A Derivatives Dilemma: The Treasury Amendment Controversy and the Regulatory Status of Foreign Currency Options

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A DERIVATIVES DILEMMA: THE TREASURY AMENDMENT CONTROVERSY AND THE REGULATORY STATUS OF FOREIGN CURRENCY OPTIONS

Thomas A. Tormey*

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INTRODUCTION

The rapid expansion of worldwide over-the-counter ("OTC") derivatives markets has put intense pressure on traditional regulatory classifications. Indeed, several spectacular losses have highlighted the challenges derivatives pose to the domestic securities and commodi-

1. Under the conventional definition, a derivative is, as its name suggests, a financial instrument whose value derives from the value of an underlying asset, reference rate, or index. An over-the-counter ("OTC") derivative is individually negotiated off any formally organized exchange. Group of Thirty, Derivatives: Practices and Principles, at 2-3, 28 (July 1993) [hereinafter Group of Thirty Report]. Beyond this general definition, establishing a more precise meaning for the variety of transactions encompassed by the umbrella term "derivatives" is difficult. See Martin Mayer, The Bankers 290 (1997) ("The conventional definition [of derivatives] is misleading, because most financial instruments turn out on examination to change in value as a function of what happens to other financial instruments."); Saul S. Cohen, The Challenge of Derivatives, 63 Fordham L. Rev. 1993, 1993, 1997 (1995) ("It is commonly remarked that there is no generally accepted meaning to the term derivative. ... Attempting to define derivatives is very difficult because instruments capable of bearing that label are infinitely protean ... "). Although acknowledging that the term "bet" has a pejorative quality, Martin Mayer has described derivatives in the following way: "A derivative is a bet, not an investment—a bet on the direction, dimension, duration and speed of changes in the value of another financial instrument." Mayer, supra at 290. Because derivatives have been at the center of much recent controversy, see infra note 3, other commentators have described them in terms of public perception. See, e.g., Joanne T. Medero, Managing Risk of Derivatives—Recent Developments Affecting Dealers and End-Users, 907 PLI/Corp 409, 411 (Nov. 1995) ("The term 'derivative' has become a buzzword, and too often refers to any financial instrument where someone has lost money.").

2. See Cohen, supra note 1, at 1997 (arguing that derivatives "evolve too rapidly to be encompassed under any preexisting regulatory structure"); Mayer, supra note 1, at 303-32 (describing the inherent problems of regulating derivatives). At the end of March 1995, the gross market value of OTC derivatives contracts was estimated at a little over $2.2 trillion and the global notional amount of outstanding OTC derivatives contracts was estimated at $47.5 trillion. Bank for International Settlements, Central Bank Survey of Foreign Exchange and Derivatives Market Activity 1995 1 (May 1996) [hereinafter BIS Survey]. As of February 1997, the global notional amount of outstanding OTC derivatives contracts had grown to an estimated $55 trillion. Suzanne McGee & Elizabeth MacDonald, Pre-Emptive Strike by Derivatives Players, Wall St. J., Feb. 21, 1997, at C1.

3. See, e.g., Sarah Lubman & John R. Emshwiller, Before the Fall: Hubris and Ambition in Orange County: Robert Citron's Story, Wall St. J., Jan. 18 1995, at A1 (describing Orange County Treasurer Robert Citron's aggressive use of derivatives which ultimately led to large losses for the County); Leslie Wayne, $1.5 Billion Loss Seen for County, N.Y. Times, Dec. 2, 1994, at D1 (reporting a statement on December 1, 1994, by Robert Citron announcing losses from derivatives); Mayer, supra note 1, at 311 (describing the background to the Procter & Gamble derivatives losses); G. Bruce Knecht, P & G Amends Lawsuit Naming Bankers Trust, Wall St. J., Feb. 7, 1995, at A3 (reporting on Procter & Gamble's lawsuit against Bankers Trust for its losses on derivatives transactions); Mayer, supra note 1, at 286-88 (describing the Gibson Greetings suit against Bankers Trust); Michael Quint, Gibson Suit on Trades Is Settled, N.Y. Times, Nov. 24, 1994, at D1 (reporting on Gibson Greetings' settlement with Bankers Trust for losses on derivatives transactions).
ties regimes. This phenomenon is particularly apparent in the controversy surrounding the regulatory status of foreign currency options.

The Commodity Exchange Act (the “CEA”), generally requires that most types of commodity options be traded on designated commodity exchanges unless exempted by the CFTC. If an option is sold in violation of the CEA, the transaction may be voided. In 1974, Congress voted to exclude “transactions in foreign currency . . . unless such transactions involve the sale . . . for future delivery conducted on a board of trade,” from CEA jurisdiction and CFTC regulation. While it is clear that this exclusion, commonly known as the Treasury Amendment, applies to OTC spot, forward, and future foreign


5. An option is one of the wide variety of instruments “that carry the label ‘derivatives.’” Mayer, supra note 1, at 269; Group of Thirty Report, supra note 1, at 2; Richard W. Jennings et al., Securities Regulation 1 (7th ed. 1992). In exchange for payment of a premium, an option contract gives the option holder the right but not the obligation to buy (known as a “call”) or sell (known as a “put”) an underlying commodity (or settle the value for cash) at a price (called the “strike price”), during a period or on a specified date. Thus, the holder can choose not to exercise the option and let it expire. The holder benefits from favorable movements in the price of the underlying commodity but is not exposed to corresponding losses. An option is profitable if the holder exercises the right when the current market price is above the strike price for a call option or below the strike price for a put option. A profitable option is said to be “in the money.” John Downes & Jordan E. Goodman, Dictionary of Finance and Investment Terms 390-91 (Barron’s Financial Guides, 4th ed. 1995); Group of Thirty Report, supra note 1, at 32; Robert C. Lower, The Regulation of Commodity Options, 1978 Duke L. J. 1095, 1096 n.2 (1978).

7. Id.
9. Id. This section is commonly known as the Treasury Amendment because it was originally proposed by the Treasury Department. See John M. Quitmeyer & David Yeres, Supreme Court to Decide Scope of CFTC Jurisdiction, 16 Future & Derivatives L. Rep. 18 (July 1996). The Treasury Amendment also excludes transactions in “security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments,” 7 U.S.C. § 2(ii). See infra note 105 and accompanying text for the full text of the Treasury Amendment.
10. Spot transactions are purchases of foreign currency for immediate delivery, generally within two days. The Committee on Futures Regulation of the Association of the Bar of the City of New York, The Evolving Regulatory Framework for Foreign Currency Trading 5 (1986) [hereinafter Committee on Futures Regulation]. In a spot transaction, one party agrees to deliver a certain amount of currency in exchange for a certain amount of another currency. The rate of exchange used in these transactions is commonly referred to as the “spot” rate. Id. at 5.
11. A forward contract obligates one counterparty to buy, and the other to sell, a specified underlying commodity at a specific price, amount, and date in the future. Forward contracts are not standardized but are customized with terms and conditions tailored to fit the objectives of the counterparties with respect to contract size, delivery grade, delivery locations, delivery dates, and credit terms. Committee on Futures
currency transactions, there has been considerable debate over whether it applies to currency option transactions.

On one side of the debate, the CFTC has taken the position that the Treasury Amendment does not encompass foreign currency options, and that therefore such instruments remain subject to CFTC regulation. The Commission believes that CEA jurisdiction is necessary to prevent the predatory practices of unscrupulous currency operators which have repeatedly exposed unsophisticated retail investors to substantial losses.

On the other side of the debate, the Treasury Department and the various commercial institutions that participate in the interbank OTC currency option market (the “Interbank Industry” or the “Industry”) have argued that the Treasury Amendment clearly removes currency options from the CFTC’s jurisdiction. In the Industry’s view, the

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Regulation, supra note 10, at 6-7; Group of Thirty Report, supra note 1, at 30; Downes & Goodman, supra note 5, at 205.

Futures contracts are functionally similar to forwards in that they are agreements to buy or sell a specific amount of an underlying commodity at a particular price on a stipulated future date. Unlike forwards, however, futures are standardized with respect to quantity and quality of the underlying commodity, the time and place of delivery, and the method of payment, with the price being the only variable left to be determined. Group of Thirty Report, supra note 1, at 32; see Downes & Goodman, supra note 5, at 214. Futures also differ from forwards in that they can generally be satisfied through cash settlement or offset. The right to settle or offset allows futures participants to readily cut their losses or take their profits, without negotiating. In addition, “the anonymous nature of futures trading and the relatively small [typical] contract size makes futures contracts accessible to members of the general public, including retail speculators, who are unable to transact in forwards.” Group of Thirty Report, supra note 1, at 32; Downes & Goodman, supra note 5, at 205, 214.

12. See CFTC Interpretative Letter, 50 Fed. Reg. 42,983 (1985); see also Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 974 (4th Cir. 1993), cert. denied, 114 S. Ct. 1540, reh’g denied, 114 S. Ct. 2156 (1994) (“The [CFTC], pressing for greater regulation of transactions in foreign currencies, contends that the Treasury Amendment’s exemption is intended to be narrowly tailored to exclude only spot and cash forward transactions, leaving all other futures and options to be regulated by the broad inclusive regulatory language of the [CEA].”). The organized exchanges, such as the Chicago Mercantile Exchange (the “CME”) and the Chicago Board of Trade (“CBOT”), have also taken this position. As one commentator has noted:

The exchanges, concerned by the burgeoning off-exchange currency markets, see the Treasury Amendment as a way to level the playing field. CBOT Chairman Patrick H. Arbor was quoted as saying, “If off-exchange ... markets in these instruments are to be exempt completely from regulation, the exchange markets in the same instruments should enjoy the same exemptive treatment.” Quitmeyer & Yeres, supra note 9, at 20.

13. See Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 974 (4th Cir. 1993) (noting the CFTC argument that interpreting the Treasury Amendment to exclude OTC currency options and futures trading from the ambit of the CEA would permit the operation of “bucket shops and boiler rooms, the very type of fraudulent businesses Congress sought to outlaw in enacting the CEA”).

14. Letter from Charles 0. Sethness, Assistant Secretary, Department of Treasury, to Susan M. Phillips, Chairman, CFTC (May 5, 1986), quoted in Committee on Futures Regulation, supra note 10, at 36; see also Quitmeyer & Yeres, supra note 9, at 18
CFTC's aggressive assertion of jurisdiction over currency option transactions reflects the Commission’s tendency to seize any “opportunity to exert authority in the publicity surrounding sizable investor losses, regardless of the jurisdictional fit.” The Industry has legitimate concerns that subjecting the OTC currency option market to the costs associated with CFTC regulation would significantly damage the United States’s ability to compete as a world financial center. Moreover, in the Industry’s view, CFTC regulation of the interbank market is unnecessary. Because the main players in the interbank market are commercial banks and other highly sophisticated financial entities, that market is already more than adequately regulated by the federal banking agencies, or in some circumstances by the SEC.

(“Almost from the beginning, there has been tension between Treasury’s interest in global markets, which are dominated by large institutions that presumably do not require much protection, and the CFTC’s desire to protect investors.”). The Treasury’s interest in sustaining the efficiency of the currency markets stems from the fact that both it and the Federal Reserve frequently intervene in that market to effect the exchange rate of the U.S. dollar relative to other currencies. See Raj Bhala, Self-Regulation in Global Electronic Markets Through Reinvigorated Trade Usages, 31 Idaho L. Rev. 853, 869 (1995); see also Ellen Thalman, G-7 Position Shift on Dollar Won't Stop Buying Trend for Long, Analysts Say, Wall St. J., Feb. 10, 1997, at C13, (describing analysts’ debate over whether remarks made by Treasury Secretary Robert Rubin could be interpreted to mean that the Treasury Department would intervene to halt the ascending strength of the dollar relative to the yen).

15. Roberta Romano, A Thumbnail Sketch of Derivative Securities and Their Regulation, 55 Md. L. Rev. 1, 55-58 (1996). While it is not entirely clear why the CFTC has been so aggressive in asserting its regulatory authority, some of its motivation may be inferred. At one level it seems clear that the Commission desires to fulfill its statutory mandate and to protect the integrity of the nation’s commodity markets. At another level, however, it could be suggested that the Commission’s regulatory zeal is a function of its territorial response to the “recurring proposals to absorb the CFTC into the SEC.” Id. at 82. In light of those proposals, the rapid growth of OTC derivative transactions and the competitive effect of that growth on the volume of exchange traded transactions must be somewhat disturbing to the CFTC. CBOT Chairman Patrick H. Arbor has predicted that failure to check these rapidly expanding off-exchange markets will ultimately obviate the need for the CFTC “because there won’t be enough trades on the CBOT” to justify CFTC regulation. Quitmeyer & Yeres, supra note 9, at 20; see also Aaron Lucchetti, Titan Returns to Shake Up CME’s Board, Wall St. J., Feb. 10, 1997, at C1, C13 (attributing the CME’s 12% decline in volumes from 1994 to 1997 partly to the fact that “[t]rading in foreign-currency...has been hurt by...increasing over-the-counter competition from banks”).

16. The costs of CFTC regulation would include the expense of registration for and compliance with CFTC regulation, meeting the capital requirements imposed by the CEA, being forced to trade on a CFTC designated exchange and being exposed to the liability associated with the private rights of action available under the CEA. See 1 Timothy J. Snider, Regulation of the Commodities Futures and Options Markets, at §§ 7.07-7.13 (2d ed. 1995).

17. See Amicus Brief for the Foreign Exchange Committee at 6, Dunn v. Commodity Futures Trading Comm’n, 1996 WL 392512 (No. 95-1181) (noting that in response to CFTC regulation the Interbank Industry could shift the center of its foreign currency trading overseas).

18. For a discussion of the role of the federal banking agencies and the SEC in regulating the Interbank Industry, see infra part II.B.4-5.
The long-standing tension between the Interbank Industry and the CFTC has led to considerable litigation.19 Up to this point, most of this litigation has focused on the meaning of the Treasury Amendment's use of the term “transactions in foreign currency.”20 In 1986, in Commodity Futures Trading Commission v. American Board of Trade,21 the Second Circuit held that because an option merely grants the right to engage in a future transaction, it is not technically a transaction “in” foreign currency until it is exercised, and therefore remains subject to CFTC regulation.22 Seven years later, that decision was called into question in Salomon Forex, Inc. v. Tauber23 where the Fourth Circuit held that the Treasury Amendment exempts “all transactions in which foreign currencies are the subject matter, including options” from the CFTC’s jurisdiction.24

Recently, in Dunn v. Commodity Futures Trading Commission,25 the Supreme Court resolved the conflict between the American Board of Trade and Salomon Forex decisions. Dunn arose when the CFTC brought a complaint against William C. Dunn for allegedly defrauding

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20. Prior to the Supreme Court’s decision in Dunn, 1997 WL 75492, most courts focused on the term “transactions in foreign currency” as the principal source of ambiguity. See supra note 19. Recently, however, a conflict has emerged over the meaning of the term “board of trade” as it is used in the Treasury Amendment. Compare Commodity Futures Trading Comm’n v. Standard Forex, Inc., No. CV-93-0088, 1993 WL 809966, at *7 (E.D.N.Y. Aug. 9, 1993) (holding that the term “board of trade” encompasses any association of persons involved in the business of buying and selling foreign currency) with Commodity Futures Trading Comm’n v. Frankwell Bullion Ltd., 99 F.3d 299, 304 (9th Cir. 1996) (holding that the term “board of trade” means only a formally organized exchange). For a discussion of Standard Forex and Frankwell Bullion, see infra part III.A.2.

21. 803 F.2d 1242 (2d Cir. 1986).

22. Id. at 1248.

23. 8 F.3d 966 (4th Cir. 1993), cert. denied, 114 S. Ct. 1540, reh’g denied, 114 S. Ct. 2156 (1994).

24. 8 F.3d at 976.

the general public in connection with the sale of investment contracts
in various foreign currency options trading strategies. Relying on its
previous decision in American Board of Trade, the Second Circuit
reiterated the rationale that "an option is not a transaction in foreign
currency until it is exercised," and allowed the CFTC to enjoin Dunn's
activities. In its consideration of Dunn, the Supreme Court rejected
that rationale as "wholly unpersuasive." According to the Court,
as a matter of ordinary meaning," currency options plainly represent
transactions "'in' foreign currency for purposes of the Treasury
Amendment."

Despite the Supreme Court's determination of Dunn, many issues
associated with the Treasury Amendment remain unresolved. Although the Dunn Court put to rest the debate over the term "trans-
actions in foreign currency," the tension between the CFTC and the
Interbank Industry has resurfaced in the recently emerged conflict
over the meaning of the term "board of trade." As noted above,
under the Treasury Amendment, "transactions in foreign currency"
remain subject to CFTC regulation if they involve a sale "for future
delivery conducted on a board of trade." In 1993, in Commodity
Futures Trading Commission v. Standard Forex, Inc., the Eastern
District of New York construed the term "board of trade" to include
not only organized exchanges designated as commodity markets by
the CFTC, but "any informal association of persons engaged in the
business of buying and selling" foreign currency. Under that rati-
nale, CFTC jurisdiction could be construed to extend to all foreign cur-

26. Dunn, 1997 WL 75492, at *2; see also Dunn, 58 F.3d 50, 52-53 (2d Cir. 1995)
describing Dunn's activities. One commentator has argued that the CFTC should
never have been allowed to assert jurisdiction over the Dunn case in the first place:
Dunn's alleged fraud involved investors who had not traded currency but had instead
purchased investment contracts—securities governed by the securities laws.
Quitmeyer & Yeres, supra note 9, at 19. It is true that the definition of "security" in
both the Securities Act of 1933, and the Securities Exchange Act of 1934, includes the
phrase "investment contracts." 15 U.S.C. §§ 77b(1), 78(c)(10) (1994). In addition, the
Supreme Court has expressly classified "investment contracts" as securities subject to
the jurisdiction of the SEC. See SEC v. W.J. Howey Co., 328 U.S. 293, 297 (1946). It
is far from clear, however, that the particular investment contracts at issue in Dunn
should have been subject to the securities laws. Indeed, in its determination of Dunn,
the Supreme Court declined to even address the issue of whether the investment con-
tracts involved could constitute securities. See Dunn, 1997 WL 75492. For a discussion
of whether the investment contracts at issue in Dunn could constitute securities see infra
note 212.

27. Dunn, 58 F.3d at 53-54 (citing Commodity Futures Trading Comm'n v. Ameri-
can Bd. of Trade, 803 F.2d 1242 (2d Cir. 1986)).
29. Id. at *3.
31. Id.
is discussed more fully at infra part III.A.2.
currency transactions, including those entered into by the Interbank Industry. In 1996, the Standard Forex holding was expressly rejected by the Ninth Circuit in Commodity Futures Trading Commission v. Frankwell Bullion Ltd. In Frankwell Bullion, the court interpreted the term "transactions conducted on a board of trade" to mean off-exchange trades, thus concluding that the Treasury Amendment excludes "all off-exchange transactions in foreign currency" from CFTC jurisdiction.

This Note argues that the recent emergence of this new conflict, which exposes the Interbank Industry to continued uncertainty over the prospect of CFTC regulation, threatens to prolong the Treasury Amendment controversy indefinitely. As such, despite the Supreme Court's determination of Dunn, there remains an urgent need for legislative action in this area. As one Congressman has recognized, uncertainty over the scope of the Treasury Amendment has "created numerous legal problems [which] the courts have dealt with inconsistently." To respond to these problems, Congress is currently considering a revision of the Treasury Amendment.

