

1 IN THE SUPREME COURT OF THE UNITED STATES

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3 KLEIN & CO. FUTURES, INC. :

4 Petitioner :

5 v. : No. 06-1265

6 BOARD OF TRADE OF THE :

7 CITY OF NEW YORK, ET AL. :

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9 Washington, D.C.

10 Monday, October 29, 2007

11

12 The above-entitled matter came on for oral
13 argument before the Supreme Court of the United States
14 at 10:04 a.m.

15 APPEARANCES:

16 DREW S. DAYS, III, ESQ., Washington, D.C.; on behalf of
17 Petitioner.

18 MALCOLM L. STEWART, ESQ., Assistant to the Solicitor
19 General, Department of Justice, Washington, D.C.; on
20 behalf of the United States, as amicus curiae,
21 supporting Petitioner.

22 ANDREW J. PINCUS, ESQ., Washington, D.C.; on behalf of
23 Respondents.

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1 P R O C E E D I N G S

2 (10:04 a.m.)

3 CHIEF JUSTICE ROBERTS: We'll hear argument
4 first this morning in case 06-1265, Klein & Co. Futures
5 v. Board of Trade of the City of New York. Mr. Days?

6 MR. DAYS: Mr. Chief Justice, and may it
7 please the Court:

8 A clearing futures commodity merchant, an
9 FCM, such as Petitioner, has standing to sue contract
10 markets and clearing organizations of contract markets
11 under Section 25 (b)(1) of the act for their bad faith
12 failure to enforce rules that are required by the act
13 and by the Commodity Futures Trading Commission. The
14 court of appeal's contrary ruling should be reversed for
15 three reasons, because it's contrary to the text of
16 25(b)(1), it ignores the essential rule of clearing
17 FCM's such as Petitioner recognized by the Commodity
18 Exchange Act, as well as long-standing industry rules
19 and practices -- an assessment with which the expert
20 Federal agency, the Commodity Future Trading Commission
21 concurs -- and it's in cross purposes with the goal that
22 Congress sought to achieve in enacting an express
23 private right of action in 25(b)(1) against contract
24 markets, namely to ensure the existence of fair and
25 orderly markets through a system of effective

1 subregulation. The plain language of the Commodity
2 Exchange Act confers statutory standing on Petitioner to
3 bring this private right of action against Respondents.
4 25(b)(1) makes no reference to buyer or seller but
5 instead confers standing on any person who engaged -- a
6 person who engaged in any transaction on or subject to
7 the rules of a contract market or licensed board of
8 trade.

9 JUSTICE GINSBURG: Mr. Days, can I interrupt
10 you there, and ask, if you would --

11 MR. DAYS: Yes, Justice Ginsburg.

12 JUSTICE GINSBURG: -- if you would define
13 the transactions -- the particular transactions on which
14 you rely to come within that provision and what rules of
15 the exchange or the clearinghouse do you say was
16 violated?

17 MR. DAYS: Justice Ginsburg, we view this as
18 several subsidiary transactions that ultimately end in
19 the consummation of the contract, but with respect to
20 the rules that we have in mind -- first of all Rule 6
21 (a) talks about -- that can be found in the blue brief
22 at 1a -- that such contract executed or consummated by
23 or through a member of such contract market. This is a
24 clearing FCM that does this. And 6 (a), along with the
25 knife rule, that is the contract markets rule 121(f) and

1 306(i)(2), essentially indicate the following
2 arrangement: No contract can be dealt with or entered
3 into on a contract market without a guarantee from the
4 clearing FCM. The FCM becomes the buyer and seller with
5 respect to that particular contract. It assumes that
6 contract and then, after assuming that contract, has to
7 clear it immediately, indeed, within one hour. So
8 that's -- those are the rules under the statute and with
9 respect to the contract market.

10 With respect to the clearing
11 organization, Rule 401(a), which is found at the red
12 brief at 6a, indicates that the clearing point, the
13 clearing FCM is the point that deals with the clearing
14 organization. And at that point, there's no
15 communication, no contact -- no contract between the
16 investor and the clearing organization. The clearing
17 organization becomes the buyer and seller. In other
18 words, the contract is between a clearing FCM on one
19 side of the contract and a clearing FCM on the other
20 side of the contract. The clearing organization becomes
21 the buyer and seller, but before that happens, it's
22 clear that the clearing organization views the clearing
23 FCM as the party to the contract. It is not the
24 investor. It is not any other party.

25 The important thing also about this

1 process is that the clearing FCM is always financially
2 liable from the very beginning of this transaction, this
3 process, to the very end. That is, from the --
4 executing the contract and the consummation of the
5 contract. For the Court of Appeals to talk about buyer
6 or seller and treat a clearing FCM as a mere creditor or
7 agent really misses entirely the role that clearing
8 FCM's play in this process.

9 JUSTICE GINSBURG: You think you --

10 MR. DAYS: I think --

11 JUSTICE GINSBURG: You've talked about
12 the transaction, but I also ask you, what were the rules
13 that the Defendants violated, the rules of the statute?

14 MR. DAYS: Well, it's -- it is clear, as
15 I indicated with respect to the rule of the contract
16 market, that the clearing FCM is required to clear that
17 particular order or contract. And, therefore, at that
18 point, the clearing requires some information about the
19 settlement price. Here the allegation is that there was
20 fraud at the point where the settlement price was set.
21 That then created a problem with the clearinghouse, and
22 at the clearing process there was also a continuing
23 violation because at both points the contract market and
24 the clearing organization should have been applying
25 their rules effectively and carefully, and we suggest

1 here that that was done in bad faith.

2 JUSTICE SOUTER: I think --

3 MR. DAYS: The cause of action, we
4 understand, requires that there be a showing of bad
5 faith.

6 JUSTICE SOUTER: Is -- I don't want to
7 reduce the issue down to something too simplistic, but
8 is there a rule that says don't lie, don't commit fraud?

9 MR. DAYS: Yes. In fact, the -- in order to
10 be a contract -- a market designated by the CFTC and by
11 the statute, there has to be a commitment to avoiding
12 price manipulation and cornering the market or various
13 other things of that kind. So that's in the statute,
14 and it's also subject to the rules of the CFTC. That's
15 a basic understanding. That's a given. Indeed, with
16 respect to the whole question of settlement prices and
17 margins, the understanding of those who participate in a
18 commodity futures market is that they will establish
19 their margins with the expectation that those rules will
20 be applied fairly and firmly and in good faith.

21 JUSTICE SOUTER: Am I -- am I right that we
22 really do not have to --

23 MR. DAYS: Excuse me?

24 JUSTICE SOUTER: Am I correct that we really
25 do not have to determine that issue this morning?

1 MR. DAYS: What --

2 JUSTICE SOUTER: All we have to determine is
3 whether it is possible for the Petitioner here to be
4 within the class of those with standing?

5 MR. DAYS: Absolutely.

6 JUSTICE SOUTER: Yes.

7 MR. DAYS: This is a standing case, sir.

8 CHIEF JUSTICE ROBERTS: Mr. Days, suppose
9 that the exchange has a standard sort of
10 nondiscrimination provision with respect to employment
11 practices, and it -- an employee asserts that she was
12 discriminated against in the promotion review. Would
13 she be covered by this provision?

14 MR. DAYS: No, Your Honor. I think that
15 Congress had in mind a limitation of the standing
16 position -- that is standing -- a right to those who
17 participate in the process, when it talks about a person
18 who engaged in a transaction on or subject to the rules
19 of the contract market --

20 CHIEF JUSTICE ROBERTS: Well, I suppose the
21 transaction would be her annual employment review that
22 she alleges violated the exchange rule saying the
23 exchange would not discriminate on the basis of sex.

24 MR. DAYS: I don't believe that that would
25 be a transaction on or subject to the rules of the

1 contract market. She would not or he would not be a
2 person whose transaction, that is the employment
3 contract, would be carried out on or subject to the
4 rules of the contract.

