COMMITTEE *AMICUS* BRIEF IN TAUBER v. SALOMON FOREX CASE

United States Court Of Appeals
FOR THE FOURTH CIRCUIT
No. 92–1406

LASZLO N. TAUBER, M.D.,
Appellant,

v.

SALOMON FOREX INC., *et al.*,
Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA

BRIEF OF THE FOREIGN EXCHANGE COMMITTEE AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

Interest of Amicus Curiae

The Foreign Exchange Committee (the "Committee") includes representatives of major domestic and foreign commercial and investment banks and foreign currency brokers engaged in foreign currency trading in the United States [8] The Committee was formed in 1978 under the sponsorship of the Federal Reserve Bank of New York and acts as a channel of information among the foreign currency markets and the Federal Reserve and other official institutions in the United States and abroad The Committee regularly advises the Federal Reserve Bank of New York on issues such as trading practices, risk management, and the structure, volatility and liquidity of the foreign currency markets The Committee also serves as a forum for the discussion of good practices and technical issues in the foreign currency markets and international money markets.

The institutions represented on the Committee have been trading foreign currencies off–exchange in the United States and around the world for years with the understanding that such activity was not prohibited by the United States Commodity Exchange Act (the "CEA") [9] A sudden and radical reversal of the regulatory regime for such trades would drive the OTC foreign currency markets out of the United States and would cripple the United States foreign currency markets and markets world–wide

8 See Appendix A for a list of the members of the Committee A copy of the Committee's Document of Organization is attached as Appendix B

9 7 U S C §§ 1-26

Over–the–Counter Markets in Foreign Currrency Forwards and Options

The over-the-counter ("OTC") — or off–exchange — foreign currency forwards and options markets are highly evolved, sophisticated and very active [10] Trading is conducted twenty-four hours a day, with the trading day starting in the Far East and ending in the United States, and with exchange–rate quotations available worldwide

10 These foreign currency (also referred to as "foreign exchange") markets are separate and distinct from the "contract markets" on commodity exchanges designated by the Commodity Futures Trading Commission (the "CFTC") for exchange trading of foreign currency futures and options Contract markets use standardized contracts in a limited number of currencies, for all of which the amount of currency per contract, the date of expiration, the means of delivery and other terms are standard and, with the exception of price, not subject to negotiation between the parties By using the term "forward" we do not intend to conclude that the transactions at issue are forwards rather than futures Because the term "forward" is used in the OTC market and in data sources concerning this market, it is used here rather than the term "futures," which was adopted by the District Court See Mem Op at 4, n 4

on computer screens and personal telephone pagers These markets are extremely sensitive to political and financial developments around the world

Among the most significant participants in the markets are commercial and investment banks, foreign currency brokerage companies, corporations, money managers, such as pension and mutual fund managers, cash managers, insurance companies, governments, and central banks

The OTC foreign currency markets serve a number of fundamental needs of governments and businesses worldwide The Federal Reserve Bank of New York (on behalf of the United States and foreign central banks), foreign central banks and foreign governments regularly intervene in the OTC markets to implement policies relating to their currencies In addition, the OTC markets provide businesses with access to international markets for goods and services by providing the foreign currency necessary for transactions worldwide

These liquid markets also assist international businesses faced with the vagaries of global interest rate and currency rate volatility by providing a means of hedging against the risk of an adverse exchange–rate movement OTC foreign currency forward or option contracts are commonly used to hedge inventories or accounts receivable or payable denominated in a particular currency [11] Such contracts allow participants to shift the risk of an adverse exchange–rate movement to a counterparty willing to accept that risk and the concurrent potential rewards [12]

The OTC markets are uniquely capable of meeting these varied needs because virtually every term of OTC foreign currency forward or option agreements — unlike their standardized exchange–traded counterparts — can be negotiated by the parties That an OTC option can be individually tailored is a primary reason for the high level of activity in the OTC currency markets

11 For example, a United States engineering firm may bid on an industrial contract in Italian Lira today and "lock in" the price in U S Dollars by purchasing an option to sell (or "put") Lira at the time payment on the contract is expected, thereby protecting itself if the Lira loses value in Dollars

12 The myriad functions served by the OTC currency markets are complementary For example, parties employ OTC foreign currency forwards or options to hedge against the effects of governmental intervention, such as efforts to influence the exchange rate of their currency against another currency Forwards or options can also be used for speculation on the effects of government intervention, which increases the liquidity of the market, thus making it easier for other participants to hedge their risks See Committee on Futures Regulation of the Association of the Bar of the City of New York "The Evolving Regulatory Framework for Foreign Currency Trading" at 21 (1986) (hereafter "NYC Bar Paper")