This Note has two purposes. First, it reviews the background to the Dunn decision and comments on the Supreme Court's determination of the case. Second, this Note analyzes the larger controversy surrounding the Treasury Amendment and suggests a regulatory framework to resolve that controversy. Part I of this Note describes the evolution of commodity option trading and its regulation. In particular, part I focuses on the repeated difficulties that have arisen with regard to the regulation of options. Part I concludes by discussing the background to the enactment of the Treasury Amendment and the development of the competing CFTC and Industry interpretations of it.

Part II of this Note reviews the principal cases on either side of the controversy surrounding the Treasury Amendment's use of the term "transactions in foreign currency." Although that controversy has been resolved by the Supreme Court's ruling in Dunn, a dialectic of
the judiciary’s struggles with the simple term “transactions in foreign currency” remains useful as a framework for analyzing the Treasury Amendment’s shortcomings. In particular, part II asserts that the American Board of Trade, Dunn and Salomon Forex decisions may be comprehensibly synthesized under the legal realism theory of jurisprudence.40

Through such a synthesis, part II asserts that courts have manipulated the Treasury Amendment to compensate for the shortcomings of what is a profoundly flawed statute. Those shortcomings, as the facts underlying American Board of Trade, Dunn, and Salomon Forex demonstrate, are a function of the Treasury Amendment’s failure to provide retail investors with the full protection of the CEA while simultaneously exempting the Interbank Industry from the threat of CFTC regulation. In other words, the Treasury Amendment does not adequately reconcile the legitimate interests of the CFTC with the equally legitimate interests of the Industry. Part II concludes by arguing that the recently emerged conflict between the Standard Forex and Frankwell Bullion holdings, suggests that courts will continue to reach strained readings of the Treasury Amendment in an effort to reconcile those interests on a case by case basis. To borrow a reference from another context, there will continue to be “decisions made on an ad hoc basis, offering little predictive value” to a market that “demands certainty and predictability.”41 Thus, despite the Supreme Court’s determination of Dunn, there remains an urgent need for legislative review of the Treasury Amendment.

As an alternative to the current Treasury Amendment, part III proposes a revised regulatory regime. Part III reviews the Standard Forex and Frankwell Bullion decisions and argues that the CFTC should be able to protect unsophisticated individual investors from the systematic and fraudulent marketing of currency options. At the same time, part III recognizes that for the Interbank Industry, supervision by the federal banking agencies or the SEC, combined with the remedies

40. In essence, under the legal realism theory of jurisprudence, judges manipulate legal rules to achieve what they perceive to be equitable results. G. Edward White, The Inevitability of Critical Legal Studies, 36 Stan. L. Rev. 649, 651 (1984); see also Geoffrey C. Hazard, Jr., Rising Above Principle, 135 U. Pa. L. Rev. 153, 171 (1986) (noting that from the legal realist’s perspective, courts look beyond the text of a statute or precedent to consider “the anticipated, economic, political, and social consequences of the decision”); see, e.g., Louis L. Jaffe, The Supreme Court, 1950: Term Foreword, 65 Harv. L. Rev. 107, 107 (1951) (discussing the legal “realist” allegation that the Supreme Court during President Roosevelt’s tenure manipulated constitutional doctrines and statutory interpretation to forward its program of social reform). For a more comprehensive discussion of the application of the legal realism theory of jurisprudence to the present inquiry see infra note 135.

available under common law fraud and contract law are more than adequate to sustain the integrity of the market. Thus, the Treasury Amendment should be reformulated to incorporate a legal standard that would provide retail participants with the complete protection of the CEA while simultaneously providing a safe-harbor of maximum legal certainty for the Interbank Industry. The Treasury Department has proposed a revision of the Treasury Amendment which would essentially achieve such a standard.42 Therefore, this Note advocates that the Treasury Department's proposal should form the basis of any new regulatory regime.

I. THE HISTORY OF COMMODITY OPTIONS AND FUTURES REGULATION

Futures contracts were first used in the United States by farmers and agricultural merchants as protective mechanisms against fluctuations in the price of agricultural commodities.43 In this context, a futures contract was quite simply a means to buy or sell a particular commodity for future delivery and thereby eliminate any intervening imbalance between supply and demand.44 In the first half of the nineteenth century, futures contracts were typically negotiated on an informal basis between individual merchants and farmers.45 Gradually, a more sophisticated market system evolved, culminating in the establishment of organized boards of trade in the 1840s.46

The first of these, the Chicago Board of Trade ("CBOT"), was founded in 1848.47 Although CBOT and other exchanges like it initially provided centralized markets on which standardized agricultural commodities could be bought and sold for future delivery, the development of standardized futures contracts also allowed investors to use the contracts themselves as "a medium for trading and speculation."48 By the 1860s, commodity traders had also begun dealing in the purchase or sale of "option contracts," which grant the purchaser the

42. The various proposed revisions of the Treasury Amendment, including the Treasury Department's proposal, are discussed at infra part III.C.
46. See Merrill Lynch, 456 U.S. at 357-58; Lurie, supra note 44, at 24-25; Markham, supra note 45, at 4.
47. Id.
48. Markham, supra note 45, at 4; see Lower, supra note 5 at 1099-1100.
right, but not the obligation, to buy a particular commodity at a fixed price on a future date.\textsuperscript{49}

From the outset, the use of options contracts on the commodities markets was the source of tremendous controversy.\textsuperscript{50} Like "bucket shops"—unsavory off-exchange establishments which literally allowed patrons to gamble on commodity prices\textsuperscript{51}—options were popularly perceived as "unnecessary to the functioning of the marketplace and used only to place bets on expected price changes."\textsuperscript{52} Many believed that options trading "caused excessive speculation, took advantage of small investors, and enriched speculators at the expense of farmers and grain dealers."\textsuperscript{53} Farmers, especially, complained that options trading contributed to the devastating price fluctuations of the late nineteenth and early twentieth centuries, particularly when they were used by speculators in attempts to "corner"\textsuperscript{54} the market in a particular commodity.\textsuperscript{55}

Such sentiments led to a public outcry for legislative action that reached a fever pitch when speculative abuses contributed to the precipitous drop in commodity prices at the end of World War I.\textsuperscript{56} Congress responded in 1921 with the enactment of the Futures Trading Act (the "FTA").\textsuperscript{57} Among other things, the FTA attempted to eradicate what were contemporarily perceived to be the primary sources of speculative abuse.\textsuperscript{58} First, in an effort to control futures trading, and eliminate price manipulation and bucketing, the FTA imposed a prohibitive tax on grain futures which were not executed on an exchange licensed and supervised as a "contract market" by the Secretary of Agriculture.\textsuperscript{59} Second, in an attempt to legislate options out of exist-

\textsuperscript{49} Snider, supra note 16, § 7.03; see Lower, supra note 5, at 1099; Markham, supra note 45, at 8. In the contemporary nomenclature such contracts were called "privileges." \textit{Id}. For a more comprehensive explanation of option contracts see \textit{supra} note 5.

\textsuperscript{50} Snider, supra note 16, § 7.03; Lower, supra note 5, at 1099.

\textsuperscript{51} Markham, supra note 45, at 9.

\textsuperscript{52} Lower, supra note 5, at 1099; see Snider, supra note 16, § 7.03.

\textsuperscript{53} Snider, supra note 16, § 7.03; accord Lower, supra note 5, at 1099.

\textsuperscript{54} To "corner" the market means to purchase all the available supply of a particular commodity with the purpose of controlling the price available to subsequent buyers. Jennings et al., \textit{supra} note 5, at 8.

\textsuperscript{55} Markham, supra note 45, at 5; see S. Rep. No. 93-1131, supra note 45, at 12-13, \textit{reprinted in} 1974 \textit{U.S.C.C.A.N.} at 5854. During this period, regulating options through federal legislation was frequently considered by Congress. However, "[b]ecause of their inability to distinguish between the options that farmers sought to ban and the futures contracts that the exchanges fought hard to protect, the legislators several times failed to enact any sort of regulation." Lower, supra note 5, at 1100.

\textsuperscript{56} S. Rep. No. 93-1131, supra note 45, at 13, \textit{reprinted in} 1974 \textit{U.S.C.C.A.N.} at 5855; Markham, supra note 45, at 9-12; see Lower, supra note 5, at 1100.

\textsuperscript{57} Ch. 86, 42 Stat. 187 (1921); see Lower, supra note 5, at 1100.

\textsuperscript{58} Markham, supra note 45, at 12; Lower, supra note 5, at 1100.

\textsuperscript{59} Markham, supra note 45, at 12; see Lower, supra note 5, at 1100.
ence, the FTA imposed a prohibitive tax on options regardless of where they were traded.60

In the 1922 case, *Hill v. Wallace*,61 the Supreme Court ruled that the FTA's tax on off-exchange grain futures transactions represented an unconstitutional exercise of Congress's taxing power.62 Congress reacted promptly by enacting the Grain Futures Act of 1922, which relied on the Commerce Clause to prohibit all futures transactions not executed on a designated contract market.63 In 1923, the Supreme Court upheld the constitutionality of the Grain Futures Act,64 thus approving the basis for the federal regulation of the commodities markets that continues to this day.65

Meanwhile, the FTA's options tax, which had not been at issue in *Hill*,66 had survived and constructively prohibited options trading until the Supreme Court found it unconstitutional in 1926.67 Immediately thereafter, option trading reappeared with renewed popularity.68

**A. The Commodity Exchange Act of 1936**

In 1933, speculative trading, particularly in options, was again believed to have led to a devastating collapse in commodity prices and President Roosevelt called for a comprehensive review of commodity market regulation.69 Congress responded by enacting the CEA of 1936 as the successor to both the Futures Trading Act of 1921 and the Grain Futures Act of 1922.70 Primarily, the new Act established regulatory standards for commodity market transactions in certain specifically enumerated commodities.71 In addition, the Act added criminal sanctions for actual or attempted manipulation of commodity prices.72 Finally, because many believed that options trading had played a sig-

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60. Lower, supra note 5, at 1100; see Markham, supra note 45, at 12.
61. 259 U.S. 44 (1922).
63. Ch. 369, 42 Stat. 998 (1922); Merrill Lynch, 456 U.S. at 361.
64. See Board of Trade v. Olsen, 262 U.S. 1 (1923).
66. 259 U.S. at 71-72.
67. Trusler v. Crooks, 269 U.S. 475 (1926); see Lower, supra note 5, at 1100.
68. Lower, supra note 5, at 1101 (noting that, "[a]s with most activity in the Roaring Twenties, option trading was frenetic," and that wheat options transactions represented an estimated 15% of the volume of trading done in wheat on CBOT).
69. See Markham, supra note 45, at 24-25 (quoting President Roosevelt's February 9, 1934 letter to Congress).
71. Commodity Exchange Act, ch. 545, § 3(a), 49 Stat. 1491 (1936) ("The word 'commodity' shall mean wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs and solanum tuberosum (Irish potatoes)."); accord Lower, supra note 5, at 1102 n.28.
72. Commodity Exchange Act, ch. 545, § 9, 49 Stat. 1491 (1936); Lower, supra note 5, at 1102.
significant role in the 1933 collapse, trading in options on the commodities covered by the new Act was banned altogether.73

With the exception of periodic amendments to add various new commodities to those already regulated under the original Act, the CEA stood essentially undisturbed for the next thirty-five years.74 During that period, commodity option trading in the United States was virtually non-existent.75 In 1970, however, "a keen interest in commodity options resurfaced."76

In the sixties, a very active trading market had developed in so-called "world commodities"—a category which included things like silver, platinum, coffee, and sugar.77 A number of U.S. firms were keen to take advantage of opportunities presented by that market and "quickly discovered that there was a gap in the coverage of the Commodity Exchange Act ban on options."78 Because the Act only banned options trading on certain specifically enumerated domestic commodities,79 options on the so-called "world commodities" remained unregulated and could legally be sold to the American public.80 Because of their unregulated nature, these options quickly became instruments of fraud and abuse, presenting substantial risks for the investors involved.81 Nevertheless, because of their apparently lucrative nature, as well as the explosive growth in commodity trading generally, interest in these options blossomed and ultimately "cost innocent investors many millions of dollars."82 These developments came to the attention of Congress and ultimately led to a new set of regulations.83


In response to the continued growth in size and complexity of the commodities markets in the early seventies, as well as the fraudulent use of options,84 Congress substantially amended the CEA in 1974

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75. Snider, supra note 16, § 7.03.
76. Lower, supra note 5, at 1102; see Snider, supra note 16, § 7.03.
77. Lower, supra note 5, at 1102-03; see Snider, supra note 16, § 7.03.
78. Lower, supra note 5, at 1103; see Snider, supra note 16, § 7.03.
79. See supra note 71.
81. Lower, supra note 5, at 1102.
82. Snider, supra note 16, § 7.03; see Lower, supra note 5, at 1102-09.
84. 2 Thomas A. Russo, Regulation of the Commodity Futures and Options Markets, at § 19.07 (1995).
The 1974 Act, like its predecessor, retained the requirement that all types of commodity futures contracts and most types of commodity options be traded on designated commodity exchanges unless exempted by the CFTC. Among other things, the 1974 Act also closed the loophole for the so-called world commodities. While the CEA had previously applied only to futures and options trading in specifically enumerated domestic agricultural products, the 1974 Act significantly broadened the scope of the commodity contracts that were subject to regulation. The amendments broadly redefined "a commodity" to include "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."

In addition, to replace the Secretary of Agriculture, who had previously overseen the administration of the CEA, Congress created a new independent agency, the CFTC, and entrusted to it sweeping authority to implement the CEA. The CFTC was granted exclusive jurisdiction over commodity futures, contracts and various other commodity-related activities, including options trading. The 1974 Act maintained the ban on options trading involving commodities specifically enumerated prior to 1974, but also gave the CFTC authority to

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85. 7 U.S.C. §§ 1-26; see Markham, supra note 45, at 60-72.
86. 1 Thomas Russo, Regulation of the Commodities Futures and Options Markets, § 1.01 (1994); see Snider, supra note 16, § 7.04.

While the futures markets in a number of agricultural commodities have been regulated in varying degrees since 1922, many large and important futures markets are completely unregulated by the Federal Government. These include . . . markets in a number of foreign currencies. A person trading in one of the currently unregulated futures markets should receive the same protection afforded to those trading in the regulated markets.

Id. See supra notes 80-82 and accompanying text for a discussion of the loophole for world commodities.

88. Russo, supra note 86, § 1.01; see Snider, supra note 16, § 7.04.
90. See Russo, supra note 84, § 19.07 (noting that to protect against price manipulation and fraud, "Congress thought it necessary to 'establish a regulatory authority in the commodities field similar to the Securities and Exchange Commission'" (internal citations omitted)).

92. 7 U.S.C. § 2 (1994). This section provides in pertinent part:

The [CFTC] shall have exclusive jurisdiction . . . with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option" . . . ), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market.

Id.; see Snider, supra note 16, § 7.04.
regulate or ban options trading involving commodities covered by the new Act.\textsuperscript{93}

\section*{C. The Treasury Amendment}

In the years preceding the 1974 amendments, a large off-exchange foreign currency market had developed among various commercial banks, multi-national corporations and sophisticated investors.\textsuperscript{94} This market, which came to be known as the interbank market, was conducted through privately negotiated transactions off any formal exchange and was used for both risk management and speculative purposes.\textsuperscript{95} While the 1974 amendments were being considered, the Department of Treasury became concerned that the CEA's broad grant of authority to the CFTC, together with its expansive definition of commodity, could subject the sophisticated foreign currency market to new and unnecessary regulation.\textsuperscript{96} The Treasury Department explained these concerns in a letter to the Senate Committee considering the 1974 amendments. That letter stated in pertinent part:

The Department believes the bills contain an ambiguity that should be clarified. The provisions of the bills do not clearly indicate that the new regulatory agency'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. We do not believe that either the House of Representatives or your Committee intends the proposed legislation [the CEA] to subject the foreign currency futures trading of banks or other institutions, other than on an organized exchange, to the new regulatory regime.

The Department feels strongly that foreign currency futures trading, other than on organized exchanges, should not be regulated by the new agency. Virtually all futures trading in foreign currencies in the United States is carried out through an informal network of banks and dealers. 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. The participants in this market are sophisticated and informed institutions, unlike the participants on organized exchanges, which, in some cases, include individuals and small traders who may need to be protected by some form of governmental regulation.\textsuperscript{97}

\begin{footnotesize}
\textsuperscript{93} 7 U.S.C. § 6c (b) (1994); Snider, supra note 16, § 7.04.
\textsuperscript{95} Committee on Futures Regulation, supra note 10, at 3-4.
\end{footnotesize}
The Treasury Department's principal concern was that the new regulatory requirements would adversely affect "the usefulness and efficiency of foreign exchange markets." Rather than subjecting the foreign exchange market to the jurisdiction of the newly created CFTC, the Treasury suggested that Congress look to traditional bank regulators to fulfill that role.

Where the need for regulation of transactions on other than organized exchanges does exist, this should be done through strengthening existing regulatory responsibilities now lodged in the Comptroller of the Currency and the Federal Reserve. These agencies are currently taking action to achieve closer supervision of the trading risks involved in these activities.

Finally, the Treasury expressed doubt about the newly created CFTC's ability to regulate the foreign exchange market, and articulated its concern that such regulation could impair market efficiency:

The Commodity Futures Trading Commission would clearly not have the expertise to regulate a complex banking function and would confuse an already highly regulated business sector. Moreover, in this context, new regulatory limitations and restrictions could have an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors.

To address these concerns, the Treasury Department suggested an amendment to the 1974 Act which would exclude the interbank market from CFTC jurisdiction. Congress responded by incorporating almost all of Treasury's proposed language into the text of the new Act in what is now commonly known as the Treasury Amendment:

Nothing in this chapter [the CEA] 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.

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99. See Committee on Futures Regulation, supra note 10, at 31.
101. Committee on Futures Regulation, supra note 10, at 32.
104. See Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 972 n.4 (4th Cir. 1993) ("The sole change Congress made in the amendment was that whereas the Treasury's version would have excluded from CEA regulation 'puts and calls for securities,' these were not excluded under the enacted version.").
Senate Committee discussion of the Treasury Amendment demonstrates that sensitivity to the Treasury's fears of CFTC jurisdiction was the primary motivation for its enactment:

[T]he Committee included an amendment to clarify that the provisions of the bill are not applicable to trading in foreign currencies and certain enumerated financial instruments 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. The Committee believes that this market is more properly supervised by the bank regulatory agencies and that, therefore, regulation under this legislation is unnecessary.106

1. Status of Commodity Option Trading After the 1974 Act

As noted above, with the enactment of the 1974 Act, options transactions in CEA regulated commodities were not banned outright but were subject to regulation or prohibition by the CFTC.107 For a period, the CFTC allowed commodity option trading to continue with some regulatory restrictions.108 By 1978, however, several highly publicized option trading scandals had prompted the Commission to conclude that "the offer and sale of commodity options has for some time been and remains permeated with fraud and other illegal or unsound practices."109 As a result, in 1978 the CFTC adopted a regulation generally banning transactions in commodity options.110 Congress codified that regulation later that year, but sustained CFTC authority to adopt regulations exempting options.111 The CFTC would later exercise this exemptive authority by adopting the Trade Option Exempt-


107. See supra note 93 and accompanying text.


110. 17 C.F.R. § 32.11 (1996) ("[I]t shall be unlawful . . . until further rule, regulation or order of the Commission, for any person to solicit or accept orders for . . . the purchase or sale of any commodity option, or to supervise any person or persons so engaged.")

