SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

125 Broad Street
New York, NY 10004-2498

LOS ANGELES • PALO ALTO • WASHINGTON, D.C.
FRANKFURT • LONDON • PARIS
BEIJING • HONG KONG • TOKYO
MELBOURNE • SYDNEY

February 22, 2010

Richard A. Shilts,
Acting Director, Division of Market Oversight,
Commodity Futures Trading Commission,
Three Lafayette Centre,
1155 21st Street, NW,
Washington, DC 20581.

Re: ELX Futures, L.P./Exchange of Futures for Futures Rule

Dear Mr. Shilts:

Even at 25 pages in length, the CME Group Inc.'s ("CME's") letter dated February 8, 2010 fails to respond to the Commission staff's letter dated January 22, 2010 and instead relies on conclusory, unsupported assertions, misstatements, distortions and material omissions. Specifically, the CME's letter (1) deliberately confuses and conflates illegal on-exchange trading abuses, such as wash trading, with permissible off-exchange trades; (2) focuses narrowly on the rules of the Chicago Board of Trade ("CBOT") despite the rules and histories of its exchange affiliates and its own highly publicized efforts to harmonize rules across those affiliates; (3) misrepresents the prior submissions of ELX Futures, L.P. ("ELX") and the Commission's approval of ELX's rule regarding Exchange of Futures for Futures ("EFFs"); and deliberately misreads Commission precedents. The CME's letter also seeks to paint the EFF as likely to cause unique harm to the "liquidity and transparency" of the Treasury futures market without discussing how similar rules, including basic EFRPs, in other markets do not cause the harm predicted for the EFF. In sum, the February 8 letter is simply the latest salvo in the CME's anti-competitive efforts to stifle legitimate market activity involving a competitor.

First, the CME begins with a complete mischaracterization of the Commission's action, in its attempt to undermine the effectiveness of the ELX EFF Rule. Specifically, the CME states that the EFF Rule was not actually "approved" by the Commission and that the effectiveness of the Rule therefore does not reflect a

Commission determination that the Rule is in compliance with the Commodity Exchange Act and Commission Regulations -- "On or about October 5, 2009, ELX's EFF rule was 'approved' by the Commission because ninety days passed and the Commission took no action" (page 1). In fact, the Commission issued a letter dated October 6, 2009 which affirmatively approved the EFF Rule and stated: that "Section 5c(c)(3) of the Commodity Exchange Act ("Act") states that the 'Commission shall approve any...new rule, or rule amendment unless the Commission finds that...the new rule, or rule amendment would violate the Act." Accordingly, pursuant to Section 5c(c)(3) of the Act, **on October 5, 2009, the Commission approved ELX's proposed rule amendment** (emphasis added)." The approval letter, rather than a passive act driven by a statutory clock, as CME falsely states, reflected the Commission's determination that the Rule complies with the statute and regulations and should be approved.

Moreover, the CME's letter acknowledges that ELX was explicit in its filings describing the EFF rule and the CME must therefore concede that the Rule was approved on this basis. On page 6 of its letter CME states: "In its Rule Filing, ELX states that the purpose of its proposed rule 'is to enable market participants to establish positions in futures contracts on ELX and liquidate such positions on another designated contract market ("DCM") that lists an identical contract, or to establish a position on such other DCM and liquidate it on ELX.' (Rule Filing at 1). The CFTC's review of the rule filing was extensive, and the approval was granted with full knowledge of the intentions of ELX regarding the purposes of the rule, which the Commission determined are permissible.

Notwithstanding the specific approval of the Rule, which contained a finding that the EFF Rule did not violate the Commodity Exchange Act, and the Commission staff's letter dated January 22, 2010 which reinforced this finding, CME continues to maintain in its February 8 letter that "CBOT's rules prohibiting prearranged, non-competitive transactions barred the ELX EFF transaction and remained in effect" (page 1). The CME's misstatement of the approval order underscores its continuing refusal to acknowledge the Commission's authority in determining compliance by proposed rules with the Commodity Exchange Act and Commission Regulations.