I. Trading and Offset in the OTC Foreign Currency Markets

Spot, forward and option OTC contracts on currencies are bilateral agreements between principals that impose binding delivery obligations All of the principal terms of such contracts, including quantity, exchange rate, credit issues and maturity or expiration, are individually negotiated between the parties, based on each party's objectives and its assessment of its counterparty's credit

A spot contract involves a commitment by one party to deliver a specified quantity of one currency against the other party's delivery of a specified quantity of a second currency, generally within two business days of the date of contract A forward contract is virtually identical to a spot contract, except that the date fixed for delivery of the underlying currencies is more than two days (and is generally between one week and two years) from the date of the contract [13] An option on a currency provides one party with the right, but not the obligation, to purchase (in the case of a "call" option) or sell (in the case of a "put" option) a specified quantity of a given currency, at a fixed exchange rate, at any time up to a stated expiration date or, in some cases, on such expiration date In contrast to a spot or forward contract, which imposes binding obligations on both parties, an option involves the payment of an up–front premium by the buyer and imposes a binding delivery or performance obligation on the seller of the option

The obligations imposed under spot, forward or option contracts may not be liquidated or closed out prior to the stated delivery or expiration date, except in the case of a default by a counterparty or by mutual agreement of the parties The parties to a spot, forward or option contract may agree to enter into a second offsetting transaction with the same maturity, thereby fixing each party's profit or loss on the first transaction In that event, however,

13 As stated in the NYC Bar Paper at 6

A foreign currency forward is a bilateral, executory contract between buyer and seller in which the seller agrees to deliver to the buyer, at a future date, a specified amount of foreign currency at a specified price Because they allow the parties to the contract to secure a price today for currency to be bought or sold in the future, foreign currency forwards, like options and futures contracts, can be used to hedge various foreign exchange exposures The need to hedge currency exposures arises because of the volatility of exchange rates Such exposures include "transaction exposures," which occur when an entity expects to receive payment or make payment in a foreign currency in connection with any transaction, and "translation exposures," which occur because of certain accounting rules when an entity must translate its foreign-currency denominated assets and liabilities into domestic currency on its financial statements (Footnote omitted)

each position must be maintained to maturity, the delivery obligations of the parties are not extinguished, and delivery must occur in accordance with the terms of the contract

As a matter of practice, the parties to two or more spot, forward or option contracts may routinely agree to satisfy their respective delivery obligations on a "net" basis [14] Such netting schemes reduce the risk that one party will not be able to settle its payment obligations [15] Bilateral netting of foreign currency contracts has been recognized by the bank supervisors of the G-10 countries as an appropriate way for banks to manage risks and qualify for lower capital requirements [16] Netting of delivery obligations also reduces transaction costs and protects each of the parties against the risk of counterparty bankruptcy by assuring that a bankruptcy trustee will not be able to "cherry pick" by requiring performance under profitable contracts while abandoning unprofitable contracts

Congress has expressly endorsed the development in the OTC markets of risk-reduction techniques such as netting arrangements The Federal Deposit Insurance Corporation Act and the Bankruptcy Code were amended to strengthen the enforceability of netting and close-out provisions in financial contracts [17] Within the last year, Congress further buttressed the enforceability of both bilateral and multilateral netting arrangements in the Federal Deposit Insurance Corporation Improvement Act of 1991 [18]

Acting upon the limited view of the scope of the Treasury Amendment espoused by Dr Tauber and by *amici curiae*, the Chicago Board of Trade and the Chicago Mercantile Exchange (the "Exchanges"), would effectively cripple the U S trading markets in foreign currency If, as they assert, only transactions in which "conveyance" occurs (Appellant's Brief at 12-13) or "where title or ownership is transferred or is expected to be transferred" (Exchange Brief at 10) are outside the CEA, a broad range of foreign currency trades, including a broad range of netted trades, could be illegal Such an untenable result would disrupt the United States and world-wide foreign currency markets, sap liquidity from the markets, drive trading offshore, undermine the world-wide recognition of the benefits of netting, risk management and credit management and go against the clear intent of Congress in passing legislation that supports netting

Although the Exchanges argue that affirming the District Court's opinion would vitiate Congress' findings as to the importance of futures and options trading, Congress, unlike the Exchanges (*see, e g*, Exchange Brief at 1-2), drew a distinction between foreign currencies on the one hand, and nearly all other commodities on the other, when deciding on the appropriate regulatory treatment The existence and growth of the OTC foreign currency markets have been of national benefit, and in 1974 and since then, Congress has recognized the markets' importance, as well as their ability to function properly without being subject to the CEA and the standardization requirements associated with exchange trading