111. See 7. U.S.C. § 6c(b) (1994), which provides in pertinent part:

No person shall offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity regulated under this chapter which is of the character of, or is commonly known to the trade as, an “option” . . . contrary to any rule, regulation, or order of the Commission prohibiting any such transaction . . . .
tion, and the Exemption of Swap Agreements (the "Swaps Exemption").

2. The Development of Competing Interpretations of the Treasury Amendment

As noted above, the Treasury Amendment excludes from CFTC jurisdiction and thus from the CEA's general ban on options, "transactions in" a list of enumerated commodities, including foreign currency, unless those transactions are conducted on a "board of trade." In a 1977 interpretive letter, the CFTC articulated its position that the Treasury Amendment's exclusion hinged not only on whether a deferred delivery transaction was conducted on a "board of trade," but also on the relative sophistication of the participants to that transaction. Referring to the Senate Committee's discussion of the CEA, the 1977 interpretive letter stated:

We view these remarks by the Committee as an expression that regulation by the Commission is unnecessary where there exists an informal market among institutional participants in transactions for future delivery in the specified financial instruments only so long as it is supervised by those agencies having regulatory responsibility over those participants. However, where that market is not supervised and where those transactions are conducted with participation by members of the general public, we do not understand the Committee to have intended that a regulatory gap should exist. In these circumstances, we believe the Commodity Exchange Act should be construed broadly to assure that the public interest will be protected by Commission regulation of those transactions.

In the eight years which followed the 1977 interpretative letter, the interbank market in various currency derivatives began to evolve. In particular, the interbank market in currency options—which prior to 1982 had been virtually non-existent—grew rapidly. Concerned by these developments, in 1985 the CFTC issued an interpretation of the Treasury Amendment which essentially reiterated the basic thrust

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112. Id. 17 C.F.R. § 32.4(a) (1996). For a discussion of the Trade Option Exemption see infra part II.B.3.a.
113. As its name suggests, a swap contract obligates two parties to exchange a series of cash flows at specified intervals known as payment or settlement dates. The cash flows are either fixed, or calculated for each settlement date by multiplying the quantity of the notional principal by specified reference rates or prices. Downes & Goodman, supra note 5, at 576; Group of Thirty Report, supra note 1, at 31.
117. Id.
118. See Committee on Futures Regulation, supra note 10, at 7, 18.
119. Id. at 18.
The 1985 release stated that "the Treasury Amendment cannot be read so as to place outside the Commission's jurisdiction the marketing to the general public of such off-exchange foreign currency transactions; instead the Amendment was meant to encompass only transactions among and between banks and other sophisticated, informed institutions." The release requested comment on what persons should "qualify as 'sophisticated and informed institution[s]' permitted to participate in this market." The Treasury Department, various financial institutions, and several law firms all criticized the CFTC's 1985 interpretive release as a serious misreading of the Treasury Amendment. To them, the term "transactions in foreign currency" plainly excluded both off-exchange futures and options transactions from CFTC jurisdiction. In a 1986 letter, the Treasury Department argued that, "[b]y its terms, the Treasury Amendment exemption is a transactional one that places outside the coverage of the Act all off-exchange futures transactions in the listed financial instruments. . . . [I]t contains no language limiting the coverage of the exemption based upon the characteristics of participants in a transaction." In the Treasury's view, the CFTC's interpretation of the Treasury Amendment was "not consistent with the plain meaning of the statute." As the Supreme Court would subsequently determine in Dunn, at least with regard to the meaning of the discrete term "transactions in foreign currency," the Treasury Department's view of the Treasury Amendment was correct. Indeed, the Dunn Court would summarily dismiss the CFTC's reading of the term "transactions in foreign currency" as "wholly unpersuasive." Nevertheless, in the years be-

121. Id. at 42,984.
122. Id. at 42,985 n.13.
123. See Committee on Futures Regulation, supra note 10, at 36.
124. See id.
125. Letter from Charles O. Sethness, Assistant Secretary, Department of the Treasury, to Susan M. Phillips, Chairman, CFTC 1 (May 5, 1986), quoted in Committee on Futures Regulation, supra note 10, at 36.
126. Committee on Futures Regulation, supra note 10, at 36. In addition to its desire to protect the efficiency of the domestic currency market, the Treasury was also concerned that the CFTC might take a similar position with respect to government securities markets, which are also excluded from CFTC jurisdiction by the Treasury Amendment. Id. at 38.
127. See Dunn v. Commodity Futures Trading Comm'n, No. 95-1181, 1997 WL 75492, at *3 (U.S. Feb. 25, 1997). However, as discussed below, in Commodity Futures Trading Comm'n v. Standard Forex, Inc., No. CV-93-0088, 1993 WL 809966 (E.D.N.Y. Aug. 9, 1993), the court articulated an interpretation of the Treasury Amendment's use of the term "board of trade" which essentially applied a test based on the nature of the participants to a transaction. Id. at *7, *11 (holding that the term "board of trade" includes any association of persons engaged in the business of selling currency contracts to unsophisticated investors). For a discussion of the Standard Forex holding see infra part III.A.2.
between the Commission's 1985 interpretative release and the Supreme Court's determination of Dunn, the Commission would feel sufficiently confident in its reading of the Treasury Amendment to test its validity through litigation. Interestingly, as part II discusses, in many circumstances courts would defer to that reading despite its "wholly unpersuasive" nature.

II. THE SUPREME COURT'S DECISION IN DUNN AND A SYNTHESIS OF AMERICAN BOARD OF TRADE, SALOMON FOREX, AND DUNN: REVEALING THE FLAWS IN THE TREASURY AMENDMENT

In 1997, in Dunn v. Commodity Futures Trading Commission,129 the Supreme Court unanimously concluded that currency options plainly represent "transactions in foreign currency" and are therefore excluded from CFTC jurisdiction by the Treasury Amendment.130 As noted above, the Dunn holding put to rest the long standing tension between two lower court interpretations of the Treasury Amendment. In 1986, in Commodity Futures Trading Commission v. American Board of Trade,131 the Second Circuit had held that because an option merely grants the holder the right to engage in a future transaction, it is not technically a transaction "in" foreign currency until it is exercised, and therefore remains subject to CFTC regulation.132 In 1993, that decision was called into question in Salomon Forex, Inc. v. Tauber,133 where the Fourth Circuit held that the Treasury Amendment excludes "all transactions in which foreign currencies are the subject matter, including options" from the CEA.134

This part reviews the American Board of Trade, Salomon Forex, and Dunn decisions. Although the controversy underlying these cases has been resolved by the Supreme Court's ruling in Dunn, a dialectic of the judiciary's struggles with the simple term "transactions in foreign currency" remains useful as a framework for analyzing the Treasury Amendment's flaws. In particular, this part asserts that the American Board of Trade, Salomon Forex, and Dunn decisions may be comprehensibly synthesized under the legal realism theory of jurisprudence.135 Through such a synthesis this part asserts that courts have

130. Dunn, 1997 WL 75492, at *3-4.
131. 803 F.2d 1242 (2d Cir. 1986).
132. Id. at 1248.
133. Salomon Forex, 8 F.3d 966 (4th Cir. 1993), cert. denied, 114 S. Ct. 1540, reh'g denied, 114 S. Ct. 2156 (1994).
134. 8 F.3d at 976.
135. For a general discussion of the legal realism theory of jurisprudence see Richard A. Posner, Legal Formalism, Legal Realism, and the Interpretation of Statutes and the Constitution, 37 Case W. Res. L. Rev. 179 (1987). In that article, Judge Posner analogizes statutes—that for various reasons including the "passage of time and change of circumstance" have been interpreted inconsistently—to garbled battlefield
manipulated the Treasury Amendment to compensate for the shortcomings of what is a profoundly flawed statute. Thus, this part’s focus extends beyond the judiciary’s struggles with the term “transactions in foreign currency” and into a discussion of the Treasury Amendment’s inefficacy as a statutory tool for the regulation of contemporary currency markets. That inefficacy, as the facts underlying American Board of Trade, Salomon Forex, and Dunn demonstrate, is a function of the Treasury Amendment’s failure to provide unsophisticated retail investors with the full protection of the CEA while simultaneously exempting the Interbank Industry from the threat of CFTC regulation. In other words, the Treasury Amendment does not adequately reconcile the legitimate interests of the Industry with the equally legitimate interests of the CFTC. This part concludes by arguing that the recently emerged conflict between the Standard Forex and Frankwell Bullion holdings suggests that courts will continue to reach strained readings of the Treasury Amendment in an effort to reconcile those interests on an ad hoc basis. Such decisions are inherently unpredictable and do not address the interbank market’s need for legal certainty. Thus, despite the Supreme Court’s determination of Dunn, there remains an urgent need for legislative review of the Treasury Amendment.

A. The Second Circuit’s Decision in American Board of Trade

Some background is necessary to understand the origins of the Commodity Futures Trading Commission v. American Board of Trade decision. The case revolved around an entity calling itself the American Board of Trade (“ABT”), organized by a Mr. Arthur Economou. In addition to running a commodity trading operation (which was ultimately the source of the CFTC’s suit), ABT’s principal communications, and argues that the duty of the judicial recipients of such communications is to advance, taking into account relevant policy considerations, the enterprise set on foot by their commanders, the legislators. Id. at 189. Under this Note’s argument, Judge Posner’s analogy would seem particularly appropriate to the controversy surrounding the Treasury Amendment. Due to the “passage of time and change in circumstance”—namely the development since 1974 of the interbank market in currency options—the Treasury Amendment as a statute, and as a communication, has become susceptible to inconsistent interpretation. As a consequence, where equitable maxims like “no person shall profit from his own wrongdoing” have applied, courts have often put an interpretative gloss on the Treasury Amendment in order to achieve equitable results. Id. at 181 (citing Ronald M. Dworkin, The Model of Rules, 35 U. Chi. L. Rev. 14, 23-24 (1967)). In other words, courts have reached strained readings of the Treasury Amendment, in order to do, as Judge Posner would say, the “best [they] can,” irrespective of its limitations. Id. at 179. This Note argues that this approach is an inappropriate methodology for market regulation and that the judiciary’s struggles with the Treasury Amendment highlight the necessity of revising it to reflect the prevailing characteristics of the current interbank market.

business was selling unregistered commercial paper to unsophisticated retail consumers, with the promise that the proceeds would be used to finance the establishment of a successor to the commodity and stock exchanges of Chicago and New York. ABT ultimately defaulted on its commercial paper obligations, leaving 9,100 investors of mostly modest means with losses of over sixty cents on the dollar.

With that background as perspective, it should not be surprising that ABT and the CFTC ended up in court over the validity of ABT's commodity business. The origins of the case can be traced back to 1975, when ABT applied to the CFTC to request that it be provisionally designated as an official "contract market" authorized to conduct commodity transactions for future delivery. The CFTC denied this application after a preliminary inquiry revealed that in addition to using unique trading practices of "uncertain impact," Mr. Economou's purported commodity exchange did not in fact have an exchange floor, and appeared to be nothing more than Mr. Economou himself, his wife, and the companies controlled by him.

Nevertheless, ABT apparently began to operate as an "exchange and marketplace" engaged in the sale of a variety of commodity products, including foreign currency options. In the process, ABT collected premiums and other proceeds totaling an estimated $5.1 million from members of the general public. In 1979, the CFTC brought suit in the Southern District of New York, alleging, inter alia, that ABT's sales of currency options violated the CEA, and seeking an injunction to enjoin ABT from continuing its option business.

138. In general, the term "commercial paper" refers to short-term unsecured promissory notes which corporations use to raise funds in the money market. Although commercial paper is considered a security for purposes of the federal securities laws, it is exempt from the registration requirements of those laws. Jennings et al., supra note 5, at 6 n.10 (citing § 3(a)(3) of the Securities Act of 1933).


140. Id.

141. American Bd. of Trade, Inc. v. Bagley, 402 F. Supp. 974, 976-77 (S.D.N.Y. 1975). The CEA makes it unlawful for any person to engage in commodity transactions for future delivery except through members of a "board of trade" that has been designated by the CFTC as a "contract market." 7 U.S.C. § 6. The CFTC is authorized and directed under section 5 of the CEA to grant designation as a "contract market," "when, and only when," an applicant "contract market" has met the conditions specified by the CEA. 7 U.S.C. § 7 (1994). Included in these conditions is the requirement that the CFTC "expressly finds" that the contracts the applicant "contract market" intends to trade in "shall not be readily susceptible to manipulation." 7 U.S.C. §2a(ii)(II) (1994).


144. Id. at 1245-46.

145. Commodity Futures Trading Comm'n v. American Bd. of Trade, 473 F. Supp. 1177, 1177-79 (S.D.N.Y. 1979), aff'd, 803 F.2d 1242, 1248 (2d Cir. 1986). Specifically, the CFTC's complaint alleged that ABT's transactions violated its regulatory ban on
respect to ABT's currency option transactions, Economou argued, courtesy of the Treasury Amendment, that foreign currency options transactions were exempt from regulation under the CEA. 146

The district court rejected this contention. The court reasoned that a "transaction in foreign currency and a transaction in options involving foreign currency are different animals." 147 According to the court, an "option to purchase or sell a commodity is not a transaction in that commodity:"

The option transaction is a long step removed from a transaction in the commodity involved, since the option purchaser, if he or she does nothing more when the specified date arrives, will simply see the option die. If, when the exercise date arrives, the option holder decides to exercise the option, he or she at that point, and not before, will engage in a transaction in the commodity involved. 149

Under this rationale, the court determined that ABT's transactions in currency options were not exempt from CFTC jurisdiction and were therefore illegal under the CEA. 150 In fashioning relief, the court not only enjoined ABT from engaging in any further commodity option transactions, but also ordered it to disgorge $126,706 "to make whole those members of the public who lost money through the purchase of commodity options." 151

In a 1986 decision, the Second Circuit affirmed the district court, dismissing as without merit ABT's contention that its foreign currency options transactions were excluded from CFTC regulation by the Treasury Amendment. 152 In a brief analysis, the Second Circuit reiterated the district court's rationale that an option "does not become a \textit{transaction} in that currency unless and until the option is exercised," and thus concluded that under the Treasury Amendment, ABT's currency option transactions remained subject to CFTC regulation. 153

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146. American Bd. of Trade, 473 F. Supp. at 1181.
147. Id. at 1182.
148. Id.
149. Id. at 1183.
150. Id.
152. Id. at 1248.
153. Id. (citing American Board of Trade, 473 F. Supp. at 1182). The court also cited Board of Trade of Chicago v. SEC, 677 F.2d 1137, 1154 (7th Cir. 1981), vacated as moot, 459 U.S. 1026, 1054, 1055 n.34 (1982) (holding that options on government securities also covered by the Treasury Amendment, were not "transactions in . . . government securities" because "[o]nly when the option holder exercises the option is there a transaction in a government security," but noting that "[w]e draw no conclusion as to whether the Treasury amendment affects any CFTC jurisdiction over options on foreign currency.").
As the Supreme Court determined in Dunn, the analysis articulated by the American Board of Trade court was simply implausible.\textsuperscript{154} Despite the analytical flaws of the American Board of Trade decision, however, a strong argument can be made that the result reached was equitable. It should be remembered that Mr. Economou's commercial paper business ultimately left thousands of small retail investors with losses of over sixty cents on the dollar.\textsuperscript{155} If the Second Circuit had not found—albeit through a "wholly unpersuasive" reading of the Treasury Amendment\textsuperscript{156}—that Mr. Economou's currency option transactions were subject to CFTC jurisdiction—thousands more retail investors may have incurred substantial losses through his commodities business. Thus, by its literal terms the Treasury Amendment's does not allow courts to protect unsophisticated retail investors from potential fraud.

Ironically, since the American Board of Trade decision the negative consequences associated with the Treasury Amendment's limited flexibility have been most apparent in their effect on the Interbank Industry. Although the American Board of Trade rationale allowed for an equitable result, it had the unfortunate collateral effect of casting uncertainty over the enforceability of the $20 billion worth of foreign currency option contracts that are traded on a daily basis on the domestic interbank market.\textsuperscript{157} Because the Second Circuit determined that such options did not enjoy the Treasury Amendment's exclusion from CFTC regulation, they were, until the Supreme Court's decision


\textsuperscript{155} See supra note 139 and accompanying text.

\textsuperscript{156} Dunn, 1997 WL 75492, at *4.

\textsuperscript{157} See Central Bank Survey of Derivatives Markets Activity Results of the Survey in the United States, at Annex II, tbl. 5-U.S. (Dec. 18, 1995) [hereinafter Central Bank Survey]. The uncertainty created by the American Board of Trade rationale is conspicuously apparent in both the Foreign Exchange and Options Master Agreement ("FEOMA") and the International Currency Options Market Master Agreement ("ICOM"), the master agreement contracts utilized by counterparties to option transactions in the interbank market. See FEOMA and ICOM (reprinted in The Foreign Exchange Committee, Annual Report 55-115 (1995)) [hereinafter FX Annual Report]. Significantly, ICOM's Guide, which was written prior to the Supreme Court's determination of Dunn, discusses at some length the background to the Treasury Amendment's enactment and the uncertainty created by the Second Circuit's interpretation of it. Id. at 99-100. Such direct recognition of the uncertainties created by the Second Circuit's interpretation of the Treasury Amendment would seem to indicate that the Interbank Industry had to cater and adapt to them. This, in turn, suggests that the uncertainties may have had an inhibiting influence on the growth and efficiency of the interbank market. For a discussion of the effects of such uncertainties see infra part III.
in Dunn, 158 technically unenforceable as illegal contracts made in violation of the CEA. 159

B. The Fourth Circuit's Decision in Salomon Forex, Inc. v. Tauber

In 1993, in Salomon Forex, Inc. v. Tauber, 160 the Interbank Industry was confronted with the threat of unenforceability created by the American Board of Trade rationale. The Salomon Forex case arose from a private debt collection action brought by Salomon Forex Inc., a foreign currency brokerage company and interbank market participant, against one of its customers who refused to pay more than $25 million in trading losses. 161

The customer, Dr. Laszlo Tauber, was as the district court remarked, “by all accounts an unusual person.” 162 In addition to being a physician with an active medical practice, he was also “a major real estate investor” and “a sophisticated foreign currency trader,” with an estimated net worth of over $500 million. 163 From 1987 to 1991, Tauber and Salomon Forex engaged in a series of over 2500 OTC currency transactions. 164 In 1991, the value of Tauber’s investments declined sharply and Salomon billed him for the almost $26 million that had come due under sixty-eight futures and option contracts. 165 When Tauber refused to pay, Salomon brought a diversity suit to enforce the debt in the United States District Court for the Eastern District of Virginia. 166

Relying expressly on the American Board of Trade rationale, Tauber’s principal argument was that his debts were unenforceable because they arose from off-exchange futures and options transactions executed in violation of the CEA. 167 He contended that the Treasury Amendment applied only to transactions in the actual commodity, “spot,” and “forward” transactions—all transactions in which physical delivery of the commodity itself is anticipated. 168 Rejecting this argu-

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159. This possibility was particularly disturbing under the rationale employed by the American Board of Trade court—which cut off CFTC jurisdiction when an option is exercised—thus making the Commission’s potential jurisdiction as unpredictable as the market forces of which it was a function. As one commentator has noted “[i]t is hard to find a compelling public policy purpose behind such an anomalous result.” Quitmeyer & Yeres, supra note 9, at 20. For an explanation of the conditions under which an option becomes profitable see supra note 5.
162. Id.
163. Id. at 769-70.
164. Id. at 770; 8 F.3d at 969.
165. 795 F. Supp. at 771.
166. Id. at 769, 771.
167. 8 F.3d at 973.
168. Id. For a description of spot and forward transactions see supra notes 10-11.
ment, the district court held that Tauber's trading debts were enforceable, because the Treasury Amendment's reference to "transactions in foreign currency" plainly exempted OTC currency options transactions from the CEA.169

In a unanimous decision, the Fourth Circuit affirmed the district court, holding that the Treasury Amendment's "broad and unqualified" exemption for "transactions in foreign currency" clearly included "options transactions."170 Central to the court's analysis was the Treasury Amendment's "unless" clause (the "board of trade proviso").171 The board of trade proviso sweeps back within CEA coverage those transactions involving sales "for future delivery conducted on a board of trade."172 The court reasoned that "[i]f Congress meant for the clause 'transactions in foreign currency' to apply only to transactions in the commodity itself, it would have no reason to exclude futures transactions conducted on an exchange."173 Indeed, in order to have meaning, "[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 board of trade proviso.174 Thus, because the board of trade proviso specifically refers to futures transactions conducted on an exchange, "the general clause 'transactions in foreign currency'" must include off-exchange or OTC futures transactions.175 From there, the court pointed out that there is no principled reason to distinguish OTC currency futures from OTC currency options—both are deferred delivery transactions with the same subject matter, namely foreign currency.176 Therefore, the court concluded that the Treasury Amendment applies not only to "transactions in the commodity itself," but to "all transactions in which foreign currency is the subject matter, including options."177

As the Supreme Court would subsequently confirm in its determination of Dunn, the analysis employed by the Salomon Forex court

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169. 795 F. Supp. at 773.
170. 8 F.3d at 975.
171. Id. The Treasury Amendment's board of trade proviso begins with "unless": "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) (emphasis added).
172. 8 F.3d at 975 (quoting 7 U.S.C. § 2(ii)).
173. Id.
174. Id.
175. Id. The court's use of the term "futures" in this context is somewhat confusing. In a technical sense, off-exchange or OTC "futures" do not exist as such—they are labeled in industry nomenclature "forwards." See supra note 11. The court may have favored the term "futures" because that is the term which corresponds to the board of trade proviso's phrase "for future delivery conducted on a board of trade." 7 U.S.C. § 2(ii) (emphasis added); see Salomon Forex, Inc. v. Tauber, 795 F. Supp. 768, 770 n.4 (E.D. Va. 1992), aff'd, 8 F.3d 966 (4th Cir. 1993) (acknowledging the inconsistent use of the futures/forwards nomenclature).
176. 8 F.3d at 975.
177. Id.
was correct.\textsuperscript{178} Moreover, by enforcing Dr. Tauber's perfectly legitimate debts, the \textit{Salomon Forex} court also reached a result which was both fair and responsive to Industry concerns over unenforceability.