5 JUSTICE KENNEDY: But suppose, to narrow
6 that hypothetical, that there's a rule that you can't be
7 an employee of the clearinghouse or the exchange if you
8 have a conviction for fraud, and they don't -- they're
9 negligent and careless about enforcing that rule and
10 that fraud causes the loss. Under either your theory or
11 the government's theory, would there be liability, and
12 is there a difference between those two theories?

13 MR. DAYS: Well, the statute itself talks
14 about the responsibilities of the contract market or the
15 clearing organization. And it describes transactions,
16 and transactions are described broadly but not in a way
17 that would encompass the examples that you gave, Justice
18 Kennedy.

19 CHIEF JUSTICE ROBERTS: So -- so, the
20 transaction has some substantive limitation that is
21 derived from where?

22 MR. DAYS: Well, it's derived from the
23 statute, if one looks at Rule 2(i) in the statute. That
24 describes transactions in a variety of ways. It's not
25 in any of the appendices, but it can be located, I

1 believe, on page 5 of the yellow brief, where we talk
2 about that and indeed the interpretation that was given
3 by the Second Circuit in the Ken Roberts case, which we
4 also cite at that page in the yellow brief.

5 JUSTICE KENNEDY: But in my hypothetical
6 there is a transaction and there are actual damages --
7 I'm reading from -- from (b)(c). There's been a
8 transaction and the liabilities for damages sustained by
9 a person who engaged in the transaction or subject to
10 the rules of the buyer.

11 MR. DAYS: Well, Justice Kennedy, I want to
12 focus on transaction. There's nothing that I've been
13 able to find, nothing that the CFTC has indicated in
14 this respect that would cover the hypothetical that you
15 and Chief Justice Roberts had mentioned. Theoretically,
16 yes, but I don't think that -- in fact not
17 theoretically, yes, I would say the transaction does not
18 incorporate those ancillary rules of an operation of a
19 contract market.

20 CHIEF JUSTICE ROBERTS: Well, why aren't
21 these ancillary rules? When I think of a futures
22 exchange market and the transaction, I think of the
23 buyers and the sellers, you know, the longs and the
24 shorts, and this strikes me as just kind of the
25 paperwork in the back office. Why is that, why should

1 we assume that's covered by the term "transaction"?

2 MR. DAYS: Well, it is a broad definition,
3 but it focuses on the process of the execution and
4 consummation of the contract, not matters that are
5 unrelated. I would view, as was indicated in the
6 American Agricultural Movement case, these people as
7 nonparticipants in the operation of the core function of
8 a contract market.

9 CHIEF JUSTICE ROBERTS: These people -- you
10 mean the ones in our hypotheticals.

11 MR. DAYS: That's correct.

12 JUSTICE BREYER: Can I ask you -- I find it
13 difficult -- I'm finding it difficult to follow the
14 exact language on page 4a of the appendix, of (b)(1)(C).
15 To you, that's probably the key provision, right? And
16 that's in the blue brief. And catch me when I read it
17 wrong, if I do. As I -- as I see it, it says -- and
18 here it says "a clearing organization." That's what we
19 are interested in here, the clearing organization.

20 MR. DAYS: Right.

21 JUSTICE BREYER: Now, a clearing
22 organization that doesn't enforce a bylaw properly or a
23 rule or reg properly, which is what you're saying
24 happened?

25 MR. DAYS: Yes, sir.

1 JUSTICE BREYER: The clearing organization
2 got all mixed and it all --

3 MR. DAYS: Correct.

4 JUSTICE BREYER: Now, they're liable for
5 actual damages to a person who engaged in a transaction
6 in a contract market. That's what it says. And the
7 contract market is the futures exchange.

8 MR. DAYS: Yes.

9 JUSTICE BREYER: Not the clearing
10 organization.

11 MR. DAYS: Yes.

12 JUSTICE BREYER: And they're liable to that
13 person for the actual losses that resulted from his
14 transaction in the futures exchange --- as such
15 transaction.

16 MR. DAYS: Yes.

17 JUSTICE BREYER: So what your claim -- they
18 were caused by the failure of the clearinghouse to
19 follow its rules.

20 MR. DAYS: Yes, sir.

21 JUSTICE BREYER: If they just read that, we
22 have a case where the clearing organization didn't
23 follow its rules the -- my client engaged in a
24 transaction over the futures exchange.

25 MR. DAYS: Yes.

1 JUSTICE BREYER: And it was caused harm
2 because the clearing organization didn't follow its
3 rules. You say that's what it says.

4 MR. DAYS: Yes, sir.

5 JUSTICE BREYER: And that's what happened?

6 MR. DAYS: Correct.

7 JUSTICE BREYER: Did I understand that
8 correctly?

9 MR. DAYS: Yes. I don't know, Justice
10 Breyer, whether you're heading toward the concern that's
11 expressed by the Respondents, namely that 25(b)(1) does
12 not contain in that second part of the statute a
13 reference to a --

14 JUSTICE BREYER: Clearing organization.

15 MR. DAYS: -- clearing organization.

16 JUSTICE BREYER: I know, but then the
17 response I'm going to ask them is, so what?

18 MR. DAYS: Well, I think that is -- "so
19 what" is a proper response, I'm glad you said it rather
20 than I, that --

21 JUSTICE BREYER: I know you're going to --
22 but I --

23 MR. DAYS: We have -- we have, we think,
24 standing with respect to a transaction that occurred on
25 the contract market even if the Respondents' argument is

1 persuasive that it didn't happen on the clearing
2 organization or subject to the rules of the clearing
3 organization.

4 JUSTICE GINSBURG: It would be an argument
5 for this case because that absence has been cured.
6 Wasn't that in the 2000 amendment that -- that they
7 changed the --

8 MR. DAYS: That's correct.

9 JUSTICE GINSBURG: -- the list to registered
10 entity and which does include clearinghouse.

11 MR. DAYS: Yes. Well --

12 CHIEF JUSTICE ROBERTS: So --

13 MR. DAYS: Yes?

14 CHIEF JUSTICE ROBERTS: The concern on the
15 other side, I take it, is that it's not just limited to
16 transactions on the exchange, but transactions subject
17 to the rules of a contract market. And I understood
18 you, in response to the hypothetical that Justice
19 Kennedy posed, that you indicated that transaction has
20 some substantive limit to it, and if that's the case,
21 which seems to me an awfully large concession, then we
22 have to figure out what the limit is. And it seems to
23 me that it could just as easily be limited to the
24 transaction between buyers and sellers of futures
25 contracts as between all these subsidiary, ancillary,

1 collateral, whatever transactions that simply implement
2 that broader transaction.

3 MR. DAYS: Well, Mr. Chief Justice, there
4 are limitations with respect to 25(b)(1). As I
5 indicated, nonparticipants in the market are not
6 explicitly covered by this, but also one has to
7 understand that there has to be a showing of bad faith
8 and there are no punitive damages. There are actually
9 damages and, therefore, this limits the extent to which
10 this provision can be used by someone who is not within
11 the category that I described.

12 JUSTICE BREYER: Correct me if I'm wrong,
13 but you're going to be more favorable to this than I
14 expect your opponent. I mean, there is nothing really
15 linguistically or otherwise wrong if you had a statute
16 that said people in the badminton court have to play
17 carefully. And if they hurt somebody on the
18 merry-go-round, they are liable.

19 And so people in the contract market have to
20 play carefully, and if they have hurt somebody over at
21 the futures exchange, they are liable.

22 But it says those people in the futures
23 exchange are people who engage in a transaction on the
24 futures exchange.

25 MR. DAYS: Yes, sir.

1 JUSTICE BREYER: And so they said well, by
2 odd fluke of fate, your clients didn't. It was the --
3 rather, their client who actually went into the futures
4 exchange and bought the commodity.

5 Your point, I take it, is -- well that's
6 true, but my client did something, he guaranteed that
7 commodity transaction in accordance with the rules of
8 the futures exchange, and that's what makes him a player
9 in the futures exchange.

