December 9, 2003

Ms. Jean A. Webb, Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: U.S. Futures Exchange, L.L.C. Application for Contract Market Designation

Dear Ms. Webb:

On November 18, 2003, U.S. Futures Exchange, L.L.C. (Eurex US) filed with the Commission a letter response to the comment letters filed by the Board of Trade of the City of Chicago and others. Some of the information contained in the Eurex US response is new or raises new issues or areas of confusion. The Board of Trade therefore requests an opportunity to file this comment letter to supplement the record and highlight these areas for the Commission.

I. Statutory Requirements.

The Board of Trade has urged the Commission to apply the statute as written to the Eurex US application. That approach reveals multiple deficiencies in the Eurex US application described in the Board of Trade's comment letters and congressional testimony. In two areas, the Eurex US response has been to attempt to refute the Board of Trade's statutory analysis: the Commodity Exchange Act's requirements that an applicant board of trade make public its known contract terms and conditions and the Commission's duty to conduct a cost-benefit analysis. In both instances, Eurex US has asserted a position, but has ignored the actual text of the statute's provisions. That failure confirms the weakness of the legal position Eurex US asks the Commission to adopt.

The Supreme Court has made clear

- you start any statutory analysis with the language of the statute;
- you apply the statute's terms as written; and
- if the conclusion based on those terms is clear, that is the end of the analysis.

Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A. 530 U.S. 1, 7 (2000)(Scalia, J.) citing Connecticut Nat. Bank v. Germain, 503 U.S. 249, 254 (1992) and *United States v. Ron Pair Enterprises Inc.*, 489 U.S. 235, 241 (1989).

Eurex US claims (p. 5), however, it does not need to file any contract terms and conditions with its application; instead, Eurex US contends it only needs to make contract terms publicly available once it has been granted contract market designation. The statute says otherwise. Congress made it a criteria of designation that "The board of trade shall provide the public with access to the rules, regulations and contract specifications of the board of trade." CEA § 5(b)(7).

Since Eurex US does not discuss the statute's text, it does not explain what part of the words "the board of trade shall provide the public with access to the …contract specifications of the board of trade" allows it to deny the public access to its contract specifications. Ironically, Eurex US has made public its rules and regulations, but not its contract terms. The only explanation it offers is that it reads the statute to make the "provide the public with access" requirement applicable only once a board of trade has become a designated contract market (p. 5), a position that might make sense if the statute did not unambiguously impose its requirement on the applicant "board of trade," not an already designated contract market (CEA § 5(b)(7)). Moreover, the requirements for a designated contract market are found in the core principles section of CEA § 5(d), not the designation criteria in CEA § 5(b). In short, Eurex US's claim that the requirement applies only to an already designated contract market and that an applicant must just show that it could make its contract specifications public is contradicted by the terms of the statute. Those terms govern. Eurex US has not complied with this designation criteria.

The excuse Eurex US offers for why it can't disclose those specifications is most disingenuous. It claims (p.5) that its competitors would benefit from learning what terms and conditions it plans to offer. But Eurex US has said it would trade two kinds of contracts: 1) contracts it trades now in Europe and 2) contracts the Board of Trade now trades. The specifications for both are already public and hardly a commercial secret. Thus, Eurex US should have no commercial or other credible reason for withholding the terms of the contracts it intends to offer.

Eurex US also claims (p.12) the CFTC is not required to conduct a cost-benefit analysis before it issues a contract market designation order. Again, it never invokes the statute's terms. That must be because the statute imposes the cost-benefit analysis requirement generically on the Commission "before issuing an order," with specific and limited exceptions not applicable here. See CEA § 15(a). Unless the CFTC finds that orders on contract market designation fit within one of the statutory exceptions, the statute leaves the CFTC no choice but to conduct a cost-benefit analysis of the issues raised by the application. By not mentioning the

statute's actual language in any way, Eurex US confirms that a correct reading of the statute imposes this cost-benefit obligation on the Commission.