Notwithstanding that result, however, the \textit{Salomon Forex} court seems to have appreciated the equitable considerations which had influenced the Second Circuit in \textit{American Board of Trade}.\textsuperscript{179} That appreciation apparently prompted the Fourth Circuit to introduce an element of inconsistency into its opinion. As noted above, after a lengthy discussion of the text of the Treasury Amendment, the Fourth Circuit concluded in \textit{Salomon Forex} that "[w]e are thus satisfied that under the appropriate interpretation of the Treasury Amendment, all off-exchange transactions in foreign currency, including futures and options, are exempted from regulation by the CEA."\textsuperscript{180} In stark contrast to that conclusion, after discussing the legislative history of the Treasury Amendment and the \textit{American Board of Trade} opinion the Fourth Circuit stated: "We hold only that individually-negotiated foreign currency options and futures transactions between sophisticated, large-scale foreign currency traders fall within the Treasury Amendment's exclusion from CEA coverage."\textsuperscript{181} These two conclusions are absolutely irreconcilable. If all transactions in foreign currency are excluded from the CEA by the plain meaning of the Treasury Amendment, how can the same transactions involving unsophisticated retail investors \textit{not} be excluded?

The internal inconsistency in the \textit{Salomon Forex} opinion may also be explained through a legal realism analysis. While the court could dispose of Tauber's inequitable attempts to avoid a legitimate debt through a plain reading of the Treasury Amendment, because of the

\textsuperscript{178} Dunn v. Commodity Futures Trading Comm'n, No. 95-1181, 1997 WL 75492, at *7 (U.S. Feb. 25, 1997). For a discussion of the Supreme Court's analysis of the Treasury Amendment in \textit{Dunn} see infra part II.D.

\textsuperscript{179} Despite articulating an interpretation of the Treasury Amendment which was diametrically opposed to the Second Circuit's interpretation in \textit{American Board of Trade}, the Fourth Circuit went to some lengths to express its apparent belief that the two opinions did not conflict. \textit{Salomon Forex}, 8 F.3d at 977-78. According to the Fourth Circuit, in \textit{American Board of Trade} the Second Circuit "in dictum, seemed to indicate that no trading in foreign currency options or futures is excluded from CEA coverage because such trading is not trading 'in' foreign currencies." \textit{Id.} (emphasis added) (citing Commodity Futures Trading Comm'n v. American Bd. of Trade, 803 F.2d 1242, 1248-49 (2d Cir. 1986)). Characterizing the core holding of \textit{American Board of Trade} as mere dictum manifests the Fourth Circuit's considerable reluctance to criticize what it evidently perceived to be the Second Circuit's equitable holding. Significantly, in its subsequent determination of \textit{Dunn} the Second Circuit was prepared to acknowledge that \textit{American Board of Trade} and \textit{Salomon Forex} were in conflict. Commodity Futures Trading Comm'n v. Dunn, 58 F.3d 50, 54 (2d Cir. 1995) ("We acknowledge that our interpretation of the phrase 'transactions in foreign currency' in \textit{American Board of Trade} conflicts with that of the Fourth Circuit in \textit{Salomon Forex, Inc. v. Tauber.}" (citations omitted)), \textit{rev'd on other grounds}, No. 95-1181, 1997 WL 75492 (U.S. Feb. 25, 1997).

\textsuperscript{180} \textit{Salomon Forex}, 8 F.3d at 976 (emphasis added).

\textsuperscript{181} \textit{Id.} at 978.
inflexibility of such a plain reading, the court could not do so consistently without creating law that would have left small retail investors vulnerable to the kind of potential fraud the Second Circuit had previously proscribed in American Board of Trade. Indeed, the Salomon Forex court expressly recognized the argument that its decision could “result in the use of the [Fourth Circuit] as a base for marketing of off-exchange [currency] contracts to the general public.” Consequently, the court contradicted its conclusion that “all” transactions in foreign currency are excluded from the CEA, by paradoxically limiting that exclusion to only those transactions involving “sophisticated, large-scale foreign currency traders.”

C. The Second Circuit’s Decision in Dunn

In Dunn,184 the Second Circuit was presented with an opportunity to revisit the issue originally encountered in American Board of Trade.185 Dunn arose out of what is alleged to have been a “Ponzi” scheme186 operated by a Bahamas corporation called Delta Options Ltd.187 Delta’s principal, William C. Dunn solicited $100 million from a number of individuals, partnerships, and companies, claiming that he had devised a profitable investment strategy for currency trading.188 Beginning in 1992, Dunn used that money to trade in relatively exotic positions, such as strangles,189 in the OTC foreign currency market.190 According to his investors, from 1992 to late 1993, Dunn sent them weekly print-outs showing impressive returns which convinced them to “roll over” their positions.191 While it is now apparent that the print-outs were misleading, so long as the “roll-over” funds and the money from new investors exceeded losses, any investor who

182. Id.
183. Id. at 976-78.
185. Id. (discussing Commodity Futures Trading Comm’n v. American Bd. of Trade, 803 F.2d 1242 (2d Cir. 1986)).
186. A “Ponzi” scheme is an investment scheme in which returns to investors are not financed through the success of the underlying business, but are instead taken from the principal sums of newly attracted investors. Typically, investors in a Ponzi scheme are promised large returns for their investments and initial investors are actually paid such returns in order to attract additional investors. Jobin v. McKay, 84 F.3d 1330, 1332 n.1 (10th Cir. 1996) (citing Sender v. Heggland Family Trust, 48 F.3d 470, 471 n.2 (10th Cir. 1995)).
187. Dunn, 58 F.3d at 51-52; Quitmeyer & Yeres, supra note 9, at 19.
188. Dunn, 58 F.3d at 51.
189. A strangle is the “sale or purchase of a put option and a call option on the same underlying instrument, with the same expiration, but at strike prices equally out of the money.” Downes & Goodman, supra note 5, at 567. Profits are made on strangles only if the value of the underlying instrument moves dramatically. Id. For a discussion of options see supra note 5.
190. Dunn, 58 F.3d at 51.
191. Id. at 52.
wished to be "cashed out" could be paid off and the scheme could continue undiscovered. By November 1993, however, the losses were too great to be offset by roll-overs and new funds. Dunn suddenly announced that Delta had incurred trading losses of $95 million and that investors would not be compensated for their losses.

In 1994, the CFTC brought suit in the Southern District of New York, alleging that Dunn had deceived his investors and requesting the appointment of a temporary receiver to collect the remaining assets of his operation. Dunn opposed the appointment, arguing that under the Treasury Amendment the CFTC could not attempt to regulate options in foreign currency. When the district court ruled that Dunn's currency options trades were subject to the CEA, and appointed a receiver, Dunn brought an interlocutory appeal to the Second Circuit.

Relying on its previous opinion in American Board of Trade, the Second Circuit unanimously affirmed the district court. In a summary analysis, the court reiterated the American Board of Trade rationale that options are not "transactions in foreign currency" until they are exercised.

Again, a legal realism analysis of the Dunn case reveals much about the flaws of the Treasury Amendment. Had the Second Circuit not read the Treasury Amendment to subject OTC currency options to CFTC jurisdiction, William Dunn, a party of obviously "unclean hands," would quite simply have gotten away with fraud. Because of the Treasury Amendment's limitations, the Second Circuit was not able to rule in a manner which would have left the sophisticated interbank market free from the threat of unnecessary regulation, while

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192. See id.
193. See id.
194. Id.
195. Id. at 52-53. It should be pointed out that the threshold question of whether the CFTC, rather than the SEC, had jurisdiction over the case against Dunn was seemingly not considered by the court. As one commentator has argued, "[a]parently overlooked was the issue of why the CFTC was involved at all. The alleged fraudulent activity involved investors who had not traded currencies but had rather purchased investment contracts, securities governed by the securities laws." Quitmeyer & Yeres, supra note 9, at 19. For a discussion of the investment contract issue associated with the Dunn case see supra note 213.
196. Dunn, 58 F.3d at 53.
197. Id.
198. Id. (citing Commodity Futures Trading Comm'n v. American Bd. of Trade, 803 F.2d 1242, 1248-49 (2d Cir. 1986)). Again, the Second Circuit did not address the investment contract issue.
199. Dunn, 58 F.3d at 53 (citing Commodity Futures Trading Comm'n v. American Bd. of Trade, 803 F.2d at 1248-49).
201. The equitable maxim, "no person shall profit from his own wrongdoing" would seem particularly appropriate with regard to the Second Circuit's determination of the Dunn case. See id. at 51-53; supra note 135.
simultaneously allowing the CFTC to protect the general public from fraudulent operators like Dunn. Therefore, relying on the American Board of Trade rationale, the court chose to apply an interpretation of the Treasury Amendment which although "wholly unpersuasive," at least allowed it to enjoin the fraud involved.

Significantly, the court did so with considerable reluctance. Noting that the Fourth Circuit had rejected its American Board of Trade rationale, the Second Circuit deferred to the general principle that "a later panel may not disregard the reasoning of a decision because an entirely different line of reasoning was available." Thus, noting only that "[w]hatever doubts this panel may have about the interpretation given the Treasury Amendment in American Board of Trade ... are not grounds for our declining to follow it," the Second Circuit concluded that the conflict between American Board of Trade and Salomon Forex "is for the Supreme Court, not us, to resolve."

D. The Supreme Court's Determination of Dunn: Toward a More Predictable Treasury Amendment Jurisprudence

Significantly, although in Dunn the Supreme Court unambiguously held that the Treasury Amendment's phrase "transactions in foreign currency" plainly encompasses currency options, it nevertheless seems to have appreciated the equitable considerations which had prompted lower courts to indulge in results-oriented jurisprudence. As the Court acknowledged, "an important public policy dispute" underlying the Treasury Amendment's application, would survive its opinion in Dunn, "with substantial arguments favoring each side."

In the face of such apparent sensitivity to its concerns, the CFTC was understandably "disappointed" by the Dunn Court's decision. Through the Dunn holding, the Supreme Court not only refused to sanction CFTC action against Dunn specifically, it has completely eviscerated what had been the CFTC's primary basis for asserting jurisdiction over the currency option markets generally.

203. See Dunn, 58 F.3d at 53.
204. Id.
205. Id. at 54.
209. Because the Dunn Court held that the Treasury Amendment's term "transaction in foreign currency" clearly encompasses currency options, the CFTC can no longer claim that it retains jurisdiction over currency options until they are exercised. Dunn, 1997 WL 75492, at *3-4. Nevertheless, the CFTC may still contend that a broad reading of the term "board of trade" allows it to police all currency option transactions. This contention has proved successful in the past. See Commodity Futures Trading Comm'n v. Standard Forex, Inc., No. CV-93-0088, 1993 WL 809966, at
Yet the Dunn decision is best understood not as an evisceration of the CFTC's ability to protect small investors, but as a simple repudiation of results-oriented jurisprudence. Although the Dunn Court recognized the CFTC's concern "that options are particularly susceptible to fraud and abuse if not policed," it confined its inquiry to the most "narrow issue" presented by Dunn. Indeed, the Court focused on the question of whether the phrase "transactions in foreign currency" . . . includes transactions in options to buy or sell foreign currency," seemingly to the exclusion of all other considerations.

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Dunn, 1997 WL 75492, at *8.

Id. at *3.

In particular, the Court apparently felt it unnecessary to even address the question of whether the investment contracts at issue in Dunn could constitute securities. See id. at *1-8. Dunn's operation, Delta Options Ltd., sold investment contracts to the public. Id. at *2; see also Dunn, 58 F.3d at 51 (same). Although these investment contracts were marketed as opportunities to participate in a currency option trading strategy, the Court focused on the question of whether the phrase "transactions in foreign currency" . . . includes transactions in options to buy or sell foreign currency," seemingly to the exclusion of all other considerations.

The facts of Dunn are highly suggestive of the "common enterprise" element defined in Howey: Dunn solicited money from various investors who arguably relied on his self-professed expertise in currency trading and expected to make a profit solely through his efforts. See Dunn, 58 F.3d at 51. The currency options transactions at issue were made with the pool of money collected from investors; and were executed in Delta Options' name with no options being sold directly to investors. Id. In factual circumstances analogous to those in Dunn, several cases have found that "investment contracts" in commodity options or forwards represent securities as defined by Howey.

On the other hand, as one commentator has noted, most investment contracts to participate in options and futures transactions would seem to lack the commonality and reliance requirements necessary to make them securities under Howey.
alone creates a "common enterprise" as defined by Howey. See, e.g., Burton v. Heinold Commodities, Inc., 646 F. Supp. 360, 361-62 (E.D. Va. 1986) (holding that even where plaintiff relied upon expertise of promoter in buying and selling commodities, plaintiff's investment contract in commodities account was not a security within the meaning of the securities laws); SEC v. Belmont Reid & Co., 794 F.2d 1388, 1391 (9th Cir. 1986) (holding that transactions involving the sale of gold for future delivery were not securities, because (1) profits would not have come "solely" from the efforts of others but from fluctuations in the price of gold; and (2) to the extent purchasers relied on the managerial skill of seller, they did so as an ordinary buyer, who having advanced the purchase price, relies on an ordinary seller to fulfill his obligations); NOA v. Key Futures, Inc., 638 F.2d 77, 79-80 (9th Cir. 1980) (holding that agreements to deliver silver bars within 30 days of receipt of payment with outstanding buyback option at market price were not securities, because profits depended solely on fluctuations in the price of silver); LTV Fed. Credit Union v. UMIC Gov't Sec., 523 F. Supp. 819, 830 (N.D. Tex. 1981) (holding that standby commitment to take delivery of government securities at holder's option at set price, was not a security because profits depended on fluctuation in the price of underlying securities), aff'd, 704 F.2d 199 (5th Cir.), cert. denied, 464 U.S. 852 (1983). Under the analysis applied by these courts, the investment contracts in Dunn may not represent securities. Despite investors' purported reliance on Dunn's self-professed expertise, profits ultimately depended on favorable movements in the currencies involved. See Dunn, 58 F.3d at 51.

In addition, other courts have held that the 1974 Amendments to the CEA stripped the SEC of any jurisdiction it may have had over commodity options as investment contracts. See, e.g., SEC v. Uninvest, Inc., 410 F. Supp. 1029, 1030-31 (N.D. Ill. 1976) (holding that after the 1974 Amendments to the CEA, options on silver futures contracts were not subject to SEC jurisdiction); cf. SEC v. American Commodity Exch., 546 F.2d 1361, 1366-68 (10th Cir. 1976) (holding that investment schemes offering fictitious options on commodity futures were "investment contracts" within SEC jurisdiction because the offers were made prior to the effective date of the 1974 CEA Amendments). The Supreme Court's holding in Reves v. Ernst & Young, 494 U.S. 56 (1989) could lend support to this approach. See id. at 67 (holding that for purposes of determining whether a note constitutes a security, lower courts should "examine," inter alia, "whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.").

In any case, regardless of the justification, the Second Circuit's American Board of Trade and Dunn decisions, and indeed the Supreme Court's determination of Dunn, were clearly predicated on an unquestioning acceptance of the CFTC's assertion of jurisdiction. See Commodity Futures Trading Comm'n v. Dunn, 58 F.3d 50, 53 (2d Cir. 1995), rev'd on other grounds, No. 95-1181, 1997 WL 75492 (U.S. Feb. 25, 1997); Commodity Futures Trading Comm'n v. American Bd. of Trade, 473 F. Supp. 1177 (S.D.N.Y. 1979), aff'd, 803 F.2d 1242 (2d Cir. 1986).

In sum, although the Supreme Court's narrow ruling on the statutory construction question presented by Dunn appears beyond reproach, the Court's failure to address the investment contract issue associated with the facts of the case is disappointing. As discussed infra at notes 397 and 404, this omission may prove significant in light of two of the proposed revisions to the Treasury Amendment currently being considered by Congress.

213. In addition to eschewing the investment contract issue associated with Dunn, discussed supra at note 212, the Court deemed it unnecessary to decide which administrative agency—the Treasury Department or the CFTC—should be entitled, under the Chevron doctrine, to deference to its interpretation of the Treasury Amendment. Dunn, 1997 WL 75492, at *7 n.14 (quoting Dole v. United Steelworkers of America, 494 U.S. 26, 42 (1990)). In Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984), the Supreme Court held that if a statute is ambiguous, the interpretations of the agency charged with administering it "are given controlling
With regard to its specific holding on the "narrow" statutory construction question presented, the Dunn Court's opinion was unequivocal: "There can be no question that the purchase or sale of a foreign currency option is a transaction 'respecting' foreign currency. We think it equally plain as a matter of ordinary meaning that such an option is a transaction 'in' foreign currency for purposes of the Treasury Amendment."214

For the Court, a literal reading of the Treasury Amendment's board of trade proviso confirmed that currency options transactions are exempted from the CEA. As the Court noted, "[t]o fall within the proviso, a transaction "must involve the sale [of foreign currency] for future delivery" conducted on a board of trade.215 The CFTC, aware that this language indicates that OTC transactions, or transactions conducted off a board of trade "for future delivery" are exempt from the CEA, contended that it provided a basis for distinguishing options and futures.216 In the CFTC's view, the term "for future delivery" encompasses only futures, because unlike options, a futures contract anticipates actual "delivery" of the underlying currency at the time the transaction is consummated.217

The Court rejected this distinction summarily. As the Court recognized, both OTC currency futures and OTC options are transactions

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214. Dunn, 1997 WL 75492, at *3. Although this Note recognizes that any doctrinal analysis of Supreme Court decisions is best left to constitutional scholars, it is not unreasonable to assert that the literal reading of the Treasury Amendment articulated by the Dunn holding is consistent with the current Court's general "inclination to give statutes their 'plain meaning.'" Quitmeyer & Yeres, supra note 9, at 20. For general commentary on the current Supreme Court's textualist approach to statutory interpretation see Stephen Breyer, On the Uses of Legislative History in Interpreting Statutes, 65 S. Cal. L. Rev. 845 (1992); William N. Eskridge, Jr., The New Textualism, 37 UCLA L. Rev. 621, 656-66 (1990); Richard J. Pierce, Jr., The Supreme Court's New Hypertextualism: An Invitation to Cacophony and Incoherence in the Administrative State, 95 Colum. L. Rev. 749 (1995).