II. The Development and Significance of the Markets

Before 1974, OTC transactions in foreign currency forwards were commonplace [19] The Federal Reserve Bank of New York, for example, used OTC forward transactions before 1974 as a means of intervening in currency markets on behalf of the United States Department of the Treasury, the Federal Reserve and foreign central banks [20] After 1974, an OTC market in currency options contracts developed among banks in London By 1981, banks in the United States began trading in options contracts, and since that time, the domestic OTC currency options markets have grown dramatically [21]

The global significance of these markets and the full scope of activity in this countryis evident from a study

14 Netting may be effected under an agreement entered into prior to the execution of any transaction or by a separate agreement of the parties entered into subsequent to the date of the offsetting contracts but prior to their maturity date In addition, the parties may agree either to "payment netting," in which payments under a number of open contracts are netted, or to "netting by novation," in which all contracts entered into for delivery of the same currencies on the same delivery date are cancelled and replaced by a single contract providing for payment of a net amount of each currency involved The agreement between the parties may also provide for the liquidation of all open contracts and the netting of all amounts due upon the occurrence of an event of default

15 Bank for International Settlements, Basle, Switzerland, "Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries" at 2-4 (Nov 1990)

16 See 12 C F R Part 208, Appendix A (1992)

17 12 U S C §1821(e)(8)(A)(iii) and 11 U S C §§362, 546 and 548, respectively

18 12 U S C §§4401-4407 See Patrikis and Walraven, "The Netting Provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991," XII *Futures International Law Letter* (May 1992) Mr Patrikis is the General Counsel of the Federal Reserve Bank of New York

19 H Grubel, *Foreign Exchange, Speculation, and the International Flow of Capital* (1966)

20 Coombs, "Treasury and Federal Reserve Foreign Exchange Operations," Federal Reserve Bank of New York, 44 *Monthly Review* 131, 133-38 (1962)

21 Exchange-trading of foreign currency options did not begin until 1982 See J Walker, *How the Options Markets Work*, at 164 (1991)

conducted by the Bank for International Settlements ("BIS") in Basle, Switzerland (the "central bankers' bank") According to the BIS, in 1989 the gross average daily turnover in foreign currency forwards in twenty-one countries was $28 billion [22] The same study showed that the average daily turnover of currency options was $22 billion, of which half was in the United States Japan, the United Kingdom and France also accounted for significant portions of this turnover The BIS noted that "[t]he great bulk of currency options written or purchased by banks are over-the-counter instruments, with exchange-traded options amounting to a small portion of the total" *Id* at 5 Exchange-traded futures operations were of limited importance [e]ven in the United States, where the most active futures markets are located, transactions in currency futures accounted for only about 5% of forward operations Id The BIS concluded that the growth in the importance of foreign currency derivative products (such as OTC forwards and options), as well as the growth in the range of currencies traded, demonstrates "the increased sophistication of both bank and non-bank participants in foreign exchange markets and the greater integration of financial markets" *Id* at 9

Some indication of the size of the OTC currency forwards and options markets in the United States alone[23] is given by data submitted by major market participants to the Federal Reserve Bank of New York[24] Average daily turnover in the OTC foreign currency forwards and options markets as reflected in the Federal Reserve Bank of New York's triennial studies from 1977 to 1989 is set forth in the table below In 1989, the reported average daily turnover in the United States in the OTC foreign currency forwards and options markets was $6.17 billion and $5 10 billion, respectively [25]

22 Bank for International Settlements, Basle, Switzerland, "Survey of Foreign Exchange Market Activity" at 12 (Feb 1990)

23 This data do not reflect trades booked by U S market participants in other trading centers such as London, Singapore and Tokyo The United States may not be the major booking center for many of these U S institutions

24 Since 1977, the Federal Reserve Bank of New York has conducted triennial surveys of turnover in the foreign currency markets The surveys are voluntary and do not include all participants, therefore it is likely that they significantly understate the volume of trading Data from the most recent survey, conducted in 1992, will be published this fall The data set forth in the table in the text were taken from the Federal Reserve Bank of New York Foreign Exchange Turnover Surveys (July12, 1977, June23, 1980 Sept 7, 1983, Aug 20, 1986, and Sept 13, 1989) OTC foreign currency options were not included in the Surveys until 1986

25 Federal Reserve Bank of New York, *Foreign Exchange Turnover Survey*, Sept 13, 1989 The data represent only the average dollar amount traded each day, and thus reflect the flow of transactions, rather than the total dollar amount of transactions outstanding Anecdotal evidence suggests that several trillion dollars of foreign currency forwards and options transactions are outstanding

Average Daily Turnover Reported to the Federal Reserve Bank Of New York

YEAR	OTC FOREIGN CURRENCY FORWARD CONTRACTS IN THE U S (in billions of $)	OTC FOREIGN CURRENCY OPTION CONTRACTS IN THE U S. (in billions of $)
1977	0 25	—
1980	1.08	—
1983	1 01	—
1986	2.87	0 29
1989	6 17	5.10