10 MR. DAYS: Yes. As to him, yes --

11 JUSTICE BREYER: He --

12 MR. DAYS: -- that is right.

13 JUSTICE BREYER: He guaranteed through the
14 clearinghouse the payment of the contract made on the
15 futures exchange --

16 MR. DAYS: That's correct.

17 JUSTICE BREYER: -- which he didn't make,
18 but he guaranteed it.

19 MR. DAYS: Well, that's not correct.

20 JUSTICE BREYER: He made it.

21 MR. DAYS: Well, that's not correct, Justice
22 Breyer. The clearing --

23 JUSTICE BREYER: He didn't walk on to the
24 floor and make it. It was his client who walked on to
25 the floor and said whatever. Is that right?

1 MR. DAYS: Well, it's hard to know who walks
2 on what floor. I think what is clear about this
3 industry is that it is the clearing FCM who is always at
4 the center of this, the essential participant in this
5 entire process.

6 The FCM's may not know who the customer is.
7 They certainly don't know who the customer is on the
8 other side. The clearinghouse doesn't know who the
9 customer is, or the investor is. So the investor
10 actually plays a very small role other than putting up
11 his or her money at the beginning of the process.

12 CHIEF JUSTICE ROBERTS: No. I mean the --
13 the market is about investors. It's about buyers and
14 sellers. Now, you're -- the clearinghouse and these
15 FCM's may or may not be covered by the language of the
16 statute, but it's an awful big stretch to say they are
17 central to the market.

18 What's central to the market are the
19 investors. That's why they have these. They wouldn't
20 have this market for -- for your clients, I mean for the
21 clearinghouse or anything else. The market is there for
22 the buyers and the sellers. That's the central
23 transaction.

24 MR. DAYS: We don't argue that investors are
25 barred from bringing suits under 25(b)(1). They would

1 be persons who engaged in transactions on, or subject
2 to, the rules of the contract market.

3 JUSTICE GINSBURG: Didn't Judge Friendly
4 refer to the FCM as a central player or a principal in
5 --

6 MR. DAYS: Yes. That -- that's certainly
7 been the case in Leist where Judge Friendly wrote the
8 opinion. And also --

9 JUSTICE SCALIA: What is the transaction --
10 what is the single transaction that you think brings
11 your client within this language?

12 MR. DAYS: Well, I mentioned --

13 JUSTICE SCALIA: What is the transaction,
14 the guarantee?

15 MR. DAYS: The one -- the contract market
16 requires that the clearing FCM clear a contract with one
17 hour -- assume the contract. So the assuming of the
18 contract and the clearing required by the rules of the
19 contract market is a violation of the CEA.

20 JUSTICE SCALIA: I'm not talking about what
21 the rule is that was violated. It says "who engaged in
22 any transaction on or subject to the rules of such
23 contract market." What is, in brief, "the transaction"
24 you're relying upon?

25 MR. DAYS: Well, Your Honor, as indicated,

1 the transaction is the process of assuming this contract
2 and then going toward the clearing -- clearing
3 organization to clear it, and it's the clearing
4 organization, setting the settlement price, which really
5 dictates what happens on the clearing organization. So
6 it's the setting of the settlement price which is the
7 key point.

8 JUSTICE SCALIA: The transaction does not
9 require two parties?

10 MR. DAYS: Well, there are two parties here.

11 JUSTICE SCALIA: You have a one-party
12 transaction?

13 MR. DAYS: There is a -- we can view this as
14 one sole transaction, as one transaction with a number
15 of subsidiary activities along the process between
16 execution and consummation, or one can view various
17 transactions that ultimately end up with the
18 consummation of the contract.

19 JUSTICE GINSBURG: Why isn't it just --

20 MR. DAYS: I don't think it makes any
21 difference one way or another.

22 JUSTICE GINSBURG: -- the guarantee, the
23 relationship between the clearing organization and the
24 clearinghouse -- the clearing organization has to give a
25 guarantee and has to put up margin?

1 MR. DAYS: That's correct.

2 JUSTICE GINSBURG: So there is a transaction
3 between the clearinghouse and the clearing organization.

4 MR. DAYS: Oh, absolutely. Well, they are
5 same thing. You mean the clearing FCM and the
6 organization. Thank you.

7 CHIEF JUSTICE ROBERTS: Mr. Days, we'll give
8 you a minute for rebuttal. Mr. Stewart.

9 ORAL ARGUMENT OF MALCOLM L. STEWART,
10 ON BEHALF OF THE UNITED STATES,
11 AMICUS CURIAE SUPPORTING PETITIONER

12 MR. STEWART: Mr. Chief Justice, and may it
13 please the Court:

14 For purposes of this case, the Court may
15 assume that the word "transaction" in Section 25(b)(1)
16 is limited to the purchase and sale of futures and
17 options contracts.

18 The Court may also assume that, in order to
19 engage in such a transaction, a person must be a
20 necessary and direct participant in the transaction.
21 Even under those --

22 CHIEF JUSTICE ROBERTS: Where -- where do
23 all of those assumptions come from? I would have
24 thought the limitation of "transaction" beyond the plain
25 language would be a significant concession in this case.

1 I mean --

2 MR. STEWART: When I say "assume," I am
3 saying that the Court need not decide at this point how
4 far, if at all, beyond the core transactions that occur
5 on contract markets the statute breaches. That is, with
6 respect to the hypothetical case of an exchange or a
7 clearinghouse that has an anti-discrimination rule and
8 is alleged to have violated that rule.

9 Yes, on the one hand, you could say that in
10 literal terms that is a transaction subject to the rules
11 of the exchange. On the other hand, I think there is
12 significant force to Respondents' contention that that
13 seems very far afield from what was the core of
14 Congress's concern. And with respect to the
15 anti-discrimination hypothetical, there would also be
16 the argument that there is a different Federal statute.

17 CHIEF JUSTICE ROBERTS: So we have to figure
18 out what was the core of Congress's concern and limit
19 "transaction" in that way?

20 MR. STEWART: I think the Court can at least
21 start from the assumption that Congress referred to
22 transactions on, or subject to, the rules of the
23 contract market. And none of the things that have been
24 posited in the hypotheticals, the anti-discrimination,
25 would be transactions on a contract market.

1 CHIEF JUSTICE ROBERTS: But they would be
2 subject to the rules of the contract market.

3 MR. STEWART: They would be subject to the
4 rules. But our point here is that the United States and
5 the CFTC have not had occasion to decide how far, if at
6 all, beyond the core transactions on the contract market
7 the statute extends.

8 But our point is, even if we look at the
9 core of what Congress was driving at, the buying and
10 selling of futures options contracts, the clearing FCM
11 is a proper plaintiff because it assumes direct
12 contractual liability to the clearinghouse. Even before
13 the clearing process is completed, it was defined as the
14 buyer or seller of the contracts in the NYFE rules, and
15 its participation is essential.

16 Now -- now, we have a somewhat different
17 conception of the relevant transaction than does the
18 Petitioner. In our view, when Eisler executed his
19 trades on the floor of the exchange, he set in motion a
20 process that would quickly and inevitably culminate in
21 the clearing of the trades by the clearing organization,
22 and at the end of the day there would be an array of
23 contractual relationships.

24 Klein would have a contractual obligation to
25 the clearinghouse. The clearing FCM on the other side

1 of the trade would have its own obligation to the
2 clearinghouse. Klein would have an agreement with its
3 customer, First West, that would entail rights and
4 obligations running between them. And there would be a
5 similar set of rights and obligations on the other side
6 of the trade.

7 JUSTICE GINSBURG: What about the argument
8 that if we accept your view of it, allowing the FCM to
9 sue, then there could be multiple liability?

10 MR. STEWART: I think that's incorrect. I
11 think the customer would also be an appropriate
12 plaintiff, that is, the customer would have his own
13 rights and obligations arising out of the -- the
14 contract with the clearing FCM. But the fact that they
15 might both be conceivable plaintiffs wouldn't mean that
16 they could both recover in the same case.