216. Id.

217. See id. at *4, *7.
in the same subject matter, namely foreign currency. Distinguishing futures and options on the basis of the potential for each to result in actual delivery is divorced from the practical and economic realities of the OTC currency market. Like holders of OTC futures, parties to OTC options contracts are not required to fulfill their obligations by actually delivering the underlying commodity at the time of execution—as the Court put it—"[n]o currency changes hands at the time the futures contract is made." In fact, as the Court pointed out, the typical futures contract is extinguished before delivery by entry into an offsetting transaction. Moreover, both OTC futures and OTC options are contracts for future or deferred delivery in that they both grant the holder the right to require the purchase or sale of a currency on a future date. Therefore, the Court concluded that "[b]ecause options convey the right to buy or sell foreign currency at some future time . . . they are transactions 'invol[ving]' . . . the sale of foreign currency for future delivery." Thus, for the Court "the proviso's language fairly accommodates both options and futures.

The Court went on to note that the legislative history of the Treasury Amendment supported its determination that all transactions in foreign currency, including options, are excluded from the CEA. The Court acknowledged that because the currency option market simply did not exist in 1974, and indeed did not really develop until sometime after 1982 Congress could not have specifically intended to exempt currency option transactions from the CEA. The general intent of Congress, however, was clear. As the Court stated, "Congress' broad purpose in enacting the Treasury Amendment was to provide a general exemption from CFTC regulation for sophisticated off-

218. Id.
219. See id. at *4. Among other things, in some circumstances options are granted on futures contracts, which would seem to add additional complexity to any attempt at distinguishing the two instruments on the basis of actual delivery. See Group of Thirty Report, supra note 1, at 34.
221. Id.; see Mayer, supra note 1, at 291-92 (noting that "[o]nly 0.64 percent of outstanding futures contracts were settled by the physical delivery of the products involved in 1993").
222. Dunn, 1997 WL 75492, at *7. For a discussion of options see supra note 5.
223. Id.
224. Id.
225. Dunn, 1997 WL 75492, at *5-7. Although Justice Scalia concurred with both the Court's judgment and its textual analysis of the Treasury Amendment, he did not join the Court's discussion of the Treasury Amendment's legislative history. According to Scalia, "the Court's extensive discussion of legislative history . . . as though that were necessary to confirm the 'plain meaning of the language,' or (worse) might have power to overcome it . . . achieve[s] nothing useful and sow[s] confusion in the law." Id. at *8.
226. See supra notes 118-19 and accompanying text.
exchange foreign currency trading." According to the Court, the fact that the participants in the interbank market—the very same participants that existed in 1974, namely large banks—are now currently trading currency options in addition to forwards, did nothing to change the original exclusionary intent of the statute. "[T]he reasons underlying the Treasury Department’s desire [in 1974] to exempt off-exchange commodity futures trading from CFTC regulation apply with equal force today . . . [w]e therefore think the purposes underlying the Treasury Amendment are most properly fulfilled by giving effect to the plain meaning of the language as Congress enacted it." 229

Despite the conclusive nature of the Dunn Court’s decision, a legislative review of the Treasury Amendment remains necessary. The Treasury Amendment was enacted in 1974 to address the Treasury Department’s concerns that the sophisticated interbank market might be subject to CEA jurisdiction. As the American Board of Trade decision demonstrates, by 1986 the Treasury Amendment no longer filled that purpose. Because it was not drafted to anticipate the subsequent development of currency derivative instruments that could be used both by the Interbank Industry for legitimate business purposes and unscrupulous currency traders for fraud, by its literal terms the Treasury Amendment does not adequately address the policy requirements of contemporary currency markets. As a result, where they have felt it necessary, lower courts have consistently read into the Treasury Amendment various provisions that allow them to proscribe fraud.

As the Supreme Court’s holding in Dunn indicates, such results-oriented jurisprudence is unacceptable. Quite apart from undermining public confidence in the doctrinal integrity of the judiciary, results-oriented jurisprudence is inherently unpredictable and maintaining a dependable, predictable legal system is vital to the continued strength of the domestic economy. 230 Thus, the Treasury Amendment needs to

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228. Id. For a discussion of the legislative history of the Treasury Amendment see supra part I.C.
229. Id. But for a discussion of the Standard Forex court’s flexible interpretation of the Treasury Amendment see infra part III.A.2.
230. See, e.g., Commodity Futures Trading Comm’n v. Dunn, 58 F.3d 50, 53 (2d Cir. 1995) (holding that where currency options were marketed to the general public, the term “transactions in foreign currency” does not encompass currency options until those options were exercised); Commodity Futures Trading Comm’n v. American Bd. of Trade, 803 F.2d 1242, 1248 (2d Cir. 1986) (same); Commodity Futures Trading Comm’n v. Standard Forex, Inc., No. CV-93-0088, 1993 WL 809966, at *7, *11 (E.D.N.Y. Aug. 9, 1993) (holding that the term “board of trade” includes any association of persons engaged in the business of selling currency contracts to unsophisticated investors); Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 978 (4th Cir. 1993), reh’g denied, 511 U.S. 1138 (noting in apparent dicta that only those currency option transactions involving sophisticated institutions are exempted transactions in foreign currency" for purposes of the Treasury Amendment).
231. It is a fundamental premise of western society that “capitalistic enterprise . . . cannot do without legal certainty.” Steve Campbell, Comment, Brother, Can You
be revised in a way that would allow courts to achieve equitable results without having to resort to results-oriented jurisprudence.

There is another reason for revising the Treasury Amendment. Although the Dunn Court rendered a definitive interpretation of the term “transactions in foreign currency,” the recently emerged conflict between the Standard Forex and Frankwell Bullion courts' interpretations of the term “board of trade” threatens to prolong the Treasury Amendment controversy indefinitely. As part III of this Note argues, this new conflict demonstrates that the current formulation of the Treasury Amendment remains flawed despite the Dunn decision. As such, the conflict between Standard Forex and Frankwell Bullion reflects what the Dunn Court recognized as the compelling public policy considerations which remain on both the Interbank Industry and CFTC side of the Treasury Amendment debate. As the Dunn holding indicates, however, and indeed as the Supreme Court expressly stated, those kinds of considerations “are best addressed to the Congress, not the courts.”

III. A Revision of the Treasury Amendment

The controversy surrounding the Treasury Amendment is essentially a function of the fundamental challenge presented by derivatives generally. As the derivatives markets have expanded they have created tremendous definitional problems for preexisting regulatory regimes. In the instant context, the preexisting regulatory structure created by the Treasury Amendment has been rendered obsolete by the subsequent development of the interbank market in currency options. This part argues that as a result, the current formulation of the Treasury Amendment is entirely inadequate as a regulatory tool for

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233. 99 F.3d 299, 304 (9th Cir. 1996). The conflict between Standard Forex and Frankwell Bullion is discussed at infra part III.A.2.
234. As noted above, under the Treasury Amendment, “transactions in foreign currency” remain subject to CFTC jurisdiction if they involve a “sale . . . for future delivery conducted on a board of trade.” See 7 U.S.C. § 2(ii).
236. *Id.* (citing United States v. Rutherford, 442 U.S. 555 (1979)).
237. See supra notes 1-5 and accompanying text.
238. See Cohen, supra note 1, at 1996; see also supra notes 1-5 and accompanying text.
the contemporary currency markets. Because of that inadequacy, courts have manipulated the text of the Amendment in order to achieve equitable results. Such a situation is unacceptable to both the CFTC and the Interbank Industry. As the Treasury Department has stated:

[S]ince the Treasury Amendment’s enactment, the scope of CEA coverage has continued to be a troublesome source of legal uncertainty . . . . Determining how to draw the line between instruments that are subject to the CEA and those that are not, in a manner that provides logical consistency and predictability . . . has been difficult under current law.

As an alternative to “current law,” this part proposes a new regulatory regime which would address both the CFTC’s and the Interbank Industry’s concerns.

A. The CFTC’s Requirement: Protecting the General Public from the Fraudulent Marketing of Foreign Currency Options

This section argues that in circumstances where currency options are systematically marketed to unsophisticated retail investors CFTC jurisdiction is necessary.

1. Protecting Unsophisticated Retail Investors

As a threshold matter, the Interbank Industry might argue that there is no need for CFTC intervention in any transaction involving currency options, even where there is actual fraud, because injured parties will always have recourse to fraud and contract remedies.

239. As many as ten years ago the Federal Reserve Board recognized a public policy need for a more flexible reading of the Treasury Amendment:

We understand that the CFTC has concerns about protecting members of the general public to the extent that currency futures and options may be marketed by banks and other dealers operating in the interbank market to customers outside the traditional bank foreign exchange market. Where market participants differ from the knowledgeable bank clientele usual in the interbank market, we would agree that supplemental protection would be useful . . . . Therefore we believe a somewhat flexible standard is appropriate for measuring proper customer participation in the bank OTC futures and options markets covered by the Treasury Amendment.

Letter from Michael Bradfield, Federal Reserve Board, to Kenneth M. Raisler, General Counsel, CFTC (Mar. 5, 1986), quoted in Committee on Futures Regulation, supra note 10, at 37-38.


242. See Quitmeyer & Yeres, supra note 9, at 20.
This argument would clearly hold true for the corporate constituents of the Interbank Industry, who presumably have both the financial acumen to appreciate that they are being defrauded and the resources to seek redress for their injuries through fraud or contract law.\textsuperscript{243} A small retail investor, however, does not have those advantages.

Indeed, such an investor, unlike the large institutional participants in the interbank market, is uniquely vulnerable to the kind of systemic and fraudulent marketing of currency options that once characterized bucket shop operations.\textsuperscript{244} As the CFTC has noted, "[f]raudulent sales of foreign currency futures and option contracts to the public have been a significant problem since at least the late 1980s."\textsuperscript{245} Recently the CFTC has been disturbed by an "increase in advertising on the Internet of foreign currency... options being offered to the public."\textsuperscript{246} As the Commission has argued, "[t]he availability of such new technology to solicit customers" enhances the threat that currency options will be used to defraud unsophisticated retail investors.\textsuperscript{247}

Given these legitimate concerns, this Note argues that where currency options are fraudulently and systematically marketed to unsophisticated retail customers, the CFTC is needed to both assist the injured customers seek redress and enjoin continued fraud and exploitation.\textsuperscript{248}

2. Legal Realism Revisited: Standard Forex and Frankwell Bullion

That CFTC action is necessary to protect unsophisticated retail investors from the fraudulent use of currency options is amply demonstrated through an analysis of the factual circumstances of American Board of Trade\textsuperscript{249} and Dunn.\textsuperscript{250} More recently, the policy arguments for such protection were reflected by the facts underlying Commodity Futures Trading Commission v. Standard Forex, Inc.\textsuperscript{251}

\textsuperscript{243} See infra notes 350-80 and accompanying text.

\textsuperscript{244} For a discussion of "bucket shops" and other fraudulent uses of options which have historically provided the justification for options regulation, see supra notes 46-84 and accompanying text.

\textsuperscript{245} CFTC Explanatory Statement Concerning the CFTC's Proposed Revision of the CEA's Treasury Amendment 2 [hereinafter CFTC Proposal] (on file with the Fordham Law Review).

\textsuperscript{246} Id. at 2-3. See infra notes 251-71 and accompanying text (discussing Commodity Futures Trading Comm'n v. Standard Forex, Inc., No. CV-93-0088, 1993 WL 809966 (E.D.N.Y. Aug. 9, 1993), a case involving the fraudulent marketing of currency futures to unsophisticated retail investors).

\textsuperscript{247} CFTC Proposal, supra note 245, at 3.

\textsuperscript{248} Congress has repeatedly recognized the need for such protection. See supra notes 46-84 and accompanying text.

\textsuperscript{249} See supra part II.A.

\textsuperscript{250} See supra part II.C.

a. How the Standard Forex Court Recognized the Need for CFTC Protection of Unsophisticated Retail Investors

In *Standard Forex*, the CFTC sought an injunction against an entity calling itself Standard Forex, Inc., which had been fraudulently marketing forward contracts in British pounds to members of the general public. Standard Forex promised customers that they were certain to earn profits through their accounts. Although the company required each of its customers to sign a risk disclosure statement, that statement was written in English while many of Standard Forex's customers were new immigrants who spoke little or no English. Indeed, Standard Forex apparently targeted unsophisticated investors exclusively; as the court observed "no contracts were marketed to large institutional investors . . . Standard Forex sold itself purely as an investment vehicle for the general public." After obtaining customers, Standard Forex proceeded to trade currency with them under an agreement which to the court sounded "dangerously close to illegal bucketing, which occurs when the trading company itself holds the opposite half of a customer's position rather then putting the trade through to a neutral market." Not surprisingly, by the time the CFTC stepped in to try to enjoin Standard Forex's activities, there had already been substantial losses, with 194 customers losing in excess of $3,000,000, or over seventy-five percent of their original investment.

As discussed above, despite the limited flexibility of the Treasury Amendment's language, the CFTC has in the past expressed its apparent belief that the Treasury Amendment is applicable only to interbank transactions involving sophisticated institutions and not to transactions involving members of the general public. In *Standard Forex*, the court deferred to this interpretation of the Treasury Amendment, through a rather novel reading of the Amendment's board of trade proviso. As noted above, the board of trade proviso excludes from the CEA "transactions in foreign currency . . . unless such transactions involve the sale . . . for future delivery conducted on

252. See supra note 11 for a discussion of forward contracts.  
254. *Id.* at *6.  
256. *Id.* at *11.  
257. *Id.* at *9 n.9 (citing 7 U.S.C. § 6b(a)(iv) (1994)).  
259. See supra notes 116-22 and accompanying text. That interpretation relies primarily on the Treasury Amendment's legislative history for support. See *id.* The CFTC has characterized Congress' remarks about the passage of the Treasury Amendment as an "expression" that the Amendment was meant to exclude only the interbank market from its jurisdiction, and was not therefore "intended" to cut off CFTC jurisdiction over public currency option fraud. CFTC Interpretive Letter, 50 Fed. Reg. 42,983 (1985).
a board of trade." The meaning of this language would appear to be clear—all deferred delivery transactions are excluded from the CEA unless conducted on a board of trade. As a result, because Standard Forex was not a formally organized board of trade such as CBOT, this language would seem to have precluded CFTC jurisdiction. But in light of the gross fraud committed by Standard Forex, and with no relief other than CFTC intervention apparently available, it is perhaps not surprising that the court concluded otherwise.

The court began by noting that the CEA itself defines a "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 on consignment." After reviewing the Treasury Amendment's legislative history, the court then determined that Congress "intended to exempt only interbank transactions that were already regulated by the banking regulatory agencies." From there, the court concluded that for purposes of the Treasury Amendment, "[t]he definition of the term 'board of trade' includes both formally organized exchanges and informal associations of persons engaged in the business of buying and selling," foreign currencies, including Standard Forex.

The problem with applying such a broad definition of the term "board of trade" is that it renders the Treasury Amendment meaningless. As the court itself recognized, "given the breadth of the meaning of board of trade, the 'unless' clause of the amendment threatens to swallow the whole. Almost all transactions in futures contracts could be characterized as occurring on a 'board of trade' involving 'informal associations of people engaged in the business of buying and selling commodities.'"

As this acknowledgment would suggest, Congress may well have understood the term "board of trade" as used by the Treasury Amendment to mean a formally organized exchange, rather than a "board of trade" as defined by the CEA. Such an inconsistency is not inconceivable—as the Supreme Court remarked in Dunn, Congress's choice of language for the CEA "has been far from consis-

262. Id. at *10.
263. Id. at *7; see also Commodity Futures Trading Comm'n v. Co. Petro Marketing Group, Inc., 680 F.2d 573, 581-82 (9th Cir. 1982) (holding that a gasoline broker operating a chain of retail gasoline outlets and marketing futures contracts in petroleum products was a "board of trade"); Commodity Futures Trading Comm'n 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, 1993 WL 102177 (3d Cir. Apr. 8, 1993) (holding that a company selling precious metal futures contracts was a "board of trade"); In re Stovall, Comm. Fut. L. Rep. ¶ 20,941, 23,779-82 n.28 (Dec. 6, 1979) (holding that a broker's agency operation was a "board of trade").
Indeed, legislative remarks on the enactment of the Treasury Amendment appear to confirm that the term "board of trade" as used in the Treasury Amendment was meant to refer exclusively to organized exchanges: "[T]he Committee included an amendment to clarify that the provisions of the bill are not applicable to trading in foreign currencies and certain enumerated financial instruments unless such trading is conducted on a formally organized futures exchange."  

Nevertheless, for the Standard Forex court, only by defining the term "board of trade" in such a broad manner could it provide a remedy for Standard Forex's defrauded customers. Thus, ignoring the apparent paradox created by its holding, the court defined the term "board of trade" to include Standard Forex. Finding that Standard Forex's "unlawful conduct was systematic as opposed to an isolated occurrence" the court granted the CFTC's request for a preliminary injunction. Additionally the court issued an order freezing all of Standard Forex's assets to assure that relief could be made available to its customers.