Moreover, the global OTC markets for foreign currency forwards and options have evolved — and continue to evolve — in a constructive, responsible fashion The Committee, for example, devotes substantial effort to the identification and recommendation of better practices *See, e g*, The Foreign Exchange Committee, *1991 Annual Report*, at 5-6 (discussing, *inter alia*, historical rate rollovers, the use of points in the brokered foreign currency markets and dispute resolution), The Foreign Exchange Committee, *1990 Annual Report*, at 4-6 (discussing, *inter alia*, the use of confirmation practices) Affirming the decision of the District Court will allow this evolution to continue

Dr Tauber and the Exchanges ignore the domestic and global importance of the OTC foreign currency forward and options markets and the fact that much of the trading in these markets crosses national borders (and thereby facilitates trade among countries) Prohibiting an important segment of the world-wide OTC foreign currency markets from operating in this country and discouraging U S persons from participating in the OTC foreign currency markets would result in extraordinary costs and would damage the United States' ability to compete as a world financial center If the legitimate needs of commerce cannot be served by the OTC markets in the United States, those needs will no doubt be met by other financial centers to the significant detriment of the United States

Argument

Under any interpretation of the Treasury Amendment and existing precedent, the decision of the District Court must be affirmed The plain language of the Treasury Amendment and the structure of the CEA mandate the

conclusion that all of the forward and option contracts between Salomon Forex and Dr Tauber are enforceable and not subject to the CEA Even if the language and structure of the statute are ignored, the option contracts in question are excluded from the CEA because they were exercised, and Dr Tauber is a sophisticated institutional investor whose trading is excluded under the CFTC's interpretation of the Treasury Amendment Moreover, Salomon Forex is not a "board of trade" for purposes of the CEA and cannot be construed as such

I.
The Plain Language of the Treasury Amendment Mandates a Broad Transactional Exclusion From the CEA.

The plain language of the Treasury Amendment excludes from the CEA all off-exchange foreign currency transactions, without regard to their nature or the character of their participants Mem. Op. at 12 The Treasury Amendment plainly states

> [n]othing in this [Act] 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

Unless a foreign currency transaction is both for future delivery and occurs on a board of trade, it is excluded from the CEA and consequently from the jurisdiction of the CFTC

A court must find the plain meaning of a statute conclusive except in those rare cases in which substantial unambiguous evidence supports a contrary interpretation *See Griffin* v *Oceanic Contractors, Inc*, 458 U S 564, 571 (1982); *Matala* v *Consolidation Coal Co*, 647 F 2d 427, 429–30 (4th Cir 1981). *See also Ford Motor Credit Co* v. *Cenance*, 452 U S. 155, 158 n.3 (1981). The District Court correctly determined that "the Treasury Amendment's plain language is not qualified in any respect " Mem. Op. at 13. Nowhere does the statute limit the exclusion according to the nature of the transaction or participants, or whether or not the participants make or take delivery of the currency Moreover, there is no clear and substantial evidence that Congress intended any such limitation. This Court must therefore find that each of the foreign currency transactions between Salomon Forex and Dr. Tauber were excluded from the CEA *See In re Forfeiture Hearing as to Caplin & Drysdale*, 837 F 2d 637, 641 (4th Cir. 1988)

A. The Language of the Treasury Amendment Excludes All Transactions in Foreign Currency.

A contract providing the right to receive foreign currency (or the obligation to deliver currency) is a "transaction in foreign currency " Whether the transaction is a spot, forward, or option contract, if it provides the right to obtain foreign currency, it is a transaction in foreign currency The District Court, refusing to find ambiguity where none exists, accepted this plain meaning of the Treasury Amendment and concluded that further inquiry was not required Mem Op at 13

Dr Tauber and the Exchanges erroneously assert that foreign currency transactions that do not necessarily result "in" delivery of currency are not transactions in foreign currency, but merely involve foreign currency and are therefore subject to the CEA As support for this distinction, Dr Tauber and the Exchanges rely on two cases[26] which held that the Treasury Amendment has limitations when applied to the marketing of currency options to the general public and not to sophisticated institutional investors such as Tauber *See CFTC* v *American Board of Trade, Inc*, 473 F Supp 1177 (S D N Y. 1979), *aff'd*, 803 F 2d 1242 (2d Cir 1986), *CFTC v Sterling Capital Co*, [1980 – 1982 Decisions] Comm Fut L Rep (CCH) ¶ 21,169 (N D Ga 1981), *modified on other grounds*, [1980 - 1982 Decisions] Comm Fut L Rep (CCH) ¶ 21,170 (N D Ga 1981)[27]

No reliance whatsoever can be placed on this meaningless distinction "In" and "involve" are defined, respectively, as "indicat[ing] inclusion" and "include " *See* Webster's Ninth New Collegiate Dictionary 607, 637 (1986) Had Congress used the word "involve" rather