Second, the CME's letter, like its prior statements, repeatedly mischaracterizes EFFs as illegal wash trades or other forms of non-competitive trades and deliberately confuses permissible non-competitive trades with illegal wash trades -- "Certainly, the Commission would agree that prearranged, matched trades that negate market risk are wash trades, even if they otherwise have a legitimate purpose" (page 10). This argument is completely specious and the CME knows it. CME mischaracterizes the EFF as a "wash trade" willfully ignoring the Commission staff's letter, and ample case law to the contrary. All forms of permissible off-exchange transactions, including EFPs, EFSs and EFFs, are non-competitive by definition and design; indeed, their non-competitive nature is their defining characteristic. They are distinguished from wash trades in that they are submitted with the label of a non-competitively executed trade, and are carefully identified to avoid harming or confusing the market, as is the case with wash trading. If the EFF trades are illegal wash trades, then the CME participates in the same illegality on a daily basis by processing EFRPs. In addition, these trades not only contemplate simultaneous or near-simultaneous trades in different markets, they require that this be the case. Participants using these trades compete off-exchange for price and quantity, and assume the risk of price differences between the markets. To ignore the absence of market deception, which is the hallmark of a wash trade and which upsets the price discovery function of the markets, and still label these transactions illegal wash trades, is disingenuous at best.

For this reason, the precedents relied upon by the CME have no applicability here. The reliance on the **Pinemore** and **Scotia** cases in particular to disallow the EFF is extremely misplaced. These cases were settlements and therefore have little precedential value in any event. More important, the cases both dealt with allegations of deceptive intent. Trades were prearranged in the open market, purportedly executed as competitive trades, but in reality being prearranged. The market is deceived when such trades occur, notwithstanding the purpose behind the deception. There is no deception with any kind of EFRP, including the EFF, and if there were, such deception would be common to all EFRPs. An EFF is reported as a non-competitively executed trade. Market participants understand that the trade is not priced competitively, and that the trade is done as a form of administrative trade and position management. These cases do not provide a basis for the CME's claim that "long-standing Commission precedent" is contrary to the CFTC staff's position.

Further, the repeated assertions by CME that exchanging positions between one exchange and the other is a "fictitious trade" (page 23) that does not involve a change of positions (page 16) similarly ignore the facts and the Commission's own judgment on the matter. Just as an EFP uses a cash trade to alter a futures position, the EFF uses a different OTC trade to alter a position. All EFRPs, including the EFF, must be negotiated between counterparties, involve basis risk (in the case of the EFF the price difference between buying one market's contracts and selling the other's), and effect a market position once posted with the clearinghouse(s). The tortured logic that seeks to distinguish an EFF from other EFRPs is a distinction without a difference, and has no merit.

Third, the argument that EFFs would cause market harm is also without merit. Indeed, the CME offers no support for this broad assertion. While acknowledging that the EFF would permit an investor to close a position on one market and open it on another, the CME recommends that such trades be done on the open futures market presumably to provide valuable market information such as price discovery. However, inasmuch as the goal of such trades would be to buy and sell at the same price in both markets, or as close to the same price as possible, and has no relationship to cash prices since it is only done to achieve an administrative goal rather than a hedging goal, there seems no basis to expect dire consequences resulting from EFFs. In fact, as the CME well knows, permissible non-competitive transactions are not part of the price discovery process and are not looked to by market participants for this purpose. To require a market participant looking to make an administrative position transfer to buy contracts in one market, pushing that market's price higher, and also to sell them in another, pushing that second market's price lower, risks exactly the kind of market distortion that the CME claims it is interested in avoiding. Moreover, the CME's purported concern that EFFs might become a dominant market mechanism, detracting from competitive trading volumes, is clearly exaggerated and unsupported by prior experience with EFFs in other markets. Indeed, by definition, positions are typically created competitively before they can be moved via an EFF. Further, the CME's argument is coming from an exchange operator that lists dozens of energy contracts for trading, but which actually have no open transactions since each trade is cleared in the Clearport service through transitory EFRP transactions. CME also acknowledges (page 24) that its constituent markets, in addition to energy, permit transitory EFRPs in foreign exchange, gold and silver, and yet posits that notwithstanding its rules and practices in other markets under its control with respect to Treasury futures the EFF is illegal and dangerous.

Fourth, the CME seeks to ring-fence the CBOT's markets from the practices of the other markets owned and operated by the same common holding company. The letter proclaiming this separation is in fact authored by the General Counsel of the CME Group, which illustrates the lack of substantive independence among the exchanges under CME Group's common control. The CME Group cannot allow trades in one market yet find an illegality when the same type of trades occur in another. That is not a reasonable position, and was already considered and rejected in the CFTC Staff's letter. This approach is particularly disingenuous in light of the CME's highly publicized efforts at "harmonization" of the rules of its various exchange affiliates.