II. Delegation Issues.

Some confusion seems to exist about what constitutes a delegation by a contract market of a self-regulatory function. Eurex US adopts the Commission's formulation (p.16 n16) that if a contract market enters into a contract for a third party's assistance in performing a self-regulatory function, but that contract market retains "decision-making authority" over that self-regulatory function, then the contract market has not "delegated" the function under the statute. Based on this formulation, apparently, National Futures Association claims that it may, under its corporate charter, perform the duties it has contracted to perform for Eurex US because it will not exercise "decision-making authority" for Eurex US.

Others do not seem to agree. For example, the Futures Industry Association in its recent congressional testimony on this subject stated (p. 6): "FIA supports [Eurex U.S.'s] decision to delegate these responsibilities to NFA." FIA even cites CEA § 5c(b) as authorizing such delegation. NFA's congressional testimony, for its part, is sprinkled with references to "Delegations by Contract Markets" to NFA under Regulatory Services Agreements with four other contract markets and then mentions its negotiations relating to Eurex US.

Eurex US's November 18 letter exacerbates this confusion by declaring (p. 15), "NFA, together with the Exchange's own staff, will monitor trading to prevent manipulations, price distortions, and disruptions of the delivery or cash-settlement process." Is "monitoring trading" "exercising decision-making?" It would seem to be logical that monitoring trading for trading abuses involves some decision-making. The fact that the issue is unresolved suggests some clarification of NFA's role and its legal obligations should be made on the record.

The Eurex US letter also refers euphemistically to "corporate affiliates" that will "carry out a number of non-regulatory functions" (p.16). The designation application twice refers to Eurex Frankfurt, the parent of the applicant, as performing certain "market supervision" functions for Eurex US. Having Eurex Frankfurt perform those market supervision functions, as stated in the Eurex US designation application, would result in Eurex Frankfurt performing a self-regulatory function that the statute does not allow a non-CFTC registrant to perform (CEA § 5c(b)). No one seems to argue in this instance with the words of the statute; everyone agrees Eurex Frankfurt is ineligible to be a delegate under CEA § 5c(b). The only question is what "market supervision" will the parent organization perform and does that constitute a delegated self-regulatory function under the statute? The November 18 letter sheds almost no light on this question. By calling the Eurex Frankfurt "market supervision" a "non-regulatory function," Eurex US has offered a counter-intuitive rationalization that appears to be more double-talk than straight-talk.

The issue is whether an applicant board of trade's corporate parent is being delegated a self-regulatory function under CEA § 5c(b) when the corporate parent agrees to perform "market supervision" and other functions. If so, Eurex Frankfurt will be an illegal delegate. Eurex US's November 18 letter offers no explanation of the "market supervision" Eurex Frankfurt would perform and no justification for why Eurex Frankfurt should be allowed to perform that "market supervision."

Most alarmingly, no matter who or what is a delegate, the Eurex US response neglects completely the central and overriding question: how will it police the "call around market" for options trading and the other "off-trading platform" type of trading Eurex US intends to offer as it does in Europe? While Eurex US may well intend to develop new software eventually that will allow increased options trading to be conducted on the trading screen, Eurex US has offered no evidence that it will be able to use and rely upon that software when it plans to begin operations. Thus, Eurex US and its delegates (or contractors) have not shown how they would police and self-regulate the expected off-screen trading activity which in Europe accounts for approximately 250 million contracts annually.

III. False Claims.

The Eurex US letter states (p. 14): "The Eurex Trading Platform offers all users a fair and transparent market. Members do not have any special access to trade information and no member has an informational advantage over any other member arising from the trading platform." This is a claim Eurex US has made to Congress, in press materials and even to the Commission. It is a fine sentiment, but it is also not true. The Eurex US rules and the history of its affiliates' trading in Europe (confirmed by the comment letter filed by DRW Holdings with the Commission, a comment letter Eurex US completely fails to address) demonstrate that some Eurex US members will have "special access" and an "informational advantage."