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26 Dr Tauber also relies on dicta in *Chicago Board of Trade* v *SEC*, 677 F 2d 1137, 1155, n 34 (7thCir 1982), *vacated as moot*, 459 U S 1026 (1982), even though the Court specifically noted it was drawing "no conclusion" as to whether the Treasury Amendment affected CFTC jurisdiction over options on foreign currency

27 Both of those cases involved enforcement actions by the CFTC, not an attempt by an active, sophisticated and wealthy trader in foreign currency to use the statute as a defense to the enforcement of his contractual obligations The *American Board of Trade* and *Sterling* courts strayed from the plain language of the Treasury Amendment in an attempt to protect a public they perceived as unsophisticated and vulnerable to boiler room operators There is no evidence, however, that foreign currency products currently are being marketed to the general public, by boiler room operators or otherwise If there is a need to address on the federal level the protection of the general public in the context of the foreign currency market, that is a matter best addressed by Congress, which would have the benefit of the advice of the Treasury Department, the Federal Reserve System and all supervisory and regulatory agencies with an interest in the market *See United States v Ron Pair Enterprises, Inc*, 489 U S 235, 241 (1989) ("the sole function of the courts is to enforce [the statute] according to its terms") (quoting *Caminetti* v *United States*, 242 U S 470, 485 (1917))

than "in," the meaning of the Treasury Amendment would not change one iota, and Dr Tauber would argue that his transactions did not "involve" foreign currency, for the very reasons he now argues that they are not transactions in foreign currency See Appellant's Brief at 14-20, Exchange Brief at 9-11

Moreover, as the District Court found, the CEA's legislative history "reveals no clear and unambiguous expression of legislative intent sufficient to warrant rejecting the plain, unambiguous, ordinary meaning of the statutory language " Mem Op at 15 The court's finding that the Treasury Amendment is a broad exclusion is consistent with the opinion of the Treasury Department, which considers the Treasury Amendment a "transactional exemption" upon which there is no limitation [28]

In 1974 the Treasury Department urged (and Congress provided) that foreign currency trading be excluded from the jurisdiction of the CFTC The Treasury Department sought to ensure that the amended CEA (which included foreign currency within its expanded definition of "commodity") would not interfere with or otherwise impact any transaction in the foreign currency markets except when trading occurred on a regulated futures exchange [29] In its letter to Congress, which prompted the Amendment, the Treasury wrote

> The Department feels strongly that foreign currency futures trading, other than on organized exchanges, should not be regulated by [the CFTC] [30]

Moreover, the Treasury Amendment was intended to exclude from the CFTC's jurisdiction a wide variety of transactions in the instruments described in the Amendment

> [T]he Department is concerned that the language of the bills 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 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* [31]

The Treasury Department suggested an amendment stating that [n]othing in this Act shall be deemed to govern *transactions in foreign currency* *Id*

Congress adopted the Treasury Department's proposed language As the Senate Report explained

> [T]he [Senate] Committee included [the Treasury Amendment] to clarify that the provisions of the bill are not applicable to trading in foreign currencies unless such trading is conducted on a formally organized futures exchange A great deal of the trading in foreign currency in the United States is carried out through an informal network of banks and tellers [sic] 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* [32]

The Treasury Department and Congress clearly envisioned that "transactions in" would be accorded its ordinary meaning and that the Amendment would govern a wide range of foreign currency transactions

B. The Structure of the CEA as a Whole Mandates a Broad Exclusion of Foreign Currency Trading.

Dr Tauber urges this Court to read the Treasury Amendment in a way that deprives it of any meaning He contends that the Treasury Amendment was meant to exclude only spot contracts and forward contracts for which delivery occurs Appellant's Brief at 12-14, 27-29 Likewise, the Exchanges assert (without support) that the CEA excludes only those "transactions where title or ownership is transferred or is expected to be transferred" (*i e* , only spot and some forward transactions) Exchange Brief at 10 This argument makes nonsense of the statute

Provisions of the CEA not in dispute here exclude from the jurisdiction of the CFTC spot and forward contracts in all commodities, including foreign currency Forwards are excluded from the CEA by the "cash forward contract exclusion,"[33] and spot transactions are excluded

28 Letter from Charles O Sethness, Assistant Secretary, Department of Domestic Finance, Department of the Treasury, to Susan M Phillips, Chairman, CFTC (May 5, 1986) (responding to the CFTC's request for comments on its proposed interpretation of the Treasury Amendment)

29 If a foreign currency trade in the United States or involving one or more U S parties is not excluded from the CEA under the Treasury Amendment, does not trade on an exchange or is not subject to some other exemption or exclusion from the CEA, it is unlawful 7 U S C §§ 6(a), 6c

