactions, and not just spot transactions and cash forwards.

2. The Treasury Amendment Taken in Its Entirety Confirms That "Transactions in Foreign Currency" Should Be Read Broadly.

If Congress meant for the phrase "transactions in foreign currency" to apply only to spot or cash forward transactions resulting in the actual delivery of the currency, then the Treasury Amendment's "unless" clause would be superfluous. Because the "unless" clause refers to "transaction[s] involv[ing] the sale [of a commodity] for future delivery," the general clause "transactions in foreign currency" must also include such transactions.[18/] In the words of the Fourth Circuit, "[t]he class of transactions covered by the general clause 'transactions in foreign currency' must include a larger class than those removed from it by the 'unless' clause in order to give the latter clause meaning." *Salomon Forex*, 8 F.3d at 975.

[18/] Although the CEA uses the phrase "contracts of sale of a commodity for future delivery" to refer to futures contracts, *see* 7 U.S.C. § 2(i), the Treasury Amendment's reference to transactions that "involve the sale [of a commodity] for future delivery" is clearly broader and, by any light, is broad enough to encompass options. Foreign currency options give the holder the right to require the purchase or sale of the currency on a date after the date on which the option is executed, and thus "involve" the sale of a foreign currency for future delivery.

In short, Congress would have had no reason to include the "unless" clause in the Treasury Amendment if it intended the phrase "transactions in foreign currency" not to include foreign currency futures. "[A] statute must, if possible, be construed in such fashion that every word has some operative effect." *United States* v. *Nordic Village, Inc.*, 503 U.S. 30, 36 (1992).

If the phrase "transactions in foreign currency" includes futures contracts, it also must include foreign currency options. As the Fourth Circuit recognized, there is no principled reason to distinguish between foreign currency futures and options:

> Once we conclude that the clause is to be read broadly to include futures, it is a short step to conclude that the Treasury Amendment applies to *all* transactions in which foreign currencies are the subject matter, including options. Since trading in both futures and options involves foreign currency, albeit indirectly, there is no principled reason to distinguish between them in this context.

Salomon Forex, 8 F.3d at 976 (emphasis in original).

D. An Option Is a "Transaction[ ] in Foreign Currency" Regardless of Whether the Option Is Ultimately Exercised.

In *American Board of Trade*, the Second Circuit held that "[a]n option transaction giving the option holder the right to purchase a foreign currency by a specified date and at a specified price does not become a 'transaction[ ] in' that currency

unless and until the option is exercised." 803 F.2d at 1248.[19/] The notion that a foreign currency option is not a "transaction[] in foreign currency" unless and until the option is exercised is premised on a misunderstanding of the economic substance of options. As noted above, options contracts directly convey foreign exchange risk regardless of whether they are ultimately exercised.

A rule that makes the applicability of the CEA depend on whether an option is exercised also would in effect allow unpredictable market forces and the discretion of the option holder to determine the legality of a transaction. The holder of an option anticipates and intends the exercise of the option (and delivery of the currency) if the option is "in the money" — in other words, if the exercise of the option will result in a positive cash flow to the holder of the option. Whether the exercise of the option will result in a positive cash flow will depend on movements in the price of the underlying foreign currency over the life of the option, which of course are unpredictable when the option is purchased.

It thus makes no sense to differentiate between exercised and unexercised options in applying the Treasury Amendment and to let the fact of delivery of the currency determine whether an option transaction is excluded from the CEA.

[19/] Prior to the Second Circuit's decision in this case, the members of the Industry Associations regarded this language as dictum because it was not necessary to the decision in *American Board of Trade*. As the Second Circuit remarked in this case, "we could have altered our reasoning and reached the same result by stating that because the instruments at issue in *American Board of Trade* were traded on an exchange they fell outside the Treasury Amendment." 58 F.3d at 53 (Pet. App. at 6a).

Such a rule would mean that the legality of a foreign currency option, which would depend on intervening foreign exchange movements and the discretion of the option holder, may not be known until after the exercise date of the option or the delivery of the currency — a commercially unacceptable result. From a commercial perspective, foreign currency options are "transactions in foreign currency" because foreign currency is the subject of the transactions.[20/]

II.
This Action Should Be Remanded to the District Court for a Determination of Whether the Underlying Transactions Were Conducted on a "Board of Trade."