The facts and outcome of the Standard Forex case illustrate why CFTC intervention on behalf of unsophisticated investors is necessary. Without such intervention, unsophisticated investors are vulnerable to foreign currency fraud. Standard Forex is also significant as another case which—under the lights of a legal realism analysis—reveals the flaws of the Treasury Amendment. Although the court's rationale and holding appear considerably stronger then the rationale applied by the Second Circuit in American Board of Trade and Dunn, Standard Forex nevertheless represents one more example of the judiciary's response to the inflexibility of the Treasury Amendment. In essence, the Standard Forex court, like the Second Circuit in American Board of Trade and Dunn, reached a strained reading of the Treasury Amendment in order to justify an equitable result.

b. An Unfortunate Collateral Effect: Exposing the Interbank Industry to Continued Jurisdictional Uncertainty and the Threat of CFTC Regulation

The problem with the Standard Forex court's results-oriented jurisprudence was that it exposes the Interbank Industry to the continued threat of CFTC regulation despite the Supreme Court's determination

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269. Id. at *23.
270. Id. at *24.
271. See supra part II.D.
272. See supra parts II.A.1, II.A.3.
273. See supra part II.
of Dunn. As the Treasury Department has stated, the ambiguity stemming from the Standard Forex rationale, "has significantly diminished the efficacy of the Treasury Amendment in providing a bright-line exclusion from the CEA for the markets in the enumerated financial products." This assertion is valid. While the Standard Forex holding apparently limited itself to circumstances involving informally organized associations which engaged in the business of selling currency transactions to private unsophisticated investors, the court's basic rationale could provide for CFTC regulation of the Interbank Industry. For example, a currency trading desk at any Industry institution could certainly be characterized as an "informal association of persons engaged in the business of buying and selling" foreign currency. Indeed, although his argument was rejected on procedural grounds, Dr. Tauber had urged such a characterization of Salomon's trading facilities in the Salomon Forex litigation. Disturbingly, since the Standard Forex decision, the CFTC has utilized its rationale to argue that the term "'board of trade' includes any association selling foreign currency, [thus] making the Treasury Amendment very narrow."279

In sum, while the outcome of Standard Forex may have been fair, the rationale used by the court to reach that outcome is not only vul-

274. The Dunn Court focused exclusively on the question of whether the term "transactions in foreign currency" encompasses currency options. See No. 95-1181, 1997 WL 75492 (U.S. Feb. 25, 1997); supra part II.D. It could be argued that the Dunn Court's suggestion that under Chevron principles any deference to an agency's interpretation of the Treasury Amendment is owed to the Treasury Department, rather than the CFTC, undermines the Standard Forex holding. Dunn, 1997 WL 75492, at *7 n.14 (citing Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-44 (1984)). As discussed at supra note 213, the Chevron Court held that where a statute is ambiguous, the interpretations of the agency charged with administering it "are given controlling weight." Chevron, 467 U.S. at 844. Because the Treasury Amendment's use of the term "board of trade" is arguably ambiguous, and because the Dunn Court suggested that the Treasury Department rather than the CFTC is the agency charged with administering it, the Standard Forex court arguably erred by deferring to the CFTC interpretation. See Dunn 1997 WL 75492, at *7 n.14. It is not clear that such an argument would prevail, however, because the Supreme Court did not expressly rule on the Chevron issue associated with Dunn. See id.

275. Treasury Proposal, supra note 241, commentary at 2. "The use of [the term "board of trade"] has given rise to many of the interpretive difficulties that exist under current law." Id. at 6.


277. See id. at *7.

278. 8 F.3d 966, 973 n.5 (2d Cir. 1993) (noting Tauber's appellate argument that Salomon constituted a "board of trade," but ruling that "[w]hile we would be inclined to reject that position, we choose not to decide its validity since it was not argued before the district court.").

279. Commodity Futures Trading Comm'n v. Frankwell Bullion, 99 F.3d 299, 301 (9th Cir. 1996) (emphasis added). Although, the CFTC also argued "that 'board of trade' includes all associations except banks and other sophisticated investors," it did so only as "a fallback position." Id.
nerable to analytical criticism, it was, at least from the Interbank Industry’s perspective, unacceptably broad.

The Ninth Circuit concluded as much in its recent determination of *Commodity Futures Trading Commission v. Frankwell Bullion Ltd.*280 In *Frankwell Bullion*, the Ninth Circuit squarely rejected the *Standard Forex* holding.281 As the court put it: “To hold, as *Standard Forex* did, that the Treasury Amendment excludes only transactions between banks and other sophisticated investors would require this court to craft, without any support from the statutory language, some distinction between sophisticated investors and the general public.”282

Significantly, *Frankwell Bullion* appears to have been a case that lacked the equitable considerations which were at the heart of the *Standard Forex* litigation. Although *Frankwell Bullion* involved offers by Frankwell Bullion Ltd., a Hong Kong corporation, of foreign currency transactions to the general public, it seemingly did not involve fraud.283 Instead, the CFTC brought suit alleging that Frankwell Bullion’s activities violated sections 5 and 6 of the CEA.284 Thus, *Frankwell Bullion* may represent another example of a case where the CFTC aggressively asserted its authority, “regardless of the jurisdictional fit.”285 It should not be surprising, therefore, that the Ninth Circuit rejected the CFTC’s strained reading of the term “board of trade.”286

The conflict between *Standard Forex* and *Frankwell Bullion* is reminiscent of the conflict which led to the Supreme Court’s determination of *Dunn*.287 A legal realism analysis of both reveals the shortcomings of the Treasury Amendment. Although they originate from competing interpretations of two discrete terms—“board of trade” and “transactions in foreign currency”—both the *Standard Forex* and *Dunn* conflicts arose from the same underlying issue: The Treasury Amendment’s failure to reconcile the CFTC’s legitimate desire to protect small retail investors with the Interbank Industry’s equally legitimate desire to be free from the threat of CFTC regulation.

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280. 99 F.3d 299 (9th Cir. 1996).
281. Id. at 304.
282. Id.
285. See supra note 334 and accompanying text.
286. *Frankwell Bullion*, 99 F.3d at 304.
287. See supra part II.
B. The Interbank Industry's Requirement: A Market Free from Unnecessary CFTC Regulation

As discussed above, CFTC jurisdiction appears necessary in circumstances where unsophisticated retail investors are vulnerable to the systematic and fraudulent marketing of currency options. In contrast, this section argues that CFTC regulation of the Interbank Industry would be both a superfluous and an unnecessary encumbrance to the Industry's efficiency.

1. The Interbank Currency Market

The global interbank currency market has been described as "a highly liquid, twenty-four hour, global, high-technology bazaar," with "no centralized exchange analogous to a stock market"; instead it is a market consisting primarily of "thousands of commercial and investment banks from around the world."\(^{288}\) The United States's interest in sustaining its prominence in this market is enormous.\(^{289}\) U.S. commercial and investment banks are active traders in the interbank market, U.S. brokerage companies regularly arrange deals among traders, and the Treasury Department and the Federal Reserve frequently intervene in the market to effect the exchange rate of the U.S. dollar relative to other currencies.\(^{290}\)

Even discounting the prominence of U.S. financial institutions, the United States is ineluctably involved in the interbank market because the U.S. dollar is bought or sold against other currencies in over eighty-three percent of all market trades.\(^{291}\) Such trades contribute to what by many accounts, is the largest market in the world, with the equivalent of $1.1 trillion in different currencies changing hands every day.\(^{292}\)

In the United States, the average daily turnover in the OTC foreign currency options portion of the interbank market was $20 billion in 1995.\(^{293}\) The OTC option portion of the market plays a unique role in allowing domestic corporations engaged in international trade to man-

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288. See Bhala, supra note 14, at 869-70.
289. Id. at 869.
290. Id.
291. See BIS Survey, supra note 2, at 7 ("[T]he US dollar was involved on one side in 83% of all transactions worldwide ... it thus remained by far the most important currency in the foreign exchange market, partly because of its use as a vehicle currency for cross-trading between other currencies.").
292. See id., at 5; Federal Reserve Bank of New York, U.S. Foreign Exchange Intervention, Fedpoints #44 (1994); see also Bahla, supra note 14, at 868 ("Every day, an average of one trillion dollars worth of foreign currencies are traded" in the interbank market); Jerry W. Markham, Protecting the Institutional Investor: Jungle Predator or Shorn Lamb, 12 Yale J. Reg. 345, 357 (Summer 1995) (characterizing the foreign exchange market as "one of the world's largest financial markets").
There are two fundamental reasons for this. First, OTC options, unlike futures and forwards, have a downside that is limited to the loss of the premium: if an option is not profitable, or is out-of-the-money, there is no obligation to exercise it. On the other hand, futures and forwards expose the holder to the potentially large downside associated with unfavorable movements in the underlying currency.

Second, OTC options have a significant advantage over their exchange traded counterparts. Because exchange traded options are standardized, a purchaser usually cannot use them to achieve a perfect hedge for its currency exposure. In contrast, OTC options allow a purchaser to tailor its contract to meet its specific hedging requirements. Because of these unique characteristics, OTC options make up a vital component of the domestic financial markets' risk management arsenal.

2. The Threat Posed by CFTC Jurisdiction

As the above description demonstrates, the stakes in the Treasury Amendment controversy are enormous. With so much hanging in the balance, it is not surprising that industry participants have been extremely sensitive to the threat of CFTC regulation. The Foreign Exchange Committee, a group composed of various U.S. institutions who participate in the domestic currency option market, has warned that in response to CFTC regulation “many large-scale participants in foreign currency transactions, which historically have centered their business activities in the United States, could . . . shift the center of their foreign currency trading to their overseas offices to the detriment of the United States markets.”

294. See Committee on Futures Regulation, supra note 10, at 24; BIS Survey, supra note 2, at 44.
295. For a discussion of options see supra note 5.
296. For a discussion of futures and forwards see supra note 11.
297. Committee on Futures Regulation, supra note 10, at 25. OTC options purchased through the interbank market are also one of the few hedging instruments available to “corporations with exposures in exotic currencies.” Id. at 26.
298. Id. at 25; Group of Thirty Report, supra note 1, at 2-3; see also Amicus Brief of Credit Lyonnais, Bank Julius Baer & Co. Ltd., The Chase Manhattan Bank, N.A. and Societe Generale at 2, Dunn v. Commodity Futures Trading Comm'n, 1996 WL 403318 (No. 95-1181) (noting that the “clear preference for trading currency options off-exchange is explained by the flexibility of terms, ease of participation and superior liquidity of that market”).
299. Amicus Brief for the Foreign Exchange Committee at *6, Dunn v. Commodity Futures Trading Comm'n, No. 95-1181, 1996 WL 392512. The Foreign Exchange Committee argued further that:
   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
Concededly, this kind of rhetoric may overstate the issue. If the effect of CFTC regulation were to be as devastating as the Foreign Exchange Committee's language would suggest, then surely many domestic institutions would already have moved their currency operations offshore in response to the American Board of Trade and Standard Forex decisions. Neither empirical nor anecdotal evidence is available to indicate that this has happened. Indeed, it is difficult to ascertain in any meaningful way what effect the Treasury Amendment controversy has had on the growth and efficiency of the domestic interbank market. As has been noted in another context "we cannot run history twice with and without [such controversy], we can only speculate." This truism notwithstanding, the costs of CFTC regulation would certainly be a very unappealing factor in any institution's analysis of the relative benefits of remaining in the domestic market.

At a fundamental level, many institutions would not want the CFTC to have regulatory oversight of, or access to, the details of their trading operations. Under the current regulatory scheme, CFTC regulated entities are subjected to close scrutiny under a CFTC controlled surveillance system. Moreover, an institution which chose to stay in a domestic market regulated by the CFTC could be exposed to a wide range of regulatory requirements. In addition to the expense of registration for, and compliance with such requirements, it is even conceivable that an institution could be forced to trade currency options on a CFTC designated exchange.

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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.

Id.

300. Empirical evidence is available on the relative growth of the world's major currency trading centers. Notably, growth in the United States has lagged behind that of its major competitor, the United Kingdom. In recent years, the United Kingdom's currency market has grown at a rate of 60%, while growth in the United States grew at exactly the average rate of 46%. BIS Survey, supra note 2, at 13-14. While it could be suggested that the slower rate of growth in the United States is at least in part a result of the uncertainty created by the Treasury Amendment, there is no empirical evidence available which would support such a correlation.


302. Sheila C. Bair, Lessons from the Barings Collapse, 64 Fordham L. Rev. 1, 6 (1995) ("Large, unusual, or concentrated positions on one side of the market... are carefully scrutinized. The CFTC surveillance staff briefs the Commission weekly on any unusual market conditions."). See 17 C.F.R. § 18 (1996) for the CFTC's reporting requirements with regard to positions in regulated contracts.

303. See Snider, supra note 16, §§ 7.07-7.13 (detailing the requirements imposed by CFTC regulation).

304. See id.
If the prospect of such regulation were a reality, it is not difficult to imagine a mass institutional relocation offshore. As it is, the currency markets clearly prefer OTC currency trading to trading on a CFTC regulated exchange; in the United States the turnover in OTC trading is over twenty five times greater than trading on the exchanges.305 Moreover, there is ample precedent for a move offshore in the relatively recent controversy surrounding the CFTC’s attempts to regulate the OTC commodity swap market.306

In 1987 the CFTC announced an intention, in advance of enacting a rule, to review whether it should regulate OTC commodity swaps.307 Although it is extremely doubtful that currency swaps represent futures contracts governed by the CEA,308 the Commission suggested in 1987 that it could determine that such swaps were unauthorized futures contracts made in violation of the CEA.309 This suggestion was reinforced by the CFTC’s decision to launch an enforcement investigation into the Chase Manhattan Bank’s dealer activities in swaps.310

The swap industry’s reaction to the CFTC’s action was dramatic. The domestic commodity swap business ceased to exist as all deals moved offshore and a “firestorm of criticism” for the Commission’s actions ensued.311 Although the swaps business eventually returned to domestic markets after Congress directed the CFTC to “promptly” exercise its exemptive authority with respect to swaps,312 it is easy to imagine the devastating effects that would flow from similar CFTC action in the currency option market. As one commentator has noted, this is a “particularly critical period” in the evolution of the currency option market—what happens now will dictate the structure of the market for years to come.313 Thus, if a large percentage of the institutional participants to the domestic currency option market were to move offshore, they could do so permanently.

306. See supra note 113 for an explanation of swaps transactions.
310. Romano, supra note 15, at 55.
311. Id.
312. 7 U.S.C. § 6(c)(5)(B) (1994). Congress directed the CFTC to exempt “appropriate persons” participating in the swaps markets. Id. § 6(c)(2)(B). Congress defined the term “appropriate person” with the criteria ultimately used to determine eligibility for the Swaps Exemption. Id. § 6(c)(3)(A)-(K). For a summary of the criteria used in the Swaps Exemption see infra note 316.
313. Quitmeyer & Yeres, supra note 9, at 18.
3. The Inadequacy of the Trade Option and Swaps Exemptions

In the CFTC's view, the Industry's fears of over-regulation are unfounded: many Interbank currency transactions are already exempt from the CEA by either the Trade Option Exemption or the Swaps Exemption. It is true that these exemptions are currently available to the interbank market as a means to ensure compliance with the CEA and avoid the threat of unenforceability. Both the Foreign Exchange and Options Master Agreement ("FEOMA") and the International Currency Options Market Master Agreement ("ICOM"), the master agreement contracts utilized by counterparties to option transactions in the interbank market, currently contain clauses which provide for the use of either the Trade Option Exemption or the Swaps Exemption. As the following discussion demonstrates, however,

314. See id. at 20.
315. 17 C.F.R. § 32.4(a)(1996). The Trade Option Exemption applies to those options offered or sold by a person who "has a reasonable basis to believe" that (1) the purchaser is "a producer, processor, or commercial user of, or a merchant handling," the commodity involved in the transaction, and that (2) such purchaser "is offered or enters into the commodity option transaction solely for purposes related to its business as such." Id.; see 7 U.S.C. § 6(c) (1994).

In the years prior to the enactment of the Swaps Exemption, see infra note 316, the Trade Option Exemption afforded the interbank market the most reliable safe harbor from the CFTC's commodity option ban. Committee on Futures Regulation, supra note 10, at 59. However, as this Note discusses at infra notes 318-22 and accompanying text, because the CFTC has interpreted the Trade Option Exemption to be available only to hedging rather than speculative transactions, the practical benefit of the Exemption is—for Interbank Industry purposes—extremely limited.

316. 17 C.F.R. § 35.1 (1996). The Swaps Exemption is generally only available to very sophisticated participants. Among the Swaps Exemption's "eligible swap participants" are: (i) a bank or a trust company; (ii) a savings association or credit union; (iii) an insurance company; (iv) an investment company subject to regulation under the Investment Company Act of 1940; (v) a commodity pool formed and operated by a person subject to regulation under the CEA; (vi) a corporation, partnership, proprietorship, organization, trust, or other entity which has assets exceeding $10,000,000; (vii) an employee benefit plan subject to the Employee Retirement Income Security Act of 1974; (viii) any government entity; (ix) a broker-dealer subject to regulation under the Securities and Exchange Act of 1934; (x) a futures commission merchant, floor broker, or floor trader subject to the CEA; and (xi) any natural person with total assets exceeding $10,000,000. Id. For a more comprehensive discussion of the Swaps Exemption see infra part III.B.b.

317. See FX Annual Report, supra note 157, at 55-115. FEOMA and ICOM are considered to reflect "normal market practice for international interdealer transactions." Id. at 92. The Schedules to both FEOMA and ICOM contain the following provisions:

C. The following CFTC trade option representation [shall][shall not] apply:
Each party represents and warrants that it is a commercial user of or a merchant handling the Currencies subject to each Option and was offered or entered into each Option solely for purposes related to its business as such.

D. The following CFTC eligible swap participant representation [shall][shall not] apply:
Each Party represents and warrants that it is an "eligible swap participant" under, and as defined in, 17 C.F.R. Section 35.1.
neither the Trade Option Exemption nor the Swaps Exemption is an appropriate regulatory tool for the interbank market.

a. *The Trade Option Exemption*

As ICOM and FEOMA indicate, the Trade Option Exemption is available to the Interbank Industry as a safe harbor from CFTC jurisdiction. However, the Trade Option Exemption is of very limited utility to the Interbank Industry because the CFTC has taken the position that it is available only to hedging transactions. In a 1984 interpretive letter regarding foreign currency options, the Commission acknowledged that “a narrow and limited class” of “banking institutions could qualify as offerers and purchasers . . . of foreign currency options pursuant to [the Trade Option Exemption],” provided, however, that those institutions (1) “ordinarily engaged in a direct, commercial use of the specific currency underlying the currency option being offered,” and (2) enter the option transaction for non-speculative purposes related to the business as such. Under the CFTC’s view “[o]ption purchases that exceeded any bona fide hedging requirements would be speculative and as such inconsistent with the trade option exemption.”

Because the Trade Option Exemption may not be used as a safe harbor for speculation in currency options, it is of little practical benefit to the Interbank Industry. The Industry has always used the interbank market for both hedging and speculative purposes. In addition, because the Industry’s speculative use of currency options is vital to the efficiency of the interbank market as a whole, the Trade Option Exemption would seem an inappropriate regulatory tool for the currency markets generally. As the Supreme Court has noted:

> The activity of speculators is essential to the operation of a futures market in that the composite bids and offers of large numbers of

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318. See supra note 157.


320. Id.

321. Committee on Futures Regulation, supra note 10, at 3, 24. The Interbank Industry writes options to respond to customer demand for hedging mechanism, but also speculates by trading options for their own accounts. Id. at 24.
individuals tend to broaden a market, thus making possible the execution with minimum price disturbance of the larger trade hedging orders. By increasing the number of bids and offers available at any given price level, the speculator usually helps to minimize price fluctuations rather than to intensify them. Without the trading activity of the speculative fraternity, the liquidity, so badly needed in futures markets, simply would not exist.\(^{322}\)

Furthermore, the Trade Option Exemption would seem to be ill-suited for the dynamic nature of the foreign currency trading environment.\(^{323}\) According to the CFTC, for the Trade Option Exemption to apply, the grantor of an option “must take affirmative steps to ensure that a purchasing institution . . . qualifies [under the Trade Option Exemption]. Mere reliance upon the undocumented representations of the purchaser would not be sufficient.”\(^{324}\) To require that traders receive documentation prior to executing a trade is clearly not reconcilable with the reality of an environment in which traders must determine, often in a matter of seconds, whether a particular counterparty is eligible for a particular transaction.\(^{325}\)

b. The Swaps Exemption

Although the Trade Option Exemption is of limited utility to the Interbank Industry, the CFTC might make a better argument that the Swaps Exemption provides a workable safe harbor for most sophisticated participants in the currency market. As noted above, the Swaps Exemption was enacted as result of the controversy surrounding the Commission’s efforts to regulate the commodity swap market.\(^{326}\) In the CFTC’s view, because the Swaps Exemption includes an express

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323. See infra notes 328-31 and accompanying text.
324. Trade Option Interpretive Letter, supra note 319, at 28,596.
325. As the following description illustrates, the mechanics underlying the foreign currency trading market allow for incredibly quick and efficient execution of transactions:

The foreign exchange market is an over-the-counter market. That is, there is no one physical location where traders get together to exchange currencies. Rather, traders are located in the offices of major commercial banks around the world and communicate using computer terminals, telephones, telexes, and other information channels. If a foreign exchange (FX) trader in a bank in New York deals dollars for pounds with an FX trader in London, the traders will, over the phone, agree on a price. Each trader will then enter the trade in the bank’s computer or other record system, and then get on with the business of trading. The mechanics of actually transferring the currencies are not the traders’ concern, so a trade takes a few seconds at most. Later, however, the two banks will send each other confirmation messages concerning the details of the trade, and will make arrangements for settlement of the traders’ contract.