No one can seriously argue that participants in block trades on Eurex US will not have "special access to trade information" and an "informational advantage." Certainly any member who engages in a block trade or any other form of off-screen transaction on Eurex US has an informational advantage. Those members know about large trades that have been entered into in secret at prices that by definition deviate from the public market price, and in contrast to other exchanges, may even do so through unfair and unreasonable pricing practices. And these members are then perfectly free to trade on the basis of that secret information on the Eurex US central trading platform.

For block trading that informational advantage may last at least as long as 15 minutes and perhaps longer depending on what the term "promptly" means in the Eurex US Block Trading Rule 415 (i). After a Eurex US block trade is consummated, a buyer in the block trade must report the trade to the Eurex US Block Trading Facility and then a seller has 15

minutes to confirm the transaction. Only then must Eurex US itself confirm the transaction and disclose it publicly "promptly" under its rules (apparently including all relevant terms). In the interim, of course, the buyer, the seller, a member of Eurex US acting as broker for either or both, or someone any of these parties tips off knowing that the block trade is about to be announced, could trade with others who don't know about the block trade.

Significantly, nothing in Eurex US's rules prohibit members or persons affiliated with, or tipped off by, members, from trading on the trading platform while they have this "special access" or "informational advantage." The DRW Trading comment letter confirms that this kind of trading ahead of public disclosure of large trades based on special information can have adverse consequences for market transparency and fairness. About 90% of the Eurex options trading in Europe occurs in these opaque private off-order book transactions. If that practice will continue even to a more limited extent on Eurex US, the accepted statutory goal of market transparency as embodied in open price discovery and price dissemination will be seriously compromised. See CEA § 3.

The Board of Trade's market integrity itself could be seriously compromised to the extent that Eurex US will attempt to clone Board of Trade Treasury security markets and skim off market share through these trades. Eurex US offers no hint at how it could prevent this kind of damage to the integrity of the CBOT's markets or the CBOT's decision not to allow this kind of informational advantage on its markets.

Once again, the claims made by Eurex US and the reality of its market rules and practices do not measure up. Its recent submission continues this alarming pattern.

IV. Exchange Incentive Programs; No Defense of the Top Ten Contests.

The November 18 letter states that Eurex US "will be adopting volume discount and revenue rebate plans that reduce the costs of transacting business on its market." No one has said Eurex US could not adopt those plans to the extent they are like the programs existing exchanges have adopted in the past. If that is all Eurex US plans to do, its incentive programs raise no new or difficult issues, conceptually.

By its silence, the November 18 letter suggests that Eurex US has abandoned plans for its much-criticized Top Ten contests. The only issue has been whether Eurex US should be able to award a significant percentage of its annual revenue to traders and brokers that engage in enough transactions to qualify for the top ten in each category. Substantial market integrity and customer protection issues would be raised by such a program. But if Eurex US is not going to run its Top Ten contest, as its November 18 letter suggests, those issues would be moot. The Board of Trade believes the Commission should ascertain the true Eurex US business plan and make certain that, if approved as a contract market, Eurex US will only self-certify and

offer incentive programs within the parameters of those that the Commission has approved previously.

V. Misappropriation of Surveillance Data.

During the November 6, 2003, oversight hearing before the House Agriculture Committee, it was discussed that a person controlling an exchange, but not an exchange employee or member, could become privy to and misuse confidential surveillance information without violating the CEA. Eurex US seems to be sensitive to this point. It says (p.11) it will "obtain commitments from employees of affiliates performing regulatory services that they will not trade on inside information …." That pledge falls far short of closing the statutory loophole and is facially inadequate, in any event. The statement covers only a) affiliates, not the parent corporation; b) those performing regulatory services (leaving it unclear whether this applies to Eurex Frankfurt employees since Eurex US claims they won't be performing regulatory services); and c) trading on inside information, not disclosing it to others. Thus, the effort by Eurex US to assuage concerns in this area falls well short of the goal of preventing misuse of surveillance data.