If the Court concludes that the phrase "transactions in foreign currency" encompasses foreign currency options, the Court should remand the action to the District Court for a determination of whether the transactions in this case were conducted on a "board of trade." This determination by the District Court is necessary because the "unless" clause of the Treasury Amendment carves out of the amendment any transactions in the enumerated instruments that "involve the

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[20/] Similarly, the fact that the purchaser of an option may offset or net the transaction, rather than accept actual delivery of the foreign currency, does not change the essential nature of the transaction. *See Board of Trade of City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236, 248 (1905) ("[s]et-off has all the effects of delivery"). Moreover, this analysis and the language of the Treasury Amendment are equally applicable when an option agreement provides for a cash payment, rather than delivery of a currency, based on the value of the currency at the time the option is exercised.

sale thereof for future delivery conducted on a board of trade."

As noted above, the District Court has not yet determined whether any of the underlying option transactions were conducted on a "board of trade."[21/] The District Court instead simply stated that it was "sufficiently satisfied on the subject of jurisdiction" based on the Second Circuit's interpretation of the phrase "transactions in foreign currency" in *American Board of Trade* to appoint a temporary receiver. (Pet. App. at 6b.) Because the issue of whether the option transactions in this case were conducted on a "board of trade" was not considered by the District Court or the Second Circuit or raised in the petition for writ of certiorari, it is not presently before this Court. Accordingly, this Court should remand the action to the District Court to make the factual findings necessary to make the "board of trade" determination.

The CEA defines "board of trade" as "any exchange or association, whether incorporated or unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same for sale on consignment." 7 U.S.C. § 1a(1). If this definition were construed too broadly, every participant in foreign currency transactions could be deemed a board of trade, and the Treasury Amendment's exclusion for "transactions in foreign currency" would be rendered meaningless by the "unless" clause. As noted above, a court must "give effect, if possible, to every clause and word of a statute." *United States* v. *Menasche*, 348 U.S. 528, 538-39 (1955) (internal quotation omitted).

21/ Petitioners filed a motion to dismiss the action for lack of subject matter jurisdiction, which is still pending before the District Court. (Pet. App. at 5b-6b.)

Certainly, government supervised banks and broker dealers and their affiliated dealing entities have never been — and should not be — considered "boards of trade." *See* S. Rep. No. 1131, 93d Cong., 2d Sess. 23 (1974), *reprinted in*, 1974 U.S.C.C.A.N. 5843, 5863-64. Instead, courts have interpreted "board of trade," primarily in the "bucket shop" or "boiler room" context, to extend beyond organized exchanges only in limited circumstances involving firms engaged in the mass marketing of standardized, non-negotiable commodity contracts to unsophisticated retail investors. *See, e.g.*, *CFTC* v. *Co Petro Mktg. Group, Inc.*, 680 F.2d 573, 576, 581 (9th Cir. 1982); *CFTC* v. *Standard Forex, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,063, at 41,455 (E.D.N.Y. Aug. 9, 1993); *CFTC* v. *American Metal Exch. Corp.*, 693 F. Supp. 168, 176-79, 193 (D.N.J. 1988), *aff'd in part and vacated in part on other grounds*, 991 F.2d 71 (3d Cir. 1993); *CFTC* v. *National Coal Exch., Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,424, at 26,049-50 (W.D. Tenn. Apr. 2, 1982).

Thus, a holding by this Court that the phrase "transactions in foreign currency" includes foreign currency options does not mean that the mass-marketing of those instruments to the general public will not be subject to the CEA. If such OTC foreign currency option transactions are conducted on a "board of trade," they can be policed by the CFTC to the same extent that OTC foreign currency futures are.[22/]

[22/] In the case of the government securities markets, the Securities and Exchange Commission has authority to regulate trading in securities and options on securities. *See* 7 U.S.C. § 2a(i); 15 U.S.C. §§ 77b(1), 78c(a)(10).

Conclusion

The OTC foreign currency markets are a critical element in the continued development and viability of global markets and international commerce. Given the tremendous size and importance of these markets to the United States economy and the disruption that would be caused if OTC foreign currency transactions were subject to the CEA, the Industry Associations respectfully urge that this Court reverse the Second Circuit's decision that the transactions at issue were not "transactions in foreign currency" and remand the action to the District Court to determine whether the transactions were conducted on a "board of trade."

Respectfully submitted,

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