30 S Rep No 1131, 93rd Cong , 2d Sess (1974), *reprinted in*, 1974 U S Code Cong & Admin News 5843, at 5887

31 *Id* at 5889 (emphasis added)

32 *Id* at 5863 (emphasis added)

33 "The term 'future delivery' shall not include any sale of any cash commodity for deferred shipment or delivery " 7 U S C 2

because they do not involve future delivery of a commodity Therefore, unless the Treasury Amendment is to be deemed wholly superfluous, it must be interpreted to exclude from the CEA transactions other than spot and forward trades over which the CFTC has no jurisdiction *See generally Matala*, 647 F 2d at 429

A basic canon of statutory construction requires that Congress be "presumed to have used no superfluous words," and that a statute be given effect as a whole *Platt* v *Union Pacific R R Co*, 99 U S 48, 58 (1878) *See Matala*, 647 F 2d at 429 (citing *United States* v *Snider*, 502 F 2d 645, 652 (4th Cir 1974)) To preserve the meaning of the Treasury Amendment, it must be read as a broad exclusion for all types of foreign currency transactions

Congress knew that "transactions in foreign currency" would include transactions calling for future delivery of foreign currency, as well as transactions used for hedging that would not necessarily result in actual delivery The Treasury Department wrote

> The Department feels strongly that foreign currency *futures trading*, other than on organized exchanges, should not be regulated by [the CFTC] This dealer market, which consists primarily of the large banks, has proved highly efficient in serving the needs of international business in *hedging the risks* that stem from foreign exchange rate movements [34]

Moreover, if "transactions in foreign currency" referred only to the actual exchange of the underlying currencies in spot or forward transactions, then the clause "unless such transactions involve the sale thereof *for future delivery on a board of trade*" would be superfluous Spot contracts do not involve future delivery, and forward contracts are not traded on boards of trade, so the "transactions for future delivery on a board of trade" cannot reasonably be expected to apply to either spot or forward contracts *See Chicago Board of Trade* v *SEC*, 677 F 2d 1137, 1179 (7th Cir 1982) (Cudahy, J , dissenting), *vacated as moot*, 459 U.S 1026 (1982)

Contrary to case law, Dr Tauber would have this Court render meaningless the proviso for "transactions for future delivery on a board of trade " *See, e.g*, Appellant's Brief at 12–14, 25–27 In *Abrams* v *Oppenheimer Gov't Sec , Inc* , 589 F Supp. 4, 7 (N.D Ill 1983), *aff'd*, 737 F 2d 582, 589–593 (7th Cir 1984), the District Court and the Seventh Circuit found that the fundamental question with respect to the scope of the Treasury Amendment was the "unless" clause and whether or not the contracts were traded on an exchange The red herrings of "actual delivery" and the meaning of in were not the determinative issues in interpreting the scope of the Treasury Amendment *See Abrams*, 589 F Supp at 7, *Abrams*, 737 F.2d at 590 (GNMA forward contract excluded because it was a transaction in government securities not traded on an exchange) [35]

C. Option Transactions In Foreign Currency Are Excluded by the Treasury Amendment.

The plain meaning of the Treasury Amendment applies equally to foreign currency options Options give the right to purchase or sell foreign currency, and are thus "transactions in foreign currency" because "foreign currency is the actual subject matter" of the contract Mem Op at 18 The lack of an obligation to exercise the option and thus cause delivery of the currency does not change the subject matter of the option or make it a transaction in something other than foreign currency

Dr Tauber argues, however, that in settling his options by offsetting contracts there was no delivery of foreign currency and thus, in his view, the option was not a transaction in foreign currency This argument fundamentally misstates the facts and the law As the District Court noted (Mem Op 17–18), the options contracts, like forward contracts, required delivery of currency, which obligation often was satisfied by offset because it was a more convenient method of settlement The parties could have settled by delivery of the currency without offset or netting, and would have been required to do so absent an agreement to offset That they chose not to do so was of no legal significance *See Board of Trade v Christie Grain & Stock Co* , 198 U S 236, 248 (1905) (set–off has the legal effect of a delivery), CFTC *Statutory Interpretation Concerning Forward Transactions*, 55 Fed Reg. 39,188, 39,189 (1990) (if the contract by its terms requires delivery, subsequent agreement to settle by off-

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34 S Rep No 1131, 93rd Cong , 2d Sess (1974), reprinted in, 1974 U S Code Cong & Admin News 5843, at 5887-88 (emphasis added)

35 A 1978 Senate Report concerning futures in Government securities emphasized that whether or not a transaction was conducted on an exchange was the critical issue with respect to the Treasury Amendment

When the 1974 amendment was being considered by Congress, the Treasury recommended that the *role of the CFTC with respect to Government securities be limited to futures contracts sold on organized exchanges* Congress adopted this recommendation