17 Remember that the statute limits recovery to
18 actual losses. So if the customer here, Eisler and
19 First West, had paid the required additional margin to
20 Klein, and Klein had discharged its obligation to the
21 clearinghouse, Klein would still be a person who had
22 engaged in a transaction. But Klein wouldn't be able to
23 recover because he would have suffered no actual losses.

24 So it's the person who bears the actual loss
25 at the end of the day who would be the appropriate

1 plaintiff.

2 And the fact that in some cases that might
3 be the customer and in other cases it might be the
4 clearing FCM doesn't mean that there would be
5 duplicative recovery in a single case.

6 JUSTICE ALITO: Well, when you began by
7 saying we could begin -- we could assume certain things,
8 was it included in the things that we could assume --
9 was it the proposition that the transaction was limited
10 to a purchase or sale?

11 MR. STEWART: A purchase or sale, although
12 we would extend -- I mean we would interpret the
13 clearing process as part of the purchase or sale. And
14 the reason we would do that is that clearing occurs
15 inevitably by operation of law, as it were. That is,
16 once Eisler executes his trades, Klein has no discretion
17 as to whether to discharge its obligation to clear the
18 trades.

19 Klein had previously entered into a
20 commitment to guarantee the trades that Eisler made.
21 And, therefore, what -- Klein's obligations to the
22 clearinghouse followed directly and inevitably from the
23 initial trade on the floor of the exchange.

24 JUSTICE ALITO: Is that different from
25 saying under the exchange rule the FCM is actually the

1 party that enters into the trade.

2 MR. STEWART: I think it is a different
3 thing and there are two different bases on which the
4 Court could rule in our favor, that is, Rule 306(i)(2)
5 of the rules of the exchange that were in effect at the
6 time of these trades specified that -- and that's
7 reproduced, I guess, at page 14a of the blue brief. And
8 it said -- a second sentence of Rule 306(i)(2) says
9 every such contract when made by a trading member shall
10 be made on behalf of a clearing member, who shall be the
11 buyer or seller of said contract on the terms set forth
12 therein.

13 So one way to rule for Klein in this case is
14 to simply say even if we focus entirely on the moment at
15 which the trade was executed, under the rules of the
16 exchange, Klein was deemed to be the buyer or seller.
17 But we are also making the different argument and in a
18 sense we think the more important practical argument,
19 that regardless of where the contract ran during the
20 brief period before the clearing process was
21 consummated, the salient factor is that at the
22 conclusion of the clearing process, the clearinghouse
23 would look directly and only to Klein for satisfaction
24 of any obligations arising out of unsuccessful trades.

25 In a sense the clearinghouse could be

1 analogized to a department store in which only the
2 clearing members have charge accounts. And in order for
3 anyone else to make a purchase, he has to make
4 prearrangements with a charge account holder to have
5 permission to charge things to his accounts. And that's
6 essentially what was done here. In order for Eisler to
7 execute trades on the floor of the exchange, he had to
8 have the prior commitment from Klein that Eisler would
9 be allowed to charge trades to client's account.

10 And in that situation, we think it's
11 entirely natural to say that Klein engaged in the
12 transaction, even though Eisler was making the decisions
13 as to exactly what trades to execute.

14 JUSTICE SOUTER: Mr. Stewart --

15 JUSTICE GINSBURG: Is that why the Second
16 Circuit was wrong in saying it was just like a
17 securities broker?

18 MR. STEWART: Yes. I think the Second
19 Circuit's error was not really that it had a
20 misconception of how narrow or broad the private right
21 of action is. The Second Circuit's error was that it
22 misunderstood the role that a clearing FCM plays in the
23 process. The clearing FCM doesn't simply facilitate the
24 formation of contracts between other people. The
25 clearinghouse assumes direct contractual -- I'm sorry.

1 I mean the clearing FCM assumes direct contractual
2 liability to the clearinghouse.

3 And that's fundamental to the operation of
4 the contract markets. That is, the point of the
5 clearinghouse is to give investors assurance that if
6 their trades are successful, they will get paid. And in
7 order for the clearinghouse to pay the winners, it has
8 to have confidence that it will be able to collect from
9 the losers.

10 And the way that it has that confidence is
11 by identifying a small number of people, clearing FCM's,
12 who have demonstrated financial wherewithal and
13 integrity, and saying we are going to look only to you
14 to satisfy these obligations. We are not going to put
15 ourselves in the business of going after large, large
16 numbers of individual investors to ensure that losing
17 trades will be paid.

18 JUSTICE SOUTER: Mr. Stewart, may I go back
19 to the question of multiple recoveries. And by that
20 term, as I understand it, the term does not mean
21 duplicating recoveries. And I don't understand -- and
22 this is what I want you to explain -- why there couldn't
23 be a recovery in a case analogous to this both by the
24 FCM and by the ultimate customer.

25 Let's assume that the settlement price is,

1 in fact, rigged. The FCM cannot meet the resulting
2 margin call and folds, and hence a situation like this.
3 And this happens quickly enough so that the ultimate
4 transaction is never consummated. So that the -- the
5 contracting party on the FCM side of the trade doesn't
6 get the benefit of what would have been a favorable
7 contract. Couldn't you have recovery in that case both
8 by the customer and the FCM?

9 MR. STEWART: I'm not sure if I -- if I
10 fully understand the hypothetical.

11 JUSTICE SOUTER: It may be that I don't
12 understand how it works.

13 MR. STEWART: To answer a variant of it, I
14 think there could be cases in which both the customer
15 and the clearing FCM recovered something. That is, say
16 there is a loss of a million dollars that's attributable
17 to malfeasance by the exchange, and the customer comes
18 up with half of that money -- \$500,000. And the
19 clearinghouse uses that to discharge half of its own
20 obligation to the clearinghouse.

21 Now, in that case, both the customer and the
22 clearing FCM might have a cause of action for \$500,000.
23 So there would be -- there could be multiple recoveries
24 in the sense that you're describing.

25 JUSTICE SOUTER: But in my hypo, the FCM is

1 claiming damages because his business folds. So the
2 damages are not limited simply to those flowing from
3 this transaction itself. The customer is claiming
4 damages for failure to consummate a contract that would
5 have been favorable to him.

6 MR. STEWART: If you assume that
7 consequential damage is arising out of the loss of the
8 business --

9 JUSTICE SOUTER: Right. And I am
10 assuming --

11 MR. STEWART: -- could be part of actual
12 losses, then there would be no barrier to each party,
13 the clearing FCM and the customer recovering what it
14 actually lost.

15 Our point is that there is no danger that
16 because the clearing FCM is -- there is no danger that
17 because the clearing FCM is liable for a million dollars
18 to the clearinghouse and the customer is liable to the
19 clearing FCM, each for a million dollars, that they will
20 both get a million dollars. It's only the person who
21 bears the actual loss.

22 CHIEF JUSTICE ROBERTS: Thank you,
23 Mr. Stewart.

24 Mr. Pincus.

25 ORAL ARGUMENT OF ANDREW J. PINCUS

1 ON BEHALF OF THE REPONDENTS

2 MR. PINCUS: Thank you, Mr. Chief Justice,
3 and may it please the Court:

4 I'd like to return to the language of the
5 statute, because I think it explains why the comments
6 that Mr. Stewart started with are, in fact, compelled by
7 the language of the statute. 25 (a) talks about a
8 person who engages in any transaction on or subject to
9 the rules of a contract market. And I'm focusing on the
10 "on or subject to the rules."

11 If the Petitioners claimed in their opening
12 brief any -- the fact that any transaction was governed
13 by any rule, as in the Court's discrimination
14 hypotheticals, was enough, then the "on" would be
15 superfluous. There wouldn't be any need for "on",
16 because surely a transaction on a contract market has to
17 be governed by the rules of the contract market.

