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Alex Goldman

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Options Trading in Foreign Currency Excluded from Regulation by the CFTC

by Alex Goldman

In *Dunn v. Commodities Futures Trading Commission*, 117 S. Ct. 913 (1997), the United States Supreme Court reversed the Second Circuit Court of Appeals and the district court by holding that the Treasury Amendment to the Commodity Exchange Act exempts trade in foreign currency options from the Commodities Futures Trading Commission's ("CFTC") regulation. The Court primarily relied on a "plain-meaning" reading of the statute, buttressed with an examination of legislative intent, to reach its holding. The Court granted certiorari in order to resolve a conflict on the issue between two circuits: the Second Circuit, from which the instant case arose, and the Fourth Circuit.

CFTC Contended Off-Exchange Option Trading Falls within its Regulatory Domain

In 1994, the CFTC brought this action claiming that Petitioners, commodities traders, were involved in a fraudulent scheme involving the purchase of options to buy or sell foreign currency. An "option" gives the purchaser the right, but not the obligation, to purchase or sell a fixed amount of a commodity at a fixed price sometime in the future. In this case, option purchasers contracted directly with international banks and others for the purchase of the options, rather than using a regulated board of trade or exchange. Contracting directly is

known as "off-exchange" or "over-the-counter" trading. Petitioners' customers suffered severe losses from Petitioner's allegedly fraudulent options trading, which prompted the CFTC to file this fraud action in district court.

The district court accepted, and in an interlocutory appeal, the appellate court affirmed the district court's position that regulation of options trading of foreign currency falls within the CFTC's regulatory authority. Accordingly, the appellate court affirmed the district court's appointment of a temporary receiver to assume control of Petitioner's property for the benefit of Petitioner's customers until a court could determine whether fraud actually occurred.

Whether the district court's appointment of the receiver was proper hinged on the Court's interpretation of the Treasury Amendment, 7 U.S.C. § 2(ii), to the Commodity Exchange Act ("CEA"), 7 U.S.C. § 1 (1980). The CEA provides statutory guidelines for regulation of a broad variety of commodities trading. However, the Treasury Amendment provides an exemption to the regulation that proved crucial to this case. The Treasury Amendment reads: "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). Therefore, whether the appointment of the

receiver was proper in this case depended on whether Petitioners' trading of options in foreign currency constituted "transactions in foreign currency," and thus fell outside of the CFTC's control.

The Court Held that Foreign Currency Options are Transactions "In" Foreign Currency

The Court noted that its obligation in interpreting statutes was to "apply the statute as Congress wrote it" unless doing so "would frustrate Congress's clear intention or yield patent absurdity." Using this model of statutory interpretation, the Court rejected the CFTC's argument that an option was not a transaction "in" foreign currency but only a *right* to engage in a transaction in the future. The CFTC contended that only the purchase or sale of foreign currency (the "actual exercise" of the option) was a transaction "in" foreign currency, and therefore, options trading was not excluded from regulation under the Treasury Amendment. Reversing the court of appeals, the Court found the CFTC's reading of the statute "unnatural" and explained that it would "deprive the exemption of the principal effect Congress intended." Thus, the Court was unpersuaded by the CFTC's position that options represent a class of transactions separate from those transactions "in" foreign currency.

Likewise, the Court found little merit in the CFTC's contention that

options were substantially different than futures. Futures are contracts where a party commits to purchasing or selling a set amount of a commodity on a specified future date at a specified price. The CFTC admitted that futures are transactions "in" foreign currency, and therefore, exempt under the Treasury Amendment. However, the CFTC argued that futures are different than options because with futures, unlike options, there is an *obligation* to purchase or sell. With options, there is only a *right* to purchase or sell.

The Court found no meaningful distinction between futures and options because "the existence of a futures contract does not guarantee that currency will actually be exchanged," notwithstanding the technical "obligation" to buy or sell. To apply the distinction urged by the CFTC would "leave the Treasury Amendment's exemption . . . without any significant effect at all." In rejecting the CFTC's argument, the Court noted its interpretation of the statute was consistent with "the doctrine that legislative enactments should not be construed to render their provisions mere surplusage."

The Court defined transactions "in" foreign currency according to a plain-meaning reading of the statute. It held that all transactions "in which foreign currency is the fungible good whose fluctuating market price provides the motive for trading" are transactions in foreign currency. Applying this definition, the Court found that options trading in foreign currency, regardless of whether the options actually were exercised, squarely fits within the exclusion provided by the Treasury Amendment.

Legislative Intent Demonstrated Congressional Desire for a Broad Exemption

The Court further supported its reasoning by examining the legislative intent of the Treasury Amendment. The Senate Committee Report on the Amendment clearly indicated Congressional intent to provide a broad, over-arching exception to regulation of foreign currency trading. S. REP. NO. 93-1131, at 6 (1974). One of the reasons cited was Congress's desire to avoid regulation in a sophisticated market already subject to its own internal, regulatory schemes. In addition, the Court found it wholly irrelevant that the options market in foreign currency had not yet developed at the time of the statute's enactment in 1974. Hence, even though the Treasury Amendment states that regulation is appropriate where "such transactions involve the sale . . . for future delivery conducted on a board of trade," the Court rejected the CFTC's argument that this language provided a clear indication that Congress meant to exempt over-the-counter trading in futures rather than options. The Court also rejected CFTC's claim that there is a qualitative difference between the use of the word "in" and "involving" within the statute. The Court reasoned that Congress would not make such a subtle linguistic or semantic distinction to delineate the scope of its statutes.

Court Refused to Legislate

Finally, the Court acknowledged that there were important public

policy issues with potential impact on both domestic and international trade on both sides. Petitioners claimed that failure to exclude foreign currency options trading from regulation might drive the practice from the United States. In response, the CFTC argued that small exceptions to a regulatory scheme would be made where appropriate. The Court was unwilling to consider either side's positions, reasoning that the legislature was better suited to resolve such issues.

Conclusion

The Court reversed the judgment of the Second Circuit in holding that the Treasury Amendment to the Commodity Exchange Act precludes the CFTC from regulating over-the-counter options trading. The Court reached its decision based on a "plain-meaning" reading of the Amendment and an examination of legislative intent to preclude regulation of over-the-counter currency trading. In addition, the Court remanded the case for further proceedings.

Scalia Concurred

In a brief concurrence, Justice Scalia emphasized the superfluous nature of the Court's investigation of legislative intent. The conclusion, according to Scalia, could and should have been reached solely by reading the plain language of the statutes involved. Further inquiry was unnecessary.