Even with respect to the CBOT's own rules, CME states "...although at one time CBOT did allow transitory EFRP trades[1] in its metals complex, CBOT's current rules prohibit both contingent and transitory trades." (page 22). What is unsaid is that CBOT sold its metals complex to the NYSE-Liffe, and no longer operates a metals market. When it did, however, in order to compete, it offered transitory trades because they were seen by CBOT to be pro-competitive in a rare head-to-head competition between unaffiliated exchanges for customers. No light went off in the CME's compliance department saying these trades were detrimental to the market. CBOT

[1] ELX's EFF transaction does not involve the use of transitory EFRPs.

simply decided to get out of the business, presumably to avoid competition with its parent's newest acquisition, NYMEX, which had been pre-merger in a competitive battle with CBOT.

The CME also attempts to distinguish its EFRP in agricultural products, which provides for the ability to form a single transaction to have one trade today and its reverse tomorrow, all in EFRP transactions. While CME states: "there is no obligation by either party to do the second EFRP," (p. 22) that misstates the nature of the trade. Here is CME's description of the trade in its Advisory Notice RAO910-5 issued October 2, 2009 (emphasis added?):

"Q9: Can **two** EFRPs be utilized to facilitate inventory financing in CBOT agricultural commodities?

A:9: The following transaction is permitted provided that it is entered into for the purpose of obtaining inventory financing for an agricultural commodity. A participant **may** purchase the agricultural commodity and sell the equivalent quantity of futures contracts to a counterparty through the execution of an EFP and **may** grant to the counterparty the non-transferable right to effect a second EFP on some date certain in the future which will have the effect of reversing the original EFP."

If these two transactions were independent trades, there would be no need to treat it as a special trade, as opposed to two independent EFPs, or condition it based on purpose ("inventory financing"). Clearly, the quote above allows two parties to enter into a trade where one leg is conditioned on another leg happening. They may enter into the trade, and grant a second, offsetting trade when the transaction is first entered into.

The CME also asserts that "neither COMEX nor any of the other three CME Group exchanges permits EFFs." However, prior to "harmonizing" Rule 538 on October 5, 2009, NYMEX Rules permitted EFFs between NYMEX and Brent, and in intra-exchange trades between e-Mini natural gas and crude oil futures and their larger respective physically delivered contracts. When it harmonized its rules, CME did not outlaw these earlier rules, but simply did not mention them.

In a recent earnings conference, the CEO of IntercontinentalExchange stated: "...the market has developed an active position management marketplace that exists between primarily ICE and CME NYMEX where positions are moved back and forth as needed. We have no barriers that we've put up to allow those positions to move, and I think you can see that there's been a tremendous growth in both Energy businesses over the last number of years while that market has become active." (Bloomberg Transcript Q4 2009 Earnings Call, 2/10/10). While this "position management" tool is not referred to as an EFF, it has the same impact, is widely used, pro-competitive, helpful to liquidity, and permitted by both markets without barrier. The CME says that the same type of transaction in Treasury futures, however, will harm " transparency and liquidity," with no support, and flying in the face of what happens in the energy markets.

Fifth, the CME makes a number of misleading assertions regarding ELX's prior submissions. In particular, the CME makes much of ELX's original request to the CFTC to require that CME adopt a specific rule amendment to Rule 538 to incorporate the EFF. That is true procedurally, but has no bearing on whether such a rule amendment is necessary. ELX requested the amendment because of a long history of the CBOT and CME taking anticompetitive steps to prevent competition by Liffe in Eurodollars,[2] to prevent the use of block trades to move open interest from CME to another market or vice versa.[3] The ability to provide clarity up-front, and prevent the sort of specious argument and heavy-handed conduct as happened here after the EFF was approved, and in those other situations, made the request for a clear rule perfectly sensible as a means to avoid ambiguity and anticompetitive conduct. However, the procedures necessary to obtain a compelled rule were lengthy and complex, and so we informed CFTC staff that we would drop the request, and accept a determination on the EFF rule filing without a compelled rule. The Commission's approval of the rule was effective, but as predicted, has met with an anticompetitive string of arguments, which the CFTC staff dismissed in its January 22 letter.