18 So I think that shows why "on or subject to
19 the rules of" is a term of art. It has a special
20 meaning here. And the only kinds of transactions that
21 are either on or subject --

22 JUSTICE KENNEDY: Well, but under that
23 reading they should have used the word "and" rather than
24 "or."

25 MR. PINCUS: No, Your Honor.

1 JUSTICE KENNEDY: Or which is subject to.

2 MR. PINCUS: Well, Justice Kennedy, I think
3 what Congress was explaining there is it wasn't saying
4 any transaction subject to the rules of a contract
5 market, because that would be all of the Court's
6 hypotheticals and discrimination and everything else,
7 and the word "on" wouldn't be there. And so by using
8 "on", which by definition "on" has to be subsumed in the
9 rules because if a transaction is on a contract market,
10 surely is in some way governed by a rule.

11 So if Congress meant to cover every
12 transaction that is in any way governed by a rule, it
13 wouldn't have had to include "on."

14 So the reason -- the fact that "on" is there
15 means, as we discussed in our brief, that this is a
16 special transaction on or subject to the rules singles
17 out a very special category of transactions. And that
18 --

19 CHIEF JUSTICE ROBERTS: I'm sorry. I'm not
20 following you. I think Justice Kennedy's question still
21 applies. Your argument assumes that the "or" is an
22 "and." I mean, you don't need to have a transaction
23 "on" at all. It can be simply one subject to the rules.

24 MR. PINCUS: Yes. But the fact that
25 Congress put "on" in there means that it was trying to

1 capture something other --

2 CHIEF JUSTICE ROBERTS: The fact that
3 Congress put "on" in there and then followed it with
4 "or" means you don't have to worry what "on" means if
5 you're subject to the rules of the contract market.

6 MR. PINCUS: Yes, Mr. Chief Justice. But I
7 think the reason that "on" is there is that Congress was
8 signaling that it wasn't, that the second part of the
9 clause or "subject to the rules" didn't literally mean
10 or subject to any rule, because if it literally meant
11 that, there would have been no reason to include "on."

12 CHIEF JUSTICE ROBERTS: This is like ejusdem
13 generis argument. You're saying, we should interpret
14 "subject to the rules" in the same light that we
15 interpret "transaction"?

16 MR. PINCUS: No. This is an argument that
17 on or subject to the rules that a transaction on or
18 subject to the rules is a special kind of transaction.
19 It's a term of art in the statute, and a term of art
20 that refers to trades.

21 JUSTICE STEVENS: But even if it's a term of
22 art, do you contend that client was not engaged in a
23 transaction subject to the rules.

24 MR. PINCUS: Yes, we do. Your Honor, our
25 view is that the transaction that is referred to there

1 are the transactions that include, either at the trading
2 pit or a small category of off pit trades that are
3 permitted by Section C of the Commodities Exchange Act.

4 JUSTICE STEVENS: What is the scope of the
5 term "transaction" in your view? What does it cover?

6 MR. PINCUS: It covers the trade -- the
7 contract that occurs at the pit at the moment -- during
8 open when one --

9 JUSTICE STEVENS: In fact between either the
10 buyer or the seller and the clearinghouse, not the
11 clearinghouse, the FCM or whatever?

12 MR. PINCUS: Well, FCMs may or may not be
13 involved. In this case Klein wasn't involved, because
14 Eisler was a floor, had floor privileges and he
15 actually -- he was the person who was at the pit
16 engaging in these transactions. So our -- our view is
17 that the transaction, to start with that, either occurs
18 at the pit when an offer is made, an open outcry, and
19 it's accepted at that moment that transaction and --

20 JUSTICE STEVENS: And who are the parties to
21 the transaction?

22 MR. PINCUS: The parties to that transaction
23 are the buyer and seller, the customers, the people that
24 the --

25 JUSTICE STEVENS: And the intermediaries are

1 not subject to the transaction either though they are
2 liable either for the purchase rights or the sale
3 rights?

4 MR. PINCUS: Yes.

5 JUSTICE STEVENS: They are not parties to
6 the transaction.

7 MR. PINCUS: They are not parties to the
8 transaction.

9 JUSTICE STEVENS: But you can expose them to
10 millions of dollars in liability.

11 MR. PINCUS: At the moment, Your Honor, they
12 may not even be identified. At the moment that
13 transaction occurs --

14 JUSTICE STEVENS: But they are subject to
15 liability if the transaction doesn't -- isn't
16 consummated.

17 MR. PINCUS: Under the rules of the clearing
18 organization. Yes.

19 JUSTICE KENNEDY: But the -- the buy and the
20 sell contract will be worth nothing if it isn't cleared.

21 MR. PINCUS: Well, it could -- what the
22 clearing process does after the -- after that contract
23 is formed is to eliminate, to provide a way to strip out
24 the credit risk that ordinarily wouldn't be there.

25 JUSTICE KENNEDY: I know. But you want --

1 you want us to say that the clearing is no part of the
2 transaction, but the clearing is necessary to make a
3 transaction go forward. Otherwise the contract is just
4 a nullity.

5 MR. PINCUS: No, Your Honor, we don't
6 believe that the contract is a nullity. And in fact, if
7 for example a he contract was made at the pit, and for
8 some reason the -- the clearing member who was to clear
9 the transaction went bankrupt that day and didn't exist,
10 and therefore that transaction was not cleared, that
11 transaction would still be enforceable as between the
12 buyer and the seller.

13 JUSTICE BREYER: So they had to pick it up
14 in an hour.

15 MR. PINCUS: Well, it has to be cleared in
16 an hour to go through the clearing process.

17 JUSTICE BREYER: Fine. So therefore any
18 transaction wouldn't happen in your hypothetical,
19 because if I understand it correctly -- the buyer and
20 the seller, who by the way are normally represented by
21 clearing-houses by Klein, or by brokers like Klein, but
22 in this case apparently they weren't -- they make the
23 transaction in the pit and then the rules of the
24 exchange say that the clearing-house has to pick it up,
25 a clearing member within one hour, and at that point

1 that person -- the clearing member, the broker, I guess,
2 this Klein type person -- becomes legally responsible
3 for seeing that the money is put up.

4 Now, it doesn't require a big stretch -- in
5 fact, zero stretch, of the word transaction, to think
6 that word transaction covers that entire process. From
7 the moment -- and by the way the whole process is
8 governed by the rules of the futures exchange -- so
9 there are rules in there. So why do you -- what reason
10 is there for taking that word transaction, cutting out
11 about two-thirds of the important event, ignoring the
12 fact that it is covered by the rule of the future
13 exchange, and limiting it to the physical moment when
14 somebody enters the pit in an unusual case and says "I
15 buy for" -- and then another person says "I sell for"?

16 MR. PINCUS: Well, let me first point out,
17 Your Honor, it's not an unusual case. There frequently
18 may be a case even where -- either where -- even where
19 both sides are represented by floor brokers, where the
20 floor broker who is -- who is representing the party in
21 the trade is not the clearing member. That happens all
22 the time and that's why the rules say that the clearing
23 member doesn't have to even be designated until one hour
24 after the trade. So hard to say that the clearing
25 member engages in that transaction on the floor when

1 he -- when it may not be designated.

2 The reason for the division is that Congress
3 set out a clear rule here. The transaction it referred
4 to, it used the language that it used elsewhere, as we
5 discuss in our brief, particularly in defining the
6 functions of floor trader and floor broker.

7 JUSTICE GINSBURG: Mr. Pincus, if your view
8 were correct it would have been so easy for Congress to
9 say "buyers and sellers" or even "trade," but it used a
10 word "transaction" that you say has a special meaning in
11 this context, but "transaction" appears all through the
12 law and usually it's a term that has encompassing
13 meaning, like in the Federal rules "any transaction or
14 occurrence," and you would say that Congress has given
15 it here this very constrained meaning.