Moreover, Eurex US contends that misuse of market data is less of a concern for its market since the contract market is "owned and controlled by neutral and independent exchange operators." In the first place, no one seems to know who will own Eurex US -- its offering of equity in the exchange apparently is ongoing. According to its own statements, however, Eurex US has or will offer equity in its exchange to market participants, not neutral operators. (See Eurex PowerPoint Presentation to Media on September 16, 2003.) In the second place, Eurex Frankfurt, the ultimate parent company of the exchange, is operated by a board of supervisors comprised of German banks and others that cannot be characterized as "neutral and independent exchange operators." Many of those firms have a direct proprietary stake in the markets Eurex US will trade. That is why the concern about abuse of surveillance data is so significant.

Short of a statutory change to fix the loophole in the CEA § 9(e), the CFTC may want to consider adopting the following condition on the designation of Eurex US:

> " No employee, board member or board member's firm of Eurex US or any of its affiliates, or corporate parents or owners thereof, may trade on the basis of confidential information obtained as a result of any self-regulatory activity of Eurex US or disclose such information to any other person for any reason except the performance of an official self-regulatory duty of Eurex US. Any such board member or a board member's firm that enters into or intends to enter into trades on Eurex US must disclose its identity to the CFTC and to any DCM or DCO

> trading or clearing any identical products and consent to CFTC jurisdiction before doing so."

This policy will at least allow the CFTC and US self-regulatory organizations to monitor and scrutinize any potential abuse of market surveillance in this area. Of course, in addition to imposing a condition on a Eurex US designation, the CFTC could consider adopting a new regulation aimed at dealing with the same problem on other exchanges with an ownership structure similar to Eurex US.

VI. A Complete Application.

The Commission has told Congress that a contract market designation applicant must file an application reflecting its "current business plan." (Chairman Newsome October 27, 2003 letter to House Agriculture Committee Chairman Goodlatte, p. 2.) Eurex US has not complied.

For at least six months, Eurex US has told the world that the clearing link allowing Eurex US contracts to be cleared in Germany was a part of its current business plan. That plan also includes a trading link whereby fungible trading of contracts will be allowed on Eurex US and Eurex. In fact, in a July 14, 2003, letter to the Commission, Eurex itself stated: "the parties have agreed that Eurex Clearing AG and Clearing Corporation will establish a clearing link."

Eurex US believes that no matter what it says publicly or privately to entice investors to its markets, its planned clearing and trading links do not need to be part of its application and, most importantly, the Commission may not consider those much advertised links as part of the application. This "out of sight out of mind" approach to government licensing is not consistent with the basic notions of sound government oversight embodied in the CEA § 3. A bait and switch application strategy is no way to serve the statutory public interests in effective self-regulation. Why should the CFTC consider a business plan that Eurex US has repeatedly said publicly it intends to supersede before it starts operations on its announced target date of February 1, 2004? Eurex US does not offer any answers to that basic question.

Instead, the Eurex US response hides behind the façade that The Clearing Corporation is an independent company over which Eurex has no influence and the clearing link involves only TCC and Eurex Clearing, not Eurex US (see pp.5-6). This form over substance argument asks the CFTC to ignore: 1) the 15% ownership interest Eurex now has in TCC; 2) the fact that Rudolf Ferscha who was identified to Congress as the man ultimately in charge of Eurex US is now a member of the Board of Directors at TCC; 3) Eurex US and Eurex Clearing are affiliates, both owned by Eurex Frankfurt; 4) TCC announced well over a month ago that the clearing link negotiations were close to fruition and TCC shareholders would be able to review

details of the link on October 20 and 5) Eurex and TCC have maintained publicly and consistently for over three months (and as recently as November 6, 2004) that its clearing link will be operational by February 1, 2004, less than two months from now.

Eurex US has a choice; either include the clearing link in its pending application so the CFTC can consider the merits of the current business plan or advise the public that it has decided not to pursue the link for a reasonable period of time. If a link is part of Eurex US's current business plan, then it is extremely pertinent to the statutory review period granted to the Treasury Department and the Federal Reserve Board on any plans to trade futures on U.S. Treasuries. Those agencies should not be asked to consider U.S. Treasury contract specifications and proposed exchange rules against this kind of confusing backdrop.

