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CHIEF COUNSEL AND STAFF DIRECTOR

U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, D.C. 20515

October 13, 1982

CHAIRMAN'S OFFICE
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SEC. & EXCH. COMM.

Honorable John S.R. Shad
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

It is our understanding that the Commission has scheduled an open meeting on Thursday, October 14, 1982, to consider, among other items, whether to issue orders approving proposed rule changes filed by the (1) American Stock Exchange (Amex) relating to the trading of options on Treasury securities; (2) the Chicago Board Options Exchange, Incorporated (CBOE) with respect to the trading of options on GNMA securities and Treasury securities; (3) the Philadelphia Stock Exchange (Phlx) with respect to options on foreign currency; and (4) the Options Clearing Corporation (OCC) with respect to issuance of options on GNMA, Treasuries and foreign currencies and the establishment of a system for the clearance and settlement of such options. We have received copies of correspondence dated October 7, 1982 from the Chairman and Ranking Minority Member of the House Agriculture Committee concerning these contracts. The correspondence urges you not to consider these applications at this time and encourages the CFTC to invoke the commodity options ban in Commodity Exchange Act Section 4c(c) against you should you authorize trading in those options. Furthermore, the Chicago Board of Trade has indicated its intent to bring lawsuits against the SEC and the subject exchanges if trading should be authorized.

In light of these events, we think it is appropriate that certain views of the Energy and Commerce Committee, which has jurisdiction over these issues, be reiterated.

As you are aware, this Committee held hearings in April on the decision of the Court of Appeals for the Seventh Circuit in Board of Trade of the City of Chicago v. SEC, as well as legislation expressly to set aside that decision and make the

securities statutes more clearly reflect "long-standing Congressional intent that the SEC has the sole authority to regulate options on all securities, including exempted securities."[1] That legislation, H.R. 6156, was passed by the House on September 23, 1982, and then by the Senate on October 1, 1982.

H.R. 6156 amended the definition of "security" under the federal securities statutes expressly to include options on securities, options on certificates of deposit, options on securities indices or groups, and, when traded on a national securities exchange, options on foreign currency. Congress, in enacting this legislation, expressed the view that these instruments do not fall within the exclusive jurisdiction of the CFTC and stated its desire that trading in these instruments be allowed to commence. Nonetheless, certain Members of the Agriculture Committee contend that the expanded defintion of "commodity" which is incorporated in Sections 4c(b) and 4c(c) of the CEA still gives the CFTC the power to ban trading in these options on a national securities exchange. We believe that this contention is inconsistent with Congressional intent, the legislative history of H.R. 6156 and the plain language of the statutes involved.

The Energy and Commerce Committee also recently had before it Title I of H.R. 5447 and the underlying provisions of the CEA. As the legislative history of the CEA makes clear, Congress enacted the exclusive jurisdiction proviso of Section 2(a)(1) so that trading in commodity futures and related activities with a direct nexus to futures trading, such as options on futures contracts, would be subject to regulation by the CFTC only.[2] The same rationale does not apply to options on actuals, which,

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[1] See, Congressional Record, H1526, 1527, April 22, 1982; House Comm. on Energy and Commerce, Report to Accompany H.R. 6156: Clarifying the Jurisdiction of the Securities and Exchange Commission and the Definition of Security, H.Rept. No. 97-626, Part 1, 97th Cong., 2nd Sess. at 8.

[2] See S.Rep. No. 850, 95th Cong. 2d Sess. 5-13 reprinted in [1978] U.S. Code Cong. & Ad. News 2093-2101 (detailing the history of futures trading in the United States and describing as the purpose of the CFTC, the provision of a uniform regulatory structure covering all aspects of futures trading in both regulated and unregulated commodities); S.Rep. No. 1131, 93rd Cong. 2d Sess. 13-17 reprinted in [1974] U.S. Code Cong. & Ad. News 5856-60 (describing the mechanics of futures trading and detailing the need for a centralized regulatory agency to oversee such trading).

unlike options on futures, do not have any necessary connection with futures trading. For example, options on GNMA securities were traded over-the-counter for at least five years prior to the initiation of GNMA futures trading on the Chicago Board of Trade in 1975 just as options on stocks have been traded for over eight years on the CBOE without the existence of any futures trading in stocks. The existence of such autonomous options markets both before and after enactment of the CEA in 1974 renders extremely dubious any claim that Congress intended to put such options under the CFTC's exclusive jurisdiction in 1974 and casts considerable doubt on the thesis that these options are among the "commodity options" regulated by Sections 4c(b) and 4c(c) of the CEA.

We also note that the current Chairman of the CFTC, in a 1975 article, flatly rejected the conclusion that the CFTC has exclusive jurisdiction over options on securities such as are presently pending your authorization.

> The CFTC's exclusive jurisdiction . . . [does] not extend to securities options such as those traded on the Chicago Board Options Exchange, since such options when exercised, do not result in the delivery of a futures contract.

Johnson, The Perimeters of Regulatory Jurisdiction Under the Commodity Futures Trading Commission Act, 25 Drake L. Rev. 61, 68 (1975) (emphasis supplied). Other commentators have also consistently construed the CFTC's exclusive jurisdiction under Section 2(a)(1) to reach options on futures, but not options on the underlying tangibles or intangibles. See, e.g., Bromberg, Commodities Law and Securities Law -- Overlaps and Preemptions, 1 J. Corp. L. 217, 313 (1976); Long, Commodity Options -- Revisited, 25 Drake L. Rev. 75, 132 (1975); Guttman, The Futures Trading Act of 1978: The Reaffirmation of CFTC - SEC Coordinated Jurisdiction over Securities/Commodities, 28 Am. U. L. Rev. 1, 30 (1978).

Furthermore, one of the purposes of H.R. 6156 was to give meaning to the "savings clause" contained in CEA Section 2(a)(1) which states that "except as hereinabove provided, nothing contained in this section shall...supercede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission...or...restrict the Securities and Exchange Commission...from carrying out [its] duties and responsibilities in accordance with such laws." It is clear that the language "hereinabove provided" refers specifically to the CFTC's exclusive jurisdiction clause and does not include the broad definition of "commodity" since that definition is "in this section" and not "hereinabove provided." Accordingly, that definition cannot limit SEC jurisdiction and the expanded

definition of commodity, which is incorporated into Sections 4c(b) and 4c(c), cannot be used to invalidate the rule proposals at issue here.

Finally, even if 4c(b) and 4c(c) were construed to be applicable, the CFTC has rejected that result. On February 19, 1982, pursuant to its authority under Sections 4c(b), 4c(c), and 8a(5) of the CEA, the CFTC submitted to Congress Proposed Rule 34.1 which, "if adopted, would exempt from the prohibition of Section 4c(c) and from Parts 32 and 33 of the [CFTC] Regulations, any transactions in an option on exempted securities, certificates of deposit, and foreign currency if conducted on a national securities exchange registered with and regulated by the SEC." 47 Fed. Reg. 7677, 7678 (Feb. 22, 1981) The CFTC has scheduled a meeting on this rule today and it is expected to be adopted.

The adoption of this rule, in conjunction with the recent passage of H.R. 6156, seems determinative and, we think, would also raise serious mootness problems in any lawsuits filed to challenge your approval of these contracts.

Sincerely,

JOHN D. DINGELL
Chairman
Committee on Energy
and Commerce

JAMES M. COLLINS
Ranking Minority Member
Subcommittee on
Telecommunications,
Consumer Protection, and
Finance

cc: Honorable Philip McBride Johnson
Chairman, CFTC