S Rep No 850, 95th Cong , 2d Sess (1978), *reprinted in*, 1978 U S Code Cong & Admin News 2087, 2135 (emphasis added) *See Board of Trade*, 677 F 2d at 1178 (Cudahy, J , dissenting)

set does not alter the nature of the original contract)[36] Moreover, in endorsing netting and set-off provisions in other contexts, Congress has recognized that delivery is not a necessary element of these transactions See, *supra*, p 7-8

For the same reasons, an option transaction is a transaction in foreign currency whether or not the option is exercised The holder of the option may not exercise the option (for economic or other reasons), but until he lets the option expire he has the legal right to demand delivery[37] To hold otherwise creates the impractical result that (absent an applicable exemption)[38] the legality of an option must await its exercise If delivery determines whether a transaction is excluded or exempt from the CEA, then in many cases one could not determine whether the forward or option was sold legally until after the exercise date of the option or the delivery of the commodity (which might occur six months or a year or more after the purchase or sale of the forward or option)[39] This is a commercially unacceptable result Such a result would also create substantial and unacceptable systemic risk for the foreign currency markets and market participants As a practical matter, the purchasers of options and forwards cannot predict at the time of purchase whether or not exercise or delivery of the commodity will actually take place Indeed, one of the fundamental reasons for forwards and options is to provide assurance against unknown risks or unpredictable needs for foreign currency

The District Court correctly recognized, however, that it was not necessary to distinguish between exercised and unexercised options in order to decide this case Because the options were exercised in this case, the options were "transactions in" foreign currency even under the *American Board of Trade* theory, and hence are excluded from the CEA See *American Board of Trade*, 803 F 2d at 1248 (a foreign currency option is a "transaction in" foreign currency when exercised)

D. Application of a "Sophisticated Institutional Investor" Standard Requires Affirmance.

Notwithstanding the plain language and structure of the statute (and the opinion of the Treasury Department), the CFTC in 1985 issued a Statutory Interpretation suggesting that the Treasury Amendment encompasses only transactions among and between banks and other sophisticated, informed institutional investors, and was inapplicable to transactions with the general public[40] The CFTC received numerous comments noting that its interpretation was a clear deviation from the language of the statute[41] The Treasury Department, for example, wrote that the CFTC's interpretation was "not consistent with the plain language of the statute "[42]

In this case, whether or not such a requirement exists is immaterial as both participants in the transactions at issue are sophisticated institutional investors The District Court found that since 1981 Dr Tauber has engaged in billions of dollars of foreign currency trading, his wholly-owned trading company owned a seat on the nation's largest foreign currency options exchange, he monitored the markets from terminals in his home and elsewhere, he maintained foreign bank accounts, and he had a net worth estimated at $500 million Mem Op at 3-4 In short, Dr Tauber is a sophisticated institutional investor

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36 The Tax Court also has recognized that the use of setoff to settle a foreign currency contract does not alter the underlying nature of the transactions The Tax Court stated

> [t]he most common method of settling a forward sale contract has traditionally been to enter into a purchase contract and to offset the contractual obligations to sell and purchase Offset of the contractual obligations by the seller has been held to be delivery under the sale contract satisfying the sale or exchange requirement on the date the contract is settled (Citations omitted)

Hoover Co v Commissioner, 72T C 206, 249-50 (1979)

37 The holder of an option anticipates and intends the exercise of the option (and delivery of the currency) if it is "in the money," in other words, if the option has intrinsic value Whether there will be such value will depend on movements in the price of the currency from the purchase date of the option, which are unpredictable at the time of purchase Moreover, only options that are "in the money" and thus worth exercising will provide an occasion for non-performance and consequent action for breach, and in all such cases there is a right to demand delivery absent offset by mutual consent

38 *See, e g*, the CFTC's trade option exemption which provides

> [The ban on off-exchange options as set forth in 17C F R §32 2(b)] shall not apply to a commodity option offered by a person which has a reasonable basis to believe that the option is offered to a producer, processor, or commercial user of, or a merchant handling, the commodity which is the subject of the commodity option transaction, or the products or by-products thereof, and that such producer, processor, commercial user or merchant is offered or enters into the commodity option transaction solely for purposes related to its business as such

17 C F R §32 4(a)

39 For this reason, as well as adherence to the plain meaning of the statute, this Court should reject the reasoning of those courts that have differentiated between exercised and unexercised options in applying the Treasury Amendment *See American Board of Trade*, 803 F 2d at 1248, *Sterling, supra*, at 24,784 *See also, supra*, p 15-17