The attached December 2, 2003, Eurex US and TCC presentation to prospective investors, members and customers continues unabated the clearing link representations. Products are referred to as "Traded on Eurex US and Cleared Through the Link." TCC refers to "Our Clearing Solution" explaining that "Eurex customers worldwide can choose Eurex Clearing or C Corp to clear Eurex U.S. products." Moreover, Eurex US's presentation misrepresents its legal status: "Eurex U.S. is a U.S. registered exchange, fully regulated by the Commodities (sic) Futures Trading Commission…." That may be true someday, but today it is not. The Commission would not tolerate any applicant for registration as a futures trading professional misrepresenting its registration status in that manner.[1] No reason exists to be more tolerant of an entity aspiring to become an effective self-regulatory organization under the auspices of the CEA and CFTC.

The corporate governance area is another area of application incompleteness. While the application was filed on behalf of a corporation with a single-man board of directors, Eurex US claims it will operate with a balanced board of diverse and qualified members. The CEA requires more from an applicant than "trust me." Eurex US should be required to provide some detail on who its board members will be and how they will be selected. After all, that board will be responsible for complying with the designation criteria, core principles and other

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[1] *See, e.g.*, Maloley v. R.J. O'Brien & Assocs., [Tr. Binder 1987-1990] Comm. Fut. L. Rep. ¶ 24,293 (CFTC 1988) (essential person liable for having misled experienced investor about registration status); Herzig v. British American Commodity Options Corp. [Tr. Binder 1977-1980] Comm. Fut. L. Rep. ¶ 20,936 (CFTC 1979) (explaining that when commodity professionals "have solicited customers to invest and, in doing so, have misrepresented their registration status…we will not hesitate to find them in violation of" the CFTC options antifraud rule). Cf. Morris v. Commodity Futures Trading Comm'n, 980 F.2d 1289, 1292 n.1 (9th Cir. 1992) (dicta) (stating that a commodity professional's "failure to reveal his own registration status would be a material misrepresentation").

statutory requirements. Revealing their identity and firm affiliations would allow the public and the CFTC to deal with the many corporate governance issues raised by the House Agriculture Committee at its oversight hearing on November 6, 2003.

VII. Fair Trade.

In attempting to deal with any concerns about foreign ownership of a U.S. self-regulatory organization, Eurex US offers platitudes and generalizations. In its only substantive claim, it cites (p. 9) the ability of foreign-owned primary dealers to buy and sell U.S. government securities directly from the Federal Reserve Bank. (On page 10, Eurex US invokes the example of Nasdaq Deutschland in support of its claim of reciprocity. Nasdaq Deutschland, however, was 50% owned by German banks and German exchanges.)

Eurex US leaves out one key fact. The Primary Dealer Act of 1988 requires that any foreign applicant for primary dealer status must show that its home country would allow U.S. banks to underwrite that country's government debt on the same terms as applicable to the banks residing in that country. In short, foreign primary dealers may be approved in the U.S. only if their home country will reciprocate for U.S. banks.

Eurex US has not shown, however, that U.S. exchanges seeking to expand their operations in the European Community, Switzerland or Germany would be afforded reciprocal, fair trade treatment. In these special circumstances, the Commission should follow Congress's lead and impose a requirement similar to that which Congress adopted in the Primary Dealers Act of 1988.

Conclusion.

The Board of Trade appreciates the Commission's continued diligence as it works through the many issues posed by the Eurex US application. However the Commission resolves these issues, the Commission will be setting an important regulatory precedent in many areas. Based on the information in the public record, including the November 18 response, the Board of Trade continues to believe that the Eurex US application should be denied for the only reason any application should be denied: the applicant has failed to show it meets the statutory standards Congress has enacted for all contract markets. As always, we would be happy to discuss these issues with the Commission or assist it in its deliberations in any manner it sees fit.

Respectfully submitted,

Bernard W. Dan