16 MR. PINCUS: We do say that, Your Honor.
17 Because -- let me address first your question about why
18 Congress couldn't use buyer or seller. Here Congress
19 had to -- needed a construction that would link the --
20 the transaction that was being targeted with the rules
21 of the -- of the contract market, because that was going
22 to be the test here, was it's all about whether or not
23 contract market violated its rules, and so it needed a
24 construction that referred to a transaction because
25 those are the things that are governed by the rules of

1 the contract market that might be misapplied in the
2 work -- in the way that A, B and C talk about.

3 So it would have had to -- even if it had
4 used the phrase, you know, "purchased" or "sold," a
5 commodity for future delivery or an option on a contract
6 for future delivery -- it would still have to say on or
7 subject to the rules of a contract market, in order to
8 link back to what it was doing, which was creating a
9 cause of action for the violation of the contract
10 markets own rules with respect to a transaction that was
11 subject to those rules.

12 JUSTICE GINSBURG: Why didn't it just say
13 sustained by a buyer or seller? "Shall be liable for
14 actual damages sustained by a buyer or seller." Why --
15 why would it need to be any more complicated than that?

16 MR. PINCUS: Well, because it -- it would
17 have to talk about --

18 JUSTICE GINSBURG: When everything else is
19 the same, instead of "a person," just "buyer and
20 seller."

21 MR. PINCUS: Well, because then in the --
22 several lines down it talks about actual loss and it
23 would have to say buyers and sellers there as well. And
24 --

25 JUSTICE GINSBURG: I don't know why.

1 MR. PINCUS: Well, it would be referring
2 back to buyer or seller. But I think the key here is
3 for Congress, given the structure of the act, "any
4 transaction on or subject to the rules of the contract
5 market" is -- are these transactions. Those are the
6 only transactions that -- that meet that test. Those
7 are the transactions, that very same phrase is used in
8 defining the functions of the floor broker and the floor
9 trader who execute the transactions on the floor, and so
10 by using that phrase, Congress was tying back to
11 something that it had a clear definition of. Let me --

12 JUSTICE ALITO: Where is the clear -- there
13 is no clear definition. There is no definition
14 whatsoever, anywhere, of "transaction."

15 MR. PINCUS: Well, there is no definition of
16 transaction, Your Honor, but in the definitions of floor
17 trader and floor broker, the phrase "on or subject to
18 the rules of a contract market" appears again in
19 defining what they do, and so those are the people who
20 are at the pit, either executing for their own account
21 or for a customer's account, the trades. And so by
22 using that very phrase in defining what they do -- which
23 appears by the way on, in the discussion on pages 5 and
24 6 --

25 JUSTICE STEVENS: Are they persons engaged

1 in contracts subject to the rules -- are they persons
2 engaged in transactions subject to the rules?

3 MR. PINCUS: No, Your Honor, we don't -- we
4 don't think they are, because they are acting as --

5 JUSTICE STEVENS: Who are subject to the
6 rules in your view? It doesn't include the FCM, it
7 doesn't include the broker, it doesn't include the
8 trader.

9 MR. PINCUS: Well, certainly a floor trader
10 is because that's someone who is trading for his own
11 account. A floor broker who's merely representing a
12 customer is just like someone at a house closing, if you
13 can't make the house closing you appoint someone to
14 close the house. They aren't the ones who engage in the
15 transaction; you do.

16 JUSTICE SOUTER: Neither are they the person
17 who can end up personally liable, and -- I mean, they
18 don't have -- they are not subject to margin calls.
19 There is something very different about this set of
20 relationships from the broker/seller relationship in
21 buying and selling a house.

22 MR. PINCUS: Well, those people also have --
23 well, the -- the floor broker is not subject to a margin
24 call. He is subject to liability for other things that
25 he may do wrong, but for his role as a floor broker he

1 is not subject to margin responsibility.

2 JUSTICE GINSBURG: You recognize that the
3 Second Circuit was wrong when it said that this FCM is
4 just like a securities broker. He is just making a deal
5 for a commission. It seems to me that that -- that was
6 not proper.

7 MR. PINCUS: Well, Your Honor, if that was
8 all the Second Circuit said, I would agree with you that
9 would be wrong, but the Second Circuit recognized that
10 the -- Klein here had a risk, a credit risk because it
11 had backed up the credit of its customer, Eisler, and
12 that's why in the lessons learned report that the CFTC
13 --

14 JUSTICE GINSBURG: But it's not just Klein.
15 It's every FCM. That is the job of an FCM.

16 MR. PINCUS: That is the job of the clearing
17 member of what an FCM does.

18 JUSTICE GINSBURG: So that's not -- not
19 comparable to just a broker who executes my order for
20 shares and gets a commission for it.

21 MR. PINCUS: No, Your Honor, but as the
22 Second Circuit went on to note, the fact that there is a
23 credit risk here, that Klein is taking a risk based on
24 the credit of his customer Eisler -- as the CFTC noted,
25 there is nothing in the rules that require clearing

1 members to only accept minimum margin, and it's the job
2 of a clearing member to -- to look into both the
3 credit-worthiness of its customers and the risks of the
4 various transactions that are open and demanding more
5 margin.

6 JUSTICE STEVENS: I was under the impression
7 from the briefs, and maybe I'm wrong, that you did not
8 defend the reasoning of the Second Circuit. Am I right
9 or wrong?

10 MR. PINCUS: Well, we don't -- to the extent
11 Petitioners claim that the Second Circuit based its
12 reasoning on -- on the imputation into 25(b) of the
13 limitations in 25(a), we don't agree with that.

14 JUSTICE STEVENS: Which was the principal
15 basis for its decision.

16 MR. PINCUS: But there was a second basis to
17 its decision, which talked about the fact that Klein
18 didn't engage in trading, and we agree with that basis
19 because that's what we're arguing here.

20 JUSTICE KENNEDY: Well, on that subject and
21 you -- your client obviously has an institutional
22 interest in the case, assuming you don't prevail, is the
23 government's theory much broader and more undesirable in
24 your view than that offered in Klein brief? I didn't
25 have an opportunity to ask Mr. Days if he accepted the

1 government's position.

2 MR. PINCUS: Well, it -- it certainly would
3 be better if the phrase "transaction on or subject to
4 the rules of the contract market" meant "trade" and we
5 were only discussing how expansive, how elastic the
6 definition of "trade" was.

7 We would still take the position that it's
8 not elastic enough obviously to include clearing
9 members, but we think that, given the language that
10 Congress used and the fact that that language is used to
11 refer to that "on or subject to" formulation is
12 repeatedly used to refer to trades, we think it's very
13 clear that trades have to be what it is. Otherwise,
14 when the statute talks about the fact that a floor
15 broker engages in activities on or subject to the rules
16 of a contract market, it could be talking about
17 discrimination and all kinds of other activities. But
18 even with respect to the narrower formulation urged by
19 the Solicitor General, we think that it is not right for
20 several reasons: First of all the language of the
21 statute, as I said, but there's a clarity problem. If
22 once you move beyond that contract that is executed and
23 becomes complete on the pit, how far do you go? There's
24 clearing before the contract is executed on the pit --
25 at the pit. There may be antecedent activities -- for

1 example, someone who doesn't have floor privileges has
2 to go through an FCM. There may be an introducing
3 broker that introduces that customer to the FCM or all
4 of those activities which are specified in the statute
5 just like the subsequent clearing activity is specified
6 in the statute. Are they also shoe-horned into the
7 definition of trade?

8 JUSTICE GINSBURG: Mr. Pincus --

9 MR. PINCUS: And that's where --

10 JUSTICE GINSBURG: Justice Kennedy was
11 asking you about the government's position. One of the
12 positions -- one aspect of the government's position is
13 that -- that you would not dispute that a person who
14 engaged in a transaction subject to the rules of a
15 clearinghouse would be a proper plaintiff under the
16 current law. Well, certainly the FCM is a person
17 subject to the rules of a clearinghouse.