40 CFTC Statutory Interpretation, Trading in Foreign Currencies for Future Delivery, 50 Fed Reg 42,983 (1985)

41 *See, e g*, letter from John J Conheeney, Chairman, Merrill Lynch Futures Inc and John W Ward, Chairman, Merrill Lynch International Bank, to Office of the Secretariat, CFTC at 2 (Dec 23, 1985), letter from the General Counsel, Board of Governors of the Federal Reserve System to the General Counsel, CFTC (Mar 5, 1986), and letter from John F Lee, Executive Vice President, NewYork Clearing House, to Office of the Secretariat, CFTC (Jan 16, 1986)

42 Letter from Charles O Sethness, Assistant Secretary, Department of Domestic Finance, Department of the Treasury, to Susan M Phillips, Chairman, CFTC (May 5, 1986)

II.
Salomon Forex Is Not a "Board of Trade."

A finding that Salomon Forex is a "board of trade" within the meaning of the CEA would render the Treasury Amendment meaningless because it would sweep under the CEA and render unlawful virtually all OTC foreign currency transactions by simply characterizing them as conducted on an "undesignated board of trade "[43]

The Court, however, must presume that Congress intended the Treasury Amendment to have meaning and that it "used words according to their ordinary meaning unless a different use is clearly indicated " *Matala*, 647 F 2d at 429 The ordinary meaning of "board of trade" is "a commodities exchange." *See* Webster's Ninth New Collegiate Dictionary 164 (1986) Unless this Court is willing to find that each OTC foreign currency dealer and broker is a board of trade, and that the Treasury Amendment is a meaningless appendage, this Court must conclude that Salomon Forex is not a board of trade

Legislative history supports this view Throughout the CEA's legislative history, "board of trade" is consistently referred to as an "organized exchange," and Congress clearly intended that the CFTC's authority was to be restricted accordingly[44] In its letter to Congress which prompted the Treasury Amendment, the Treasury Department wrote

[T]he provisions of the bills do not clearly indicate that the [CFTC's] authority would be limited to the regulation of futures trading *on organized exchanges*, and would not extend to futures trading in foreign currencies off organized exchanges The Department feels strongly that foreign currency futures trading, *other than on organized exchanges*, should not be regulated by the [CFTC] [45]

Similarly, the Senate Committee on Agriculture and Forestry described the Treasury Amendment as excluding currency transactions from CFTC jurisdiction unless traded "on a formally organized futures exchange," as distinguished from the "informal network of banks and tellers [sic]" through which most currency trading is accomplished *Id* at 5863

Salomon Forex, a single legal entity that trades with others in the foreign currency markets, is not a "board of trade" for purposes of the Treasury Amendment By insisting that board of trade should be construed to mean *any* broker or dealer, Dr Tauber and the Exchanges again attempt to gut the Treasury Amendment and deprive it of any meaning. On their interpretation, every transaction for future delivery executed through a broker or by a dealer would fall within the board of trade proviso, and the Treasury Amendment would have no meaning at all

Conclusion

The OTC foreign currency markets are a critical element in the continued development and viability of global markets Given the tremendous size and import of these markets and the disruption that would be caused if they were subject to the CEA, the Committee urges that this Court affirm the decision of the United States District Court for the Eastern District of Virginia

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August 3, 1992

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43 "Board of trade" is defined in the CEA as any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling any commodity or receiving the same for sale on consignment 7 U S C §2

44 Like the cases dealing more generally with foreign currency transactions, the "board of trade" cases turn on the participation of the general public *See CFTC v Co Petro Marketing Group, Inc*, 680F 2d 573 (9thCir 1982) (gasoline broker operated as an undesignated board of trade where it deceptively marketed futures contracts to the general public through newspaper advertisements, private seminars, commissioned telephone solicitors,and various other commissioned sales agents), In re Stovall, [1977- 1980 Decisions] Comm Fut L Rep (CCH) ¶20,941 (CFTC Dec 6, 1979) (a bucket shop marketing to the general public operated as a board of trade), CFTC v National Coal Exchange, Inc [1980 - 1982 Decisions] Comm Fut L Rep (CCH) ¶21,424, at 26,049-50 (W D Tenn 1982) (a broker of coal was a "board of trade" where its sales program was a "carefully contrived, but yet concerted, effort at fraudulent inducement of inexperienced members of the general public" and had all the characteristics of a "typical boiler room operation") See also CFTC Interpretative Letter No 77-12, [1977-1980 Decisions] Comm Fut L Rep (CCH) ¶20,467, at 21,912 (Aug 17, 1977) (in concluding that the sale of GNMA forwards did not appear subject to CFTC regulation, the CFTC found the lack of public participation in the transactions most compelling)

45 S Rep No 1131, 93rd Cong , 2d Sess (1974), reprinted in, 1974 U S Code Cong & Admin News 5843, at 5887 (1974) (emphasis added) See id at 5887-89