326. See supra notes 307-12 and accompanying text.
exemption for foreign currency options, it both neutralizes the Interbank Industry's basis for concern, and—in sustaining CFTC jurisdiction over traders who defraud small investors—is consistent with the underlying purpose of the CEA. 327

However, while the Interbank Industry "takes considerable comfort" 328 in the Swaps Exemption, its test for determining eligibility is far too complex to be an appropriate regulatory tool for the dynamic nature of the foreign currency trading environment. 329 As this Note's discussion of the Trade Option Exemption indicates, requiring traders to plod through each of the Swaps Exemption criteria is not reconcilable with the fast-paced reality of the foreign currency trading environment. 330 A fundamental reason for the global currency market's "enormous and growing trading volumes" is the ease and rapidity with which modern communications technology allows market participants to execute transactions. 331 Thus, requiring adherence to the unwieldy requirements of the Swaps Exemption would seem to constrain the growth of the domestic currency markets.

Moreover, the Swaps Exemption is also a regulation that can be withdrawn or reinterpreted on short notice. 332 As such the Swaps Exemption does not address the Interbank Industry's need for legal certainty. As the Treasury Department has stated:

[R]eliance on exemptive authority requires market participants to operate, as a matter of caution . . . and structure their transactions to qualify for the regulatory exemption. If the CFTC later decides to change the parameters of the exemption, market participants would be forced to restructure their transactions accordingly or fall back on the position that the transactions are not, in fact, futures or options subject to the CEA, with all the accompanying legal uncertainty. 333

In the current regulatory environment, the possibility of the CFTC changing the parameters of the Swaps Exemption is perceived as a real threat. 334 As noted above, commentators have observed that in recent years the CFTC has "aggressively expanded [its] authority,

327. See Quitmeyer & Yeres, supra note 9, at 20.
328. Id.
329. See supra note 316 for a summary of the Swaps Exemption's criteria for determining when a particular party is exempted from CFTC jurisdiction.
330. The Swaps Exemption, which articulates a complex set of criteria for determining eligibility, see supra note 316, is simply not an appropriate way to regulate such transactions. For a description of the mechanics of foreign currency trading see supra note 325.
332. See Quitmeyer & Yeres, supra note 9, at 20 n.6.
333. Treasury Proposal, supra note 241, commentary at 3.
334. See Romano, supra note 15, at 58; see also Merton H. Miller & Christopher L. Culp, Rein in the CFTC, Wall St. J., Aug. 17, 1995, at A10 (arguing that Congress needs to reign in the CFTC because the Commission has consistently exceeded its statutory authority).
seizing the opportunity to exert authority in the publicity surrounding sizable investor losses, regardless of the jurisdictional fit.\textsuperscript{335}

Such conduct not only gives the Interbank Industry legitimate cause for concern, it also highlights the very reason that the Treasury Amendment was enacted in the first place. As was recognized by Justice Scalia in the oral argument of the Dunn case:

[I]f Treasury were that confident [that the CFTC would not interfere with the efficiency of the interbank market], they would never have introduced the Treasury Amendment[.]. If they were content to rely upon the good offices of the . . . Commodity Futures Trading Commission, they wouldn't have introduced the amendment at all. They would have just said we'll cut our deal with the Commission. We know they're reasonable people.

\ldots

[I]f they trusted the CFTC to make these determinations, they wouldn't have needed the Treasury Amendment. They would have said that the CFTC has exemption authority. We will rely upon their good offices . . . to exempt those things that need exempting. They were not willing to do that.\textsuperscript{336}

Justice Scalia's argument is a good one. Indeed, its validity was recognized in 1974, when Congress expressed its belief that regulation of the interbank market under the CEA was unnecessary, because that market "is more properly supervised by the bank regulatory agencies."\textsuperscript{337}

4. A Distinctly Defined Market Dichotomy: The Interbank Industry and Retail Investors

As the Supreme Court recognized in Dunn, the justification for excluding the interbank market from CFTC regulation that existed in 1974 applies with equal force today.\textsuperscript{338} Even if the CFTC is precluded from asserting its regulatory authority over the interbank market, that does not mean that small unsophisticated investors will be at the mercy of the fraudulent marketing of currency options by an unsupervised Interbank Industry.

This is so because unsophisticated retail investors simply do not participate in the interbank market.\textsuperscript{339} Of course, there are exceptions,

\textsuperscript{335} Romano, supra note 15, at 58; see also Jeff Bailey, Ponzi Case Spawns Setbacks for CFTC, Wall St. J., Mar. 11, 1997, at B9 (reporting on CFTC Administrative Law Judge Bruce C. Levine's characterization of portions of a CFTC administrative hearing oral argument as "unbounded inanity" and "preposterous.").

\textsuperscript{336} Oral Argument, supra note 213, at 26, 36.


\textsuperscript{338} No. 95-1181, 1997 WL 75492, at *5 (U.S. Feb. 25, 1997).

\textsuperscript{339} While there is no empirical research available which would confirm that the unsophisticated general public does not participate in the interbank currency option market, it may reasonably be inferred that the general public is as a practical matter precluded from such participation. The vast majority of foreign currency transactions
like Mr. Tauber whose activities were the focus of the *Salomon Forex* litigation, and whose net worth exceeded $500 million.\(^{340}\) It hardly needs to be pointed out, however, that Mr. Tauber does not appear to have been in any need of protection from the CFTC.\(^{341}\) Indeed, for the Fourth Circuit, Tauber's status as "a sophisticated investor" was "amply demonstrated" by, *inter alia*, his very ability to trade with Salomon Forex.\(^{342}\)

Mr. Tauber's "unusual" circumstances aside,\(^{343}\) as a practical matter, unsophisticated investors do not have access to the interbank market.\(^{344}\) Significantly, in *Salomon Forex*, the Fourth Circuit noted that apart from Tauber, "Salomon Forex did not conduct trading [in currency options] with any other individual investor—all of Salomon Forex's other foreign currency investment clients were institutions."\(^{345}\)

The almost exclusively institutional nature of the interbank market is a function of that market's fundamental characteristics. To participate in the interbank market, an institution must find a willing counterparty with whom to negotiate an OTC contract.\(^{346}\) Given the nature of such transactions, which inherently involve assessments of the creditworthiness of counterparties, it would appear impossible for unsophisticated individual investors with neither the net worth, nor a


\(^{342}\) *Salomon Forex*, 8 F.3d at 978. The Fourth Circuit noted that Tauber's wholly owned corporation, Westwood Options Inc., held a seat on the nation's largest foreign currency exchange, the Philadelphia Stock Exchange; that Tauber maintained foreign bank accounts which he used to carry out foreign currency transactions and that he used foreign currency mortgages in connection with his real estate ventures. *Id.* at 969.

\(^{343}\) *See Salomon Forex*, 795 F. Supp. at 769 (noting that Mr. Tauber "is by all accounts an unusual person").

\(^{344}\) *See supra* note 339.

\(^{345}\) *Salomon Forex*, 8 F.3d at 969.

\(^{346}\) *See Bhala, supra* note 14, at 872-81 (describing the "real world" process by which two counterparties, hypothetically Bangkok Bank and Citibank, negotiate a 5 billion yen OTC foreign currency transaction and noting the strong concerns each counterparty would have for the creditworthiness of the other).
recognizable institutional credit rating, to participate.347 In sum, the CFTC has little justification for asserting jurisdiction over the interbank market. As discussed above, however, in some instances the lack of a jurisdictional mandate has done little to prevent the CFTC from asserting its regulatory authority.348

Yet any argument that CFTC jurisdiction over the interbank market is necessary to achieve the remedial purposes of the CEA and to protect retail investors, fails to recognize that interbank market participants are already supervised by the federal banking agencies, or in some circumstances by the SEC.349 As its name suggests, the main players in the interbank derivative market generally, and the currency option market specifically, are commercial banks.350 Because these banks, play the role of "market-makers or intermediaries,"351 and indeed write most of the currency options traded in the interbank market,352 they are necessarily involved in the vast majority of market transactions.353 Indeed, about 84% of all worldwide foreign currency trading occurs within two distinctly defined institutional categories: the market-maker banks and other highly sophisticated financial entities such as investment companies and broker-dealers.354

Investment companies and broker-dealers are subject to the SEC's wide array of regulatory, enforcement, and disciplinary powers under the federal securities laws.355 Though this does not mean that the SEC enjoys jurisdiction over the entire interbank market—investment

347. See id.
348. See supra note 334 and accompanying text.
349. See Quitmeyer & Yeres, supra note 9, at 20. Even if interbank transactions were subject to CFTC jurisdiction, because so many of such transactions are cross-border, it is difficult to foresee, in light of the jurisdictional and practical difficulties necessarily involved, how exactly the CFTC would police them. Indeed, the BIS Survey reports that a larger share of currency options transactions in the US dollar "takes place in the United Kingdom [(30%)] than . . . in the United States (16%)." BIS Survey, supra note 2, at 15.
350. See Romano, supra note 15, at 59; Grabbe, supra note 325, at 90; BIS Survey, supra note 2, at 12, 44.
351. BIS Survey, supra note 2, at 44; see Grabbe, supra note 325, at 90.
352. See Grabbe, supra note 325, at 90; see also Committee on Futures Regulation, supra note 10, at 24 ("Major commercial banks currently write most of the interbank foreign currency options.").
353. BIS Survey, supra note 2 at 44; see also Grabbe, supra note 325, at 90 (describing the role of market maker banks in currency transactions); Committee on Futures Regulation, supra note 10, at 24 (noting that although currency options are held by large to mid-sized corporations active in international trade, such corporations "are far more likely to buy foreign currency options than they are to write them").
354. Grabbe, supra note 325, at 90. The remaining 16% of counterparties to interbank market transactions are "mainly corporate firms and governments." BIS Survey, supra note 2, at 44. Thus, the interbank market generally is used exclusively by highly sophisticated institutions and not small retail customers.
companies and broker-dealers play a secondary role to that of the large market-maker banks—the market as a whole remains more than adequately regulated. This is so, because the market-maker banks, which are counterparties (at least initially) to the vast majority of interbank transactions, are closely supervised by the federal banking agencies. These agencies, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the "OCC") impose a variety of requirements on banks. In particular, all banks are subject to an annual examination process, which for the largest represents a continuous on-site examination. Such examination includes a review of a bank's activities with derivatives. If an examiner determines that a bank's use of derivatives is inadequately controlled, he has considerable remedial powers, including prohibiting an objectionable use as an "unsound" banking practice. Banks dealing in derivatives are also required to inform a customer if a particular product is unsuitable for them. For example, the OCC, which together with the Federal Reserve Board regulates banks in the interbank market, requires banks dealing in derivatives to ensure that their sales and trading staff sufficiently understand derivatives, so that they are able to identify circumstances when a customer does not fully understand the risks.


356. See supra note 350.
358. Schroeder, supra note 357, ¶ 7.01[1]; Romano, supra note 15, at 59.
359. Schroeder, supra note 357, ¶ 7.01[1]; Romano, supra note 15, at 59.
361. Romano, supra note 15, at 59. The federal banking authorities have broad authority to carry out their supervisory and examination functions. See Schroeder, supra note 357, ¶ 7.01[2].
362. Romano, supra note 15, at 59 ("noting that "[b]ank examiner manuals and agency memoranda provide detailed instructions concerning appropriate procedures regarding derivatives.").
363. See supra note 357.
The regulatory status of FX options associated with a particular product. Furthermore, the OCC "requires that a bank's credit officers understand the applicability of a particular transaction to the risks the customer is trying to manage." 

Finally, in addition to the protection provided by the federal banking agencies, or in some circumstances by the SEC, a non-bank counterparty which believes that it has been harmed by misconduct in the interbank market still has the remedies available under common law-fraud and contract law. Such remedies, when combined with the protection afforded by the federal banking agencies or the SEC, are not only preferable to CFTC regulation from a market efficiency standpoint, they are a more then adequate alternative.


As evidenced by the resolution of the highly publicized Gibson Greetings suit against Bankers Trust, CFTC jurisdiction over the interbank market is unnecessary, even in a worst case scenario where a bank uses currency options to defraud a non-bank participant. Although the Gibson Greetings suit involved the fraudulent sale of swaps rather than options by Bankers Trust, a large investment bank, to Gibson Greetings, a manufacturing corporation, the outcome of the case demonstrates why CFTC jurisdiction in the interbank market is unnecessary. The case was ultimately settled when Bankers Trust forgave approximately $14 million of the $20.7 million Gibson owed under its contracts. Although Gibson alleged commodities laws violations, at least one commentator has noted they need not have; Gibson “did not need the ... commodities laws for legal recourse against Bankers Trust ... as contract law and common-law fraud certainly applied.” In fact, the settlement was precipitated by the discovery of evidence which would have been the basis for a very strong com-

366. For a comprehensive description of the circumstances of this suit see Mayer, supra note 1, at 286-88.
367. Id. at 286-88, 312.
369. Romano, supra note 15, at 59 n.172. Not surprisingly, as a litigation strategy Gibson Greetings alleged every cause of action available in suing Bankers Trust, including securities and commodities laws violations. Id.
mon law fraud case.\textsuperscript{370} Ernest Patrikis, former general counsel and now first vice president of the Federal Reserve Bank of New York,\textsuperscript{371} dismisses the relevance of the Gibson suit to anything other than fraud.\textsuperscript{372} “The Gibson case,” according to him, “was fraud.”\textsuperscript{373}

In terms of consequences for Bankers Trust, in addition to settling Gibson’s monetary claim, the Federal Reserve Board of New York also exercised its authority and “in what is considered a severe disciplinary procedure,”\textsuperscript{374} executed a “written agreement” with Bankers Trust which required the bank to provide increased information to its swap customers, including daily valuation of their positions.\textsuperscript{375} Thus, while the CFTC may think otherwise, significant evidence suggests that CEA jurisdiction of the interbank market is unnecessary. Interbank market participants do not need the CFTC to assert claims for breach or fraud in an option transaction: as the Gibson Greetings example demonstrates such misconduct typically falls within the regulatory ambit of the federal banking agencies and in any case is clearly actionable under common-law fraud and contract law.\textsuperscript{376}

As noted above, this conclusion was apparent to Congress in 1974. Although the growth in the use of the currency option market, and indeed the derivatives market generally, is a relatively new phenomenon, the participants in these markets are as subject to supervision today as they were in 1974 when Congress passed the Treasury

\textsuperscript{370} The evidence came from tape recordings of BT’s sales staff’s discussion with and about Gibson Greetings. As one commentator has explained:

Trading rooms, like the Oval Office in the White House, are places where tape recordings of conversation are routine. Recordings are needed in the trading rooms because so many transactions are achieved over the telephone, without paper records or even computer verification. The tape machines capture everything a trader says, to his supervisors and colleagues and subordinates as well as to his counterparties. Thus we know that Bankers Trust routinely gave false information to Gibson about how much it was losing on the instruments the bank had tailored for the company.

In one remarkable instance, a BT salesman told Gibson that it would “not go further in the hole” by entering new positions when, in fact, Gibson immediately incurred an additional unrealized loss of approximately $4,954,000.

Mayer, \textit{supra} note 1, at 287-88. On another occasion, an employee of BT’s securities affiliate told his supervisor “I think that [Gibson] have a pretty good understanding of [their swap positions], but not perfect. And that’s like perfect for us.” \textit{Id.} at 288.

\textsuperscript{371} \textit{Id.} at 307.

\textsuperscript{372} \textit{Id.} at 312.

\textsuperscript{373} \textit{Id.} (emphasis in original).

\textsuperscript{374} Romano, \textit{supra} note 15, at 60.

\textsuperscript{375} Written Agreement by and Among Bankers Trust New York Corp. & Bankers Trust Co. & BT Securities Corp. & Federal Reserve Bank of New York, Nos. 94-082-WA/RB-HC et al., at 5 (Dec. 1994) (on file with the \textit{Fordham Law Review}); Romano, \textit{supra} note 15, at 60.

\textsuperscript{376} See Romano, \textit{supra} note 15, at 58 (drawing the same conclusion with regard to swaps transactions). As noted above, interbank market misconduct by a broker-dealer or investment company would be subject to the regulatory ambit of the SEC. \textit{See supra} part III.B.4.
Amendment as an expression of its belief that CEA regulation of the interbank market was "unnecessary." Indeed, "as problems in the banking industry deepened in the 1980s and 1990s, federal law gave increasing legal authority to the banking regulatory agencies to supervise the banking institutions for which they were responsible." Additionally, broker-dealer and investment company participation in the interbank market is subject to the SEC's substantial regulatory authority. Therefore, because participants in the interbank market remain "more properly supervised by the bank regulatory agencies"—or in the case of broker-dealers and investment companies, by the SEC—and in any case retain fraud and contract remedies, CFTC regulation would be a superfluous and an unnecessary threat to market efficiency. Thus, a new Treasury Amendment should exclude from CFTC jurisdiction all currency option transactions involving a counterparty already regulated by a federal banking agency or the SEC.

C. A New Regulatory Regime

As is apparent from the above, the jurisdictional battle associated with the Treasury Amendment controversy has been characterized by aggressive conduct on both sides of the issue. On one side of the debate, the Commission has frequently asserted jurisdiction with little statutory justification. On the other side the Interbank Industry has responded by making overblown predictions about the dire consequences of CFTC regulation. Notwithstanding such conduct, both the CFTC and the Interbank Industry have objectively reasonable requirements.

Undoubtedly, the CFTC should be able to prevent unscrupulous currency operators from defrauding unsophisticated retail customers. At the same time, banks, corporations, investment companies and other constituents of the Interbank Industry have the sophistication and financial means to protect themselves without CFTC assistance. Indeed, subjecting the Interbank Industry to the restrictions and legal uncertainty associated with CFTC regulation could be an unnecessary threat to the efficiency of domestic currency markets.

Thus, the Treasury Amendment, needs to be reformulated to incorporate a legal standard that would provide retail participants with the complete protection of the CEA while simultaneously providing a safe-harbor of maximum legal certainty for the Interbank Industry. It is worth noting that the lower court opinions in American Board of

378. Schroeder, supra note 357, ¶ 7.01[2].
379. See supra part III.B.4.
Trade, Salomon Forex, Standard Forex, and Dunn are all arguably representative of the judiciary's endeavors to achieve such a standard, although not through faithful adherence to the literal meaning of the current Treasury Amendment. As an alternative to what will likely be future judicial endeavors of that nature, this Note argues that Congress should act quickly to thoroughly reformulate the Treasury Amendment.