18 MR. PINCUS: Yes, although obviously the
19 parties haven't briefed the current law. We would take
20 the position that the current law doesn't change the
21 equation and --

22 JUSTICE GINSBURG: That's what I thought
23 your position was. So that's not an accurate.

24 MR. PINCUS: No.

25 JUSTICE GINSBURG: -- characterization.

1 MR. PINCUS: No. Our position is, again,
2 the "on or subject to" language, we believe, quite
3 clearly refers to trades and that Congress's technical
4 correct substitution of registered entities doesn't
5 change that.

6 JUSTICE SOUTER: But you're saying that
7 because a trade is on or subject to, the only thing that
8 can be on or subject to is a trade. And it seems to me
9 that that -- that's the point at which we have
10 difficulty following your argument. Why -- what is your
11 reason, textual or otherwise, for saying that because a
12 trade is on or subject to, no other subtransaction can
13 be on subject to?

14 MR. PINCUS: Because -- because trades are
15 the only thing that fit those two criteria. Only trades
16 are -- can be under the statute either on the contract
17 market, either because -- because they are executed at
18 the pit or so-called off-market trades as referred to in
19 Section 6(c) -- very small categories of off-market
20 transactions --

21 JUSTICE STEVENS: But even if the --

22 MR. PINCUS: -- that are the equivalent of
23 trades but can occur off-market.

24 JUSTICE STEVENS: But, Mr. Pincus, even if
25 you limit it to the word "trades," it does not

1 necessarily follow that the only parties to the trade
2 are the original buyer and the original seller. There
3 are two intermediates who participate in the execution
4 of the trade.

5 MR. PINCUS: I agree, Your Honor, and that's
6 the second part of our argument. Once we reach the
7 point where it's trade, then the question is what does
8 trade mean? And --

9 JUSTICE STEVENS: Does it include this
10 transaction?

11 MR. PINCUS: Well, we believe that it --
12 there are -- at the pit, again, that the transaction,
13 the on transaction, the transaction that occurs on, is
14 the open outcry transaction where, in this case, Eisler
15 made an offer and some other floor trader accepted it,
16 and that was complete there. Klein has no role in that
17 transaction, and clearing members do not have a role in
18 that transaction.

19 JUSTICE STEVENS: Why do you say --

20 MR. PINCUS: They come in later.

21 JUSTICE STEVENS: Why do you say that Klein
22 had no role in it? It was an indispensable party to the
23 transaction.

24 MR. PINCUS: It was a subsequent party. It
25 had subsequent role --

1 JUSTICE STEVENS: Before it was completed he
2 participated, he was -- he functioned as a guarantor.

3 MR. PINCUS: Well, it was not -- it need not
4 be clear at the moment of that the trade is executed at
5 the pit who the clearing member will be. Often it won't
6 be.

7 JUSTICE STEVENS: It was cleared by the time
8 it was over.

9 MR. PINCUS: No -- well, it depends what you
10 mean by "over," Your Honor. What happens in the
11 process, if I can just lay it out for one minute, is the
12 transaction occurs at the pit. It's recorded. The
13 clearing member --

14 JUSTICE STEVENS: There is no distinction
15 between A and D, but before it can be consummated B and
16 C have to play a role.

17 MR. PINCUS: Well, that activity is over.
18 I'll try to use neutral words. That activity at the pit
19 is over. The next -- that data, who bought, who sold,
20 and maybe the clearing members for those two parties are
21 identified. Maybe they're not. They might not be
22 identified for an hour according to the rules. So
23 something happened at the pit. It's then entered into
24 the computers, and at some subsequent point, yes, the
25 clearing members will be identified and the trade will

1 be cleared.

2 Our point is that is subsequent activity.
3 That is activity -- that's the clearing process. It's
4 important, but there is enforceable contract before the
5 clearing event occurs. Nothing in the rules say that
6 the contract is unenforceable.

7 JUSTICE BREYER: That's true, but is there
8 any reason that the word "transaction" would have --
9 serves a purpose by being so limited?

10 MR. PINCUS: It does, Your Honor.

11 JUSTICE BREYER: What -- what Congress would
12 Congress have wanted to do that?

13 MR. PINCUS: In -- because in the
14 environment that Congress was operating just following
15 this Court's decision in Curran, the focus entirely was
16 on protecting investors.

17 JUSTICE BREYER: That's not a reason. I
18 want to know what reason, what harm will be done if in
19 fact we take the word "transaction" and say the word
20 "transaction," while it's capable of the interpretation
21 you give, is also capable of an interpretation that
22 includes all the near contemporaneous events, including
23 the financing and guarantees? Like a mortgage in
24 selling a house.

25 MR. PINCUS: Because --

1 JUSTICE BREYER: And that also is
2 linguistically possible. What harm will be done --

3 MR. PINCUS: The harm that will --

4 JUSTICE BREYER: -- if the second is chosen
5 and not the first?

6 MR. PINCUS: The harm -- two categories of
7 harm: First, a lack of clarity. We don't know, as I
8 said, how far back are we going. The statute requires,
9 for customers that are not trade, not exchange members,
10 they have to go to an introducing broker. They have to
11 go then to an FCM.

12 JUSTICE GINSBURG: But the only one that has
13 this relationship that's different from an ordinary
14 broker, the only one is the FCM.

15 MR. PINCUS: But that's true, Your Honor,
16 but if the Court were to adopt a rule that says we're
17 going to read "transaction" broadly, and so anyone who
18 has anything to do with any aspect of the trade, either
19 before it or afterward, is covered, all of these
20 antecedent people, just in terms of the statutory
21 language, are people who have a role.

22 JUSTICE GINSBURG: But they're not people
23 who are at risk. I mean if there -- if it's a broker
24 who was just executing a trade for a commission is not
25 at risk, but this FCM is at risk, in this transaction,

1 series of transactions.

2 MR. PINCUS: But it's hard to see in the
3 language where Congress would have drawn the line. I
4 think the problem is the lack of clarity. We certainly
5 won't know, if the Court says we are going to move
6 beyond this core transaction and encompass some of the
7 ancillary activities --

8 JUSTICE BREYER: I got that.

9 MR. PINCUS: Okay.

10 JUSTICE BREYER: I got that when you said
11 there were two. What's the second?

12 MR. PINCUS: Well, let me just add to the --
13 to the first that there are subsequent activities.
14 There also are arrangements set up with banks that
15 automatically supply margins, that facilitate
16 transactions. And so the question will be, aren't those
17 banks who play an important liquidity role, aren't they
18 part of a transaction?

19 The second reason is the reason involved --

20 CHIEF JUSTICE ROBERTS: The answer would be
21 that those transactions are not subject to the rules of
22 the exchange.

23 MR. PINCUS: Well, they are --

24 CHIEF JUSTICE ROBERTS: They don't care what
25 kind of arrangement the FCM might have with its bank.

1 That's up to the FCM. There's no exchange --

2 MR. PINCUS: But it has to have an
3 arrangement, and that fact is a rule of the exchange.

4 JUSTICE GINSBURG: Is there some --

5 MR. PINCUS: So it depends what rule.

6 Again, we're --

7 JUSTICE GINSBURG: Mr. Pincus --

8 MR. PINCUS: -- on the rule where we're not
9 going to know what the answer is.

10 JUSTICE GINSBURG: The -- the agency that's
11 supposed to be the supervisor of this area, the CFTC, is
12 taking the position that the government presented to us
13 today. Apparently, it doesn't have the concern that you
14 have just expressed about reaching people who are not
15 themselves subject to the regulation of the exchange,
16 the clearinghouse.

17 MR. PINCUS: Well, I think it does have that
18 concern, Justice Ginsburg, which is why Mr. Stewart said
19 that the Court should sort of take this case on certain
20 assumptions because, as he recognized, the theory that
21 even the government put forward in its brief --

22 JUSTICE GINSBURG: I thought that what he
23 was telling us was that, even if you assume that Klein
24 has that, even if you've assume that.