---

2 Rule 432.D. Interpretation Submission No. 04-61a to Ms. Jean Webb, Secretary, July 9, 2004,

RULE 432.D. - INTERPRETATION

CME Rule 432.D. prohibits fictitious trades. A fictitious trade includes a prearranged transaction or series of transactions by means of which one or more parties engages in a transaction at CME and reverses that transaction at CME or at another board of trade. CM facilities that permit prearrangement of trades (Rule 526 – Block Transactions; Rule 538 – Transfer Of Spot For Futures; and Rule 539.C. – Pre-Execution Discussions Regarding GLOBEX Trades) may not be used to facilitate a fictitious trade as defined above.

3 (CME Special Executive Report S-4735, July 21,2008 "Block Trade Transactions of Inter-Exchange Spreads and Inter-Commodity Spreads for both E-mini® Russell 2000 and Russell 2000 Index Futures"), "All block trades must be in compliance with CME Rule 432.D. which prohibits fictitious trades. It would be a violation of Rule 432.D. to engage in block trades based on an agreement by the parties to reverse such transactions at CME or on another exchange. Accordingly, it would be impermissible for parties to execute a block trade in Russell 2000 futures (standard or E-mini) at CME Group in a particular contract month and agree to reverse the trade by executing a block trade in Russell 2000 futures at another exchange in that same contract month."

As acknowledged by the CME on page 6 of its February letter[4] the purpose and function of the EFF Rule was fully described by ELX in its filing and supporting documents. The EFF is simply another form of EFRP, and not a novel one at that, as the Commission staff's letter of January 22 documented. As an EFRP, the role of the clearinghouse for either exchange is to operate in the normal course by accepting an EFRP trade and adjusting a position accordingly. As a result, there is no special action or review required for these trades outside of what is done for EFRP transactions and ELX does not require the CME or CBOT to take any action, other than allowing the EFFs to be processed in the normal course.

The CME similarly distorts ELX's antitrust argument. Specifically, the CME seeks to portray Aspen Ski as requiring a prior business relationship between the parties, when in fact the court used the fact of the prior relationship only as an indicia of an anticompetitive intent for Aspen Ski's refusal to accept a lucrative arrangement in order to drive its competitor out of business. Similarly, CME's reliance on Four Corners Nephrology is misplaced. In Four Corners, as in Trinko, the plaintiff wanted to require the defendant, a competitor, to risk losing money, divert its resources to another company, and suffer harm to its own ability to serve its customers. ELX is not looking for any relationship with CME, but is asking CME to earn its fees, and perform the same functions for the same customers that it now does. That there may be an ancillary benefit to ELX is not the point. We are not asking CME to use its resources for ELX while displacing its relationship with its own clients.

In a separate letter by the CFTC staff dated January 22, 2010, the CME was asked to reply to 5 questions to offer further support for its Market Advisory RA0907-1. While challenging the CFTC staff's analysis, the CME fails to address substantively questions 4 and 5, and fails to substantively distinguish between EFFs and the other permitted EFRP transactions, as requested in Question 1. While the CME's letter includes purported responses to Items 4 and 5, these "responses" are in fact completely non-responsive and do not address the staff's questions. We also disagree with the responses to Questions 2 and 3, as set forth above, but by not addressing the substance of the CFTC staff's concerns in most of the questions, the CME tacitly acknowledges the weakness of its position on any other than anti-competitive grounds.

CME has failed to establish a reason based on protecting the marketplace for threatening users of the EFF Rule with prosecution. By misstating the holdings of cases, misstating the CBOT's agricultural transitory EFRP Rule, asserting that EFFs will

---

4 In its Rule Filing, ELX states that the purpose of its proposed rule "is to enable market participants to establish positions in futures contracts on ELX and liquidate such positions on another designated contract market ("DCM") that lists an *identical contract*, or to establish a position on such other DCM and liquidate it on ELX." (Rule Filing at 1).

harm liquidity and transparency when that has not been the case in its own energy markets, and by explicitly stating that what happens in one of its markets is irrelevant to finding the practice illegal in another of its markets, it is clear that the CME Group is attempting to frustrate competition with no justification other than pursuing an anti-competitive agenda. Core Principle 18 could be surmounted by a showing of countervailing market and investor harm, but in the absence of any harm to investors or the market, and in the face of clear competitive benefits to investors and the markets, Core Principle 18 cannot be trumped.

We very much appreciate the staff's consideration of these issues and would be pleased to respond to any questions or provide any further information that might be helpful to the staff.

Sincerely,

Kenneth M. Raisler

cc: Neal L. Wolkoff
(ELX Futures, L.P.)