

# High Court Rules Against CFTC in Options Case

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By EDWARD FELSENTHAL  
And AARON LUCCHETTI

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The Supreme Court, in a blow to federal regulators, ruled unanimously that "over-the-counter," or off-exchange, trading of foreign-currency options isn't subject to oversight by the Commodity Futures Trading Commission.

The law regulating commodities exchanges says the CFTC has no jurisdiction over "transactions in foreign currency" that aren't conducted through an exchange or board of trade. In using that language, Congress meant to exclude over-the-counter options trading from CFTC oversight, the high court said yesterday.

The case, *Dunn vs. CFTC*, pitted regulators against companies that want to attract individual investors to the burgeoning world of foreign-exchange trading. The CFTC wanted to extend its oversight out of concern that unscrupulous operators would try to defraud investors.

"While we are disappointed in the outcome in the case, we note that the Supreme Court's decision was limited to the narrow issue of whether the Treasury Amendment treats futures and options the same," said Dan Waldman, general counsel for the CFTC, in a statement. "The opinion does not address many of the broader policy issues . . . currently being

considered by Congress."

In Congress, both the House and Senate are considering bills to clarify and pare back some rules applied in the commodity futures markets. Industry officials and futures exchanges have lauded most parts of the proposed legislation as a way to reduce costs and to enhance the competitive stance of U.S. exchanges, which have been losing market share in recent years to the less-regulated over-the-counter interbank market. Regulators have warned, however, that the bill removes safeguards that protect the public from losing money in complex derivatives transactions.

Representatives of the futures industry welcomed the Supreme Court ruling. "This should lend stability and legal certainty to the foreign-exchange market," said Jack Gaine, general counsel for the Managed Futures Association, a Washington, D.C., trade group.

Many traders and dealers contend that over-the-counter, or "off-exchange," transactions in currency options take place in a highly sophisticated market that shouldn't be subject to CFTC oversight. A number of big banks and trade associations argued in friend-of-the-court briefs that oversight would impose significant costs for buyers and sellers and would raise uncertainty about whether billions of dollars in currency options contracts are enforceable.

But exchanges said the decision makes the regulatory playing field less even. "The Supreme Court decision makes even

more important legislation now in the House and Senate that would give us the freedom to compete," said Thomas R. Donovan, president and chief executive of the Chicago Board of Trade, the busiest U.S. futures exchange.

The case, "opens up the possibility for a bucket shop to be totally exempt from regulation," said Jack Sandner, chairman of the Chicago Mercantile Exchange. "The Supreme Court was constrained to interpret language" of the current Treasury Amendment, he added.

The case was an appeal by hedge-fund operator William Dunn, who was accused of being part of a scheme that allegedly bilked customers of \$180 million. The CFTC sued Mr. Dunn in federal court in New York in 1994, charging that he misled investors and siphoned at least \$19.5 million to Swiss accounts shortly before his scheme unraveled. Gary Stumpp, an attorney who represented Mr. Dunn in the case, denied the government's allegations of fraud, and said his client hasn't done anything improper.

The major legal issue that arose at a preliminary stage of the case was whether the Commodity Exchange Act covers the sort of transactions Mr. Dunn engaged in — namely, off-exchange trading in foreign-currency options. Federal trial and appellate courts in New York said the CFTC could regulate these transactions under the act. Indeed, the appeals court said that based on the evidence compiled, Mr. Dunn appeared to have "engaged in an old-fashioned 'Ponzi' scheme."

But the Supreme Court reversed the lower-court decisions, saying the federal law didn't intend to include such options under CFTC's jurisdiction. The CFTC conceded that it doesn't have jurisdiction over off-exchange foreign-currency futures, arguing that an option isn't technically a "transaction in foreign currency" because it generates only the right to

engage in a transaction.

But Justice John Paul Stevens called that argument "wholly unpersuasive," in his opinion for the court. Justice Stevens, back on the bench after being hospitalized last week for a heart procedure, acknowledged the CFTC's claim that options are "particularly susceptible to fraud and abuse." But he said such concerns "are properly addressed to the Congress, not the courts."