25 MR. PINCUS: Well, it's certainly their

1 position that Klein has standing, but in terms of the
2 consequences of a ruling by the Court that the statute
3 goes beyond the core activity, I think the government's
4 suggestion sort of shows that even the government is not
5 sure, once you embark on that exercise, where the
6 boundary line is. And I would point out the government
7 is not asking for deference in this case nor could it.

8 CHIEF JUSTICE ROBERTS: I think you still
9 owe Justice Breyer his second reason.

10 MR. PINCUS: I do, Your Honor, and the
11 second reason is involved in the government's response
12 to Justice Souter's question about multiple recoveries.

13 If all of these various people can assert
14 claims, then there is certainly a risk, and a
15 significant risk, that all of these various people will
16 assert different kinds of monetary harm that they will
17 claim is actual loss.

18 In this case the principal, actual loss, as
19 we discussed in the second argument in our brief, is
20 claimed as the loss from the destruction, allegedly
21 caused from the destruction, of Klein's business.

22 If there was a bad-enough event on an
23 exchange, all of the people in this -- in the row from
24 the introducing broker down to the end, down to the
25 bank, could claim that, because there was a foul-up in

1 the electronic reporting system and trades were
2 misreported for a week and, when they were unwound, the
3 consequences of that where lots of bankruptcies in the
4 futures industry, that all of those liabilities get
5 pegged to the contract market. As -- as the FIA --

6 JUSTICE STEVENS: Aren't there lots of
7 situations in which a various -- serious -- harms a
8 whole bunch of people, and they all recover?

9 MR. PINCUS: There are, Justice Stevens, but
10 this is a particular kind of industry. As the -- as the
11 Futures Industry Association notes in its brief, every
12 day more than \$5 trillion worth of contracts are traded
13 on futures exchanges. There is a huge amount of
14 concentrated risk in contract markets.

15 If the contract markets are going to be made
16 liable to a vast array of people, there is a very
17 serious risk that financial jeopardy --

18 JUSTICE STEVENS: You would agree if the
19 client had been trading on its own account with a
20 scalper, it would have been able to recover for the --
21 for its loss to itself; right?

22 MR. PINCUS: Yes, if it had been trading for
23 its own account.

24 JUSTICE STEVENS: If it's trading for itself
25 and some for other customers, it only can recover half

1 of those. Does that make sense?

2 MR. PINCUS: Yes, it does, because Klein is
3 a market insider. It has ways to protect itself other
4 than suing the contract market.

5 It can certainly sue its customer. It has
6 ways of protecting itself, as the CFTC report said, in
7 terms of demanding more margin, in terms of watching the
8 risk in its customer's portfolio, in terms of -- of
9 hedging its own risk. It's an insider, and it can do
10 that.

11 What Congress was concerned with here -- and
12 the reason our construction of the statute makes sense
13 -- is that it protects the outsiders, the PC investors
14 who are at the core of the concern here, without
15 imposing a broad array of liability on the contract
16 markets, who are in the middle of a huge, huge amount of
17 financial risk, which really puts them in the position
18 of shouldering risk that's intolerable.

19 JUSTICE KENNEDY: Are there instances where
20 multiple parties who are injured sue under state law, or
21 is this generally deemed preemptive, or it just doesn't
22 happen, or --

23 MR. PINCUS: Well, there are options. I
24 mean one of the things that Klein says here is that this
25 is its only option. It can go to the FTC.

1 In this case, for example, the FTC order
2 against Eisler assessed a civil penalty but then said
3 the order could be -- it said that obligation could be
4 fufilled by paying the injured parties. Klein -- to the
5 extent Klein has an injury, the FTC -- the CFTC in a
6 similar case could do the same thing. There are state
7 law claims. There are --

8 JUSTICE SCALIA: Mr. Pincus, will you
9 satisfy me on one point. I -- I understand your
10 argument about what "transaction" means. But even if I
11 accept that argument, explain to me again why "or
12 subject to the rules" doesn't add anything?

13 MR. PINCUS: Well, it does. It adds -- in
14 our construction "the transactions that are on" are the
15 transactions that occur on the floor. The transactions
16 that are "subject to the rules" are the ex-pit
17 transactions.

18 Once you say "or subject to the rules"
19 involves more than ex-pit trades, off-exchange trades,
20 then you're into the world of the Court's hypotheticals
21 to Mr. Days of anti-discrimination rule.

22 So it has to have a limited meaning; and, by
23 coupling it with "on," we think that Congress made clear
24 it was referring to trades.

25 JUSTICE SCALIA: Why wouldn't it have been

1 enough to just say "transactions on" if that was their
2 meaning? Why did -- did they --

3 MR. PINCUS: Because then you wouldn't
4 capture a category -- because then Congress would have
5 left out a category of trades. Congress meant to
6 capture investors who trade. There are two categories
7 of transactions that meet that test: Those that occur
8 on the exchange, on the -- physically on the pit, and
9 those that are within the industry called off-exchange
10 or off-pit transactions defined in Section 6(c) of the
11 act -- of the -- of the statute.

12 And so by -- the second phrase is meant to
13 capture those trades that may involve investors but
14 don't occur at the pit.

15 JUSTICE SOUTER: But I take it -- if your
16 ultimate, let's say, policy reason for confining it to
17 that is the -- is the policy against multiple recovery.

18 MR. PINCUS: Yes. The policy reason is the
19 risk of multiple recoveries in an area where there is a
20 huge amount of risk. The contract market is at the
21 center of things, of these \$5 trillion a day. And so
22 Congress wrote very carefully, and Congress's focus was,
23 in the wake of Curran -- and given what it said -- was
24 investors.

25 Because the -- the implied cause of action

1 that the Court recognized in Curran was all about
2 investors. The rationale --

3 JUSTICE SOUTER: Their current argument is,
4 basically, that's all Congress was thinking about.

5 MR. PINCUS: Yes.

6 JUSTICE SOUTER: But, as I understand your
7 position, it's something more. Congress was also
8 thinking probably about multiple recovery, and it didn't
9 want that. And we will impute that intent to Congress
10 because multiple recovery would be a very bad thing for
11 the industry. That's basically your argument.

12 MR. PINCUS: Yes. That is our argument.

13 JUSTICE SOUTER: Okay.

14 MR. PINCUS: Um, let me say a word about the
15 rules and whether the rules are relevant here. It seems
16 to us that Congress used a phrase in the statute, and
17 that it -- that that cannot be changed by a rule that
18 says -- if an exchange adopted a rule that said some
19 transaction was on, or subject to, the rules of it, that
20 wouldn't be enough to put it into the statutory
21 language. The test is what Congress meant. Thank you.

22 CHIEF JUSTICE ROBERTS: Thank you,
23 Mr. Pincus. Mr. Days, you have a minute.

24 REBUTTAL ARGUMENT OF DREW S. DAYS

25 ON BEHALF OF THE PETITIONER

1 MR. DAYS: Your Honors, Mr. Pincus has
2 identified what he views as some temporal gap between
3 the entering into a contract and the involvement of this
4 -- the clearing FCM. That simply is not the case.

5 Klein had a prior commitment to clear
6 Eisler's trade; so even at the time that Eisler was
7 trading, that had to be done with the understanding that
8 Klein was going to back him up.

9 If one looks at the gray brief at page 21,
10 it references to the rule of Knight -- rules of Knight
11 116 and 118 that make this very clear. The story is, as
12 we've indicated, that throughout this process the
13 clearing FCM is financially liable and, therefore, is on
14 the hook.

15 When Congress enacted the statute, it was
16 concerned with protecting the public and maintaining
17 credibility. We think that this cause of action, this
18 express cause of action for allowing FCMs to sue, is
19 most reliant to the objectives of Congress: The
20 faithful execution by an FCM that deals directly with
21 these entities, the clearinghouse and the commodity
22 contract market. Thank you very much.

23 CHIEF JUSTICE ROBERTS: Thank you, Mr. Days.
24 The case is submitted.

25 (Whereupon, at 11:06 a.m. the case in the

1 above-entitled matter was submitted.)
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