Currently, Congress is considering several proposed revisions of the Treasury Amendment. Two of these proposals provide for CFTC jurisdiction of currency option transactions, but carve out a safe-harbor for the Interbank Industry through use of the criteria articulated by the Swaps Exemption. As discussed above, the Swaps Exemption, with its numerous and complex criteria for determining eligibility, is simply not an appropriate regulatory tool for the dynamic nature of

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381. Both the CFTC and Congressman Thomas W. Ewing (R. Ill), have proposed revisions of the Treasury Amendment which would essentially use the criteria articulated by the Swaps Exemption to provide a safe-harbor from CFTC regulation. Congressman Ewing's proposal expressly uses the Swaps Exemption:

(ii) Nothing in this Chapter shall be deemed to govern or in any way be applicable to transactions in or transactions involving 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 to the general public for future delivery conducted on a board of trade. For purposes of this clause only, the term 'board of trade', as it applies to transactions in or involving foreign currency, means any facility whereby standardized contracts are systematically marketed to retail investors (other than individuals and entities described as eligible participants under the regulations of the Commission published in the Federal Register on January 22, 1993, as codified in section 35.1(b)(2) of part 35 of title 17, Code of Federal Regulations).


The CFTC's proposed amendment also uses the Swaps Exemption, although not expressly. See CFTC Proposal, supra note 245, at 3. The CFTC Proposal begins with a broad exclusion: "(I) Except as provided in clause (II) of this paragraph, nothing in this Act shall be deemed to govern... any transaction in or involving" foreign currency. Id.

The CFTC Proposal then limits that broad exclusion, with the following language: (II) If any transaction in or involving any defined financial instrument involves the purchase or sale of the instrument for future delivery or is an option... the provisions of the Act shall apply to such transaction if the transaction is (i) on an organized exchange or (ii) offered to or entered into by or with any person who is not an appropriate person.

Id. The term "appropriate person" is then defined as any person who would qualify for the Swaps Exemption under § 4(c)(3) of the CEA, as codified at 7 U.S.C. § 6(c)(3) (1994). Id.; see supra note 312.

The proposal advocated by this Note would be less onerous to the Interbank Industry than the regimes proposed by either Congressman Ewing or the CFTC. Those proposals use the Swaps Exemption as a mechanism for exempting the Interbank Industry from CFTC regulation. As is noted supra note 325 and accompanying text, the Swaps Exemption which articulates a complex set of criteria for determining eligibility is simply not an appropriate regulatory tool for the dynamic nature of the foreign currency trading environment.
the currency trading environment. A third proposal, Senate Bill 257 ("S. 257"), introduced on February 4, 1997 by Senators Lugar and Harkin, may offer some potential for a more satisfactory alternative.

1. Senate Bill 257

S. 257 begins by unambiguously excluding foreign currency option transactions from CFTC jurisdiction. In subclause (I), S. 257 states that: "Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in or involving foreign currency." To ensure that no confusion arises as to what constitutes a transaction "in or involving" foreign currency, S. 257 goes on to state that "For purposes of this clause, an 'option' shall be considered to be a transaction at the time it is purchased or sold and at the time, if any, that it is exercised."

Having established a broad exemption for transactions in foreign currency options, S. 257 crafts a limitation designed to ensure that the CFTC can protect the general public from the fraudulent marketing of currency options. Although S. 257 broadly excludes currency option transactions from the CEA, it sustains CEA jurisdiction over such transactions where they "involve the sale thereof to the general public for future delivery conducted on a board of trade." S. 257 defines the term "board of trade" as follows: "BOARD OF TRADE; FOREIGN EXCHANGE TRANSACTIONS—The term 'board of trade,' as applied to foreign exchange transactions described in subclause (I), shall include unsupervised entities that are engaged in the systematic marketing of standardized, non-negotiable foreign currency transactions to retail investors."

Standing alone, this definition of "board[s] of trade" as "unsupervised entities that are engaged in the systematic marketing of standardized, non-negotiable foreign currency transactions to retail investors" would seem to exclude Interbank Industry transactions in foreign currency options. As noted above, interbank market transactions are supervised by the federal banking agencies, or in the case of broker-dealer and investment company transactions by the SEC.

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382. See supra note 325.
384. Id. § 2(a)(1)(A)(ii)(I).
385. Id. As before, S. 257 also includes exemptions for "security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments." Id.
386. Id. § 2(a)(1)(A)(ii)(dd).
387. Id. § 2(a)(1)(A)(ii)(I).
388. Id. § 2(a)(1)(A)(ii)(aa). It is not clear why S. 257 uses the different terms, "retail investors" and "general public," to describe essentially the same thing.
389. Id. (emphasis added).
390. See supra notes 357-76 and accompanying text.
Such transactions are non-standardized, negotiable and are not systematically marketed to retail investors.\textsuperscript{391}

Unfortunately, S. 257's use of the term "shall include" indicates that a "board of trade" may encompass much more than just "un-supervised entities that are engaged in the systematic marketing of standardized, non-negotiable foreign currency transactions to retail investors." Indeed, the use of the verb "include" suggests strongly that the whole definition is merely one meaning for the term "board of trade." This makes S. 257, as a whole, susceptible to a reading that would provide for CFTC jurisdiction over the Interbank Industry.

S. 257 has other problems. In its definitional section, S. 257 directs the CFTC to define the terms "general public" and "retail investors," with the limitation that "the Commission shall not include in the definition of 'retail investors' a natural person with total assets that exceeds $10,000,000."\textsuperscript{392} If a $10,000,000 asset test were the only criterion necessary to determine eligibility for exemption from CFTC jurisdiction, S. 257 would seem to manifest an appreciation of the procedural realities of the foreign currency trading environment. Such a test would be considerably easier to apply than the numerous and complex criteria provided by the Swaps Exemption.\textsuperscript{393} A $10,000,000 asset test would also have substantive appeal: It would provide an effective means to distinguish between individuals like Mr. Tauber, who do not need CFTC protection, and the unsophisticated retail investors, like those defrauded in Standard Forex, who do.

Under S. 257, however, an asset test may not be the only criteria used to determine currency option transactions' eligibility for exclusion from the CEA. As noted above, under S. 257 it is the CFTC that would determine eligibility for such exclusion.\textsuperscript{394} Indeed, because S. 257 suggests that in determining eligibility the CFTC should take into account the criteria articulated by the Swaps Exemption,\textsuperscript{395} it is quite possible that the Interbank Industry would face the prospect of having to apply each of the Swaps Exemption's criteria to each transaction in order to avoid the threat of unenforceability.\textsuperscript{396}

Subclause II of S. 257 would create further uncertainty. Standing alone, subclause (II) emphasizes that CEA jurisdiction over foreign currency should be distinct from that of inter alia, the federal banking agencies and the SEC:

\textsuperscript{391} See supra note 1 for a discussion of OTC derivatives transactions.

\textsuperscript{392} S. 257, 105th Cong., 1st Sess. § 2(a)(1)(A)(ii)(cc) (1997). A $10,000,000 asset-test per natural person is one of the Swaps Exemption's criteria for determining eligibility. \textsuperscript{See supra note 316.}

\textsuperscript{393} See supra note 325 and accompanying text.


\textsuperscript{395} \textit{Id.}

\textsuperscript{396} As is discussed at supra part III.B.3.b, the Swaps Exemption is not an appropriate regulatory tool for the dynamic nature of the foreign currency trading environment.
(II) OTHER AGENCIES—Nothing in subclause (I) shall affect the powers of the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Department of the Treasury, the Federal Deposit Insurance Corporation, any agency of State government with the authority to charter, regulate, or license banks, or any State insurance regulatory agency, under this Act or any other provision of law.397

The intended significance of subclause II, within the context of S. 257 as a whole, is unclear. Subclause II could be construed to mean that interbank market transactions which do not involve the "general public" or "retail investors" as ultimately defined by the CFTC,398 are excluded from the CEA and instead remain subject to the exclusive jurisdiction of the federal banking agencies and the SEC. Because such a reading allows for potentially broad CFTC jurisdiction over interbank market transactions—it is, after all, the Commission that would define the terms "general public" and "retail investors"—it would not satisfactorily address the need of the Interbank Industry to be free from the threat of CFTC regulation. On the other hand, subclause (II) could conceivably be intended to mean that the CFTC cannot, under any circumstances, assert jurisdiction over an interbank participant who is already regulated by a federal banking agency or the SEC—even where that participant engages in transactions with the "general public" or "retail investors" as ultimately defined by CFTC.399 Although that reading would address the Interbank Industry's real need to be free from the threat of CFTC regulation, it is not necessarily supported by the literal meaning of S. 257 as a whole. As such, subclause II, and indeed S. 257 in its entirety, fail to provide an exclusion of sufficient legal certainty for the Interbank Industry.

2. Toward an Ideal Alternative

Although in many respects S. 257 lacks the clarity necessary to achieve an ideal alternative to the current Treasury Amendment, it

397. S. 257, 105th Cong., 1st Sess. § 2(a)(1)(A)(ii)(II) (1997). Subclause II's reference to the SEC could give rise to another jurisdictional battle over the regulatory status of currency options. Because in Dunn the Supreme Court declined to expressly address the issue of whether the investment contracts involving the sale of foreign currency options could in some circumstances constitute "securities," S. 257 could conceivably provide a future basis for SEC assertion of jurisdiction over Interbank currency option transactions which are already regulated by the federal banking agencies. For a discussion of the investment contract issue raised by the Dunn case see supra note 212.


399. This may well be the intended meaning of subclause II. See Aaron Lucchetti & Jeffrey Taylor, Bid to Overhaul Futures Trading Sparks Debate, Wall St. J., Feb. 18, 1997, at C21 (noting that S. 257 "urge[s] that the CFTC's jurisdiction in these markets be limited to off-exchange products that aren't regulated by other government arms but that are offered to the general public.").
does help to identify several useful principals for reform. It does so by highlighting the requirements necessary to adequately reconcile the legitimate needs of both the Interbank Industry and the CFTC. An ideal regulatory regime would have three essential characteristics.

First, it would contain a broad exclusion from CFTC regulation for Interbank Industry transactions in foreign currency options. Second, it would clearly proscribe CFTC interference with Interbank participants where those participants are already regulated by the federal banking agencies or the SEC. Third, an ideal regulatory regime would establish a bright-line, facile test for determining when CFTC jurisdiction over currency option sales to unsophisticated investors is appropriate.

The Treasury Department has proposed a revision of the Treasury Amendment which would essentially incorporate all three of these characteristics (the “Treasury Proposal” or the “Proposal”). The Treasury Proposal begins by prohibiting the CFTC from even asserting jurisdiction over foreign currency transactions, including options, unless those transactions take place on an organized exchange:

(ii) Except as provided for in subsection (iii), this chapter shall not apply to and the Commission shall have no jurisdiction over transactions in or in any way involving foreign currency, unless the transaction is a contract for future delivery and is conducted on an organized exchange.

The Proposal goes on to provide that in addition to jurisdiction over organized exchanges, the Commission would retain anti-fraud jurisdiction over “transactions in or in any way involving foreign currency

401. Id. § 2(a)(1)(A)(ii). The Treasury Proposal also provides that:
This chapter shall not apply to and the Commission shall have no jurisdiction over transactions in or in any way involving security warrants, security right, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless the transaction—(I) is a contract of sale for future delivery, or an option on either a future or a commodity that is not a security, and (II) is conducted on an organized exchange.

402. To respond to the uncertainties created by the Standard Forex holding, as discussed supra part III.A.2.b, the Treasury Proposal supplies a detailed definition of the term “organized exchanges.” That definition provides in pertinent part:
(a) Except as otherwise provided in this subclause, the term “organized exchange” means—
(1) a board of trade designated by the Commission as a contract market or a physical or electronic market place or similar facility affiliated with board of trade designated as a contract market, or
(2) a physical or electronic market place or similar facility through which unaffiliated persons, for their own accounts or for the accounts of their customers, enter into and execute arms' length binding transactions by accepting bids and offers made by one person that are open to all persons who conduct business through such a market place or similar facility.
if the transaction is a contract of sale for future delivery or an option and is conducted between any unregulated person and a retail customer.\textsuperscript{3}\textsuperscript{4}3

In defining the terms “unregulated person” and “retail customer,” the Treasury Proposal crafts a bright-line test for determining CFTC jurisdiction. The Proposal defines an “unregulated person” as any person who is not currently regulated by one of the federal banking agencies or is not a broker-dealer or investment company regulated by the SEC.\textsuperscript{4}4\textsuperscript{4}4 Borrowing two exemptive criteria from the SEC’s Regulation D,\textsuperscript{4}0\textsuperscript{4}0 the Treasury Proposal then defines the term “retail customer” as any natural person with a net worth above $1,000,000 or with an annual income in excess of $200,000 (or $300,000 when combined with one’s spouse).\textsuperscript{4}0\textsuperscript{6}

Through these definitions, the Treasury Proposal would seem to provide an easily administered test for determining whether a particular transaction is subject to the CEA: For transactions between entities that are regulated by the federal banking agencies or the SEC, and natural persons whose net worth exceeds $1,000,000, or whose annual income is in excess of $200,000 the CEA does not apply and

\begin{itemize}
  \item[(b)] Notwithstanding subclause (a), the term “organized exchange” does not include—
  \item[(1)] parties engaged in privately negotiated bilateral transactions, even if such parties use electronic means to communicate or execute transactions . . . .
\end{itemize}

\textit{Id.} § 2(a)(1)(A)(v)(IV). This definition, in the Treasury's view “clarifies that entities engaged in the business of buying or selling Treasury Amendment instruments, such as banks, broker-dealers, futures commission merchants, and government securities dealers and brokers, will not be deemed to be organized exchanges; rather, the definition includes entities that serve as a marketplace for arms' length transactions.” \textit{Id.} commentary at 6.

\textsuperscript{4}0\textsuperscript{3}3 \textit{Id.} § 2(a)(1)(A)(iii) (emphasis added); see 7 U.S.C. §§ 6b, 6o (1994) (granting the CFTC the authority to proscribe fraudulent conduct in activities governed by the CEA).

\textsuperscript{4}0\textsuperscript{4}4 Treasury Proposal, \textit{supra} note 241, § 2(a)(1)(A)(v)(I). The Treasury Proposal also exempts affiliates of regulated persons, but only to the extent that the affiliates conduct exempted transactions through regulated persons. \textit{See id.}; \textit{see also} 12 U.S.C. § 3902 (defining the federal banking agencies); 15 U.S.C. § 78c(a) (defining a broker-dealer as regulated by the SEC); 15 U.S.C. § 80a-8 (defining an investment company as registered under the Investment Company Act of 1940). For a discussion of the role of the federal banking agencies and the SEC in regulating the Interbank Industry see \textit{supra} part III.B.4-5. As is discussed at \textit{supra} note 397, with regard to S. 257, the Treasury Proposal’s reference to the SEC could give rise to another jurisdictional battle over the regulatory status of currency options. Because in \textit{Dunn} the Supreme Court declined to expressly address the issue of whether the investment contracts involving the sale of foreign currency options could in some circumstances constitute “securities,” the Treasury Proposal could conceivably provide a future basis for assertion of SEC jurisdiction over Interbank currency option transactions which are already regulated by the federal banking agencies. For a discussion of the investment contract issue associated with the \textit{Dunn} case see \textit{supra} note 212.

\textsuperscript{4}0\textsuperscript{5}5 \textit{See} 17 C.F.R. § 230.501 (1996) (defining a class of sophisticated investors for whom the full protections of federal securities regulation is considered unnecessary).

\textsuperscript{4}0\textsuperscript{6}6 Treasury Proposal, \textit{supra} note 241, § 2(a)(1)(A)(v)(II).
the CFTC may not assert jurisdiction. Conversely, where a transaction is between any entity unregulated by the federal banking agencies or the SEC, and a natural person with net worth of less than $1,000,000, or with less than $200,000 in annual income the CEA applies and the CFTC has jurisdiction. Although there may be some disagreement over whether the jurisdictional threshold established by this test is appropriate, the test itself appears sufficiently facile to satisfy the requirements of the fast-paced currency trading environment. Certainly, it offers a more practical alternative to the Swaps Exemption. At the same time, the test would allow the CFTC to regulate the sale of currency options to the unsophisticated general public. Significantly, the CFTC's enforcement actions in American Board of Trade, Dunn and Standard Forex involved currency transactions between unregulated entities and retail customers as defined by the Treasury Proposal.

As such, the Treasury Proposal's jurisdictional test, together with its provisions for proscribing CFTC interference with the interbank market, would seem to come close to achieving an ideal regulatory regime. With such a regime in place, courts would no longer have to reach strained readings of the Treasury Amendment in order to achieve equitable results. All three of the cases which have reached such strained readings, namely American Board of Trade, Dunn, and Standard Forex, did so in circumstances involving transactions between what the Treasury Proposal defines as unregulated entities and retail customers which would remain subject to CFTC jurisdiction. Under the Treasury Proposal, the strained interpretations of the Treasury Amendment reached by these courts would not have been necessary: The CFTC would have had the jurisdiction necessary to redress the fraud involved. At the same time, the Interbank Industry would have been secure in the knowledge that because it is already regulated by the federal banking agencies or the SEC, its currency option transactions would remain free from CFTC regulation.

407. Because the Treasury Amendment's jurisdictional test is based on the SEC's Regulation D, 17 C.F.R. § 230.501 (1996), a strong argument could be made that it is appropriate. If the SEC believes that natural persons with net worth in excess of $1,000,000, or with annual income in excess of $200,000 are sufficiently sophisticated to be able to protect themselves without the full protection (or the encumbrances) of the securities laws, there would seem to be little justification for arguing that the same persons need the regulatory protection (or the encumbrances) of the CEA. For example, Dr. Tauber, the principal protagonist in the Salomon Forex litigation whose net worth exceeded $1,000,000 and who would therefore have qualified for the Treasury Proposal's exemption from the CEA, could not reasonably be characterized as someone in need of the CEA's protection. See Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 975 (4th Cir. 1993); supra part II.B.

408. For a discussion of the practical requirements of foreign currency traders see supra part III.B.3.

409. For a discussion of the Swaps Exemption see supra part III.B.3.b.

410. For a discussion of these enforcement actions see supra parts II and III.A.2.a.

411. For a discussion of these cases see supra parts II and III.A.2.a.
Conclusion

As the derivatives markets have expanded they have posed tremendous definitional challenges to preexisting regulatory regimes. The preexisting regulatory scheme created by the Treasury Amendment has proved inadequate to cope with the subsequent development of the interbank market in currency options. Thus, as it is currently formulated, the Treasury Amendment is inherently flawed. As a result, courts will continue to reach strained readings of the Treasury Amendment unless it is revised in a manner that reconciles the legitimate needs of the Industry with the equally legitimate needs of the CFTC. Although in Dunn the Supreme Court resolved the issues associated with the conflicting interpretations of the term “transactions in foreign currency,” the recently emerged conflict between the Standard Forex and Frankwell Bullion courts’ interpretations of the term “board of trade” threatens to prolong the Treasury Amendment controversy indefinitely. Indeed, that conflict indicates that decisions in this area will continue to be made on an ad hoc basis, a situation offering little predictive value to a market which demands legal certainty.

Clearly, a legislative revision of the Treasury Amendment is necessary. As an alternative to the current Treasury Amendment this Note proposes a regulatory regime with three essential characteristics. First, an ideal regulatory regime would unambiguously exclude Interbank Industry transactions in foreign currency option transactions from CEA jurisdiction. Second, it would proscribe CFTC interference with Interbank participants where those participants are already regulated by the federal banking agencies or the SEC. Third, an ideal regime would establish a bright line, facile test for determining when CFTC jurisdiction over currency option sales to unsophisticated investors is appropriate. Because the Treasury Proposal would seem to incorporate all three of these characteristics, it, rather than the other proposals currently being considered by Congress, should form the basis of any new regulatory regime.