Chicago Merc to Buy Board of Trade

Linkup of Old Rivals Shows Fast Rise of Derivatives And Electronic Trading

Biggest Yet in a Merger Wave

The Chicago Mercantile Exchange Holdings Inc. and the Chicago Board of Trade agreed to join forces to form the world's largest financial market, one that

By ***Aaron Lucchetti, Alistair MacDonald*** *and* ***Edward Taylor***

will dwarf exchanges in the U.S. and Europe—even the New York Stock Exchange.

The Chicago Merc announced plans to buy the smaller CBOT Holdings Inc. for about $8 billion. As the biggest deal yet in a global consolidation of the financial-exchange industry, the plan sets aside more than a century of crosstown rivalry.

The agreement reflects the rapid growth in the investment industry's hottest sector: derivatives, or contracts whose value is derived from the movements in other financial instruments such as stocks and bonds. The linkup will make trading in many such derivatives a simpler matter, while also raising concerns that the increased power of the combined exchanges could lead to higher fees for traders.

Having grown far beyond their roots in putting together buyers and sellers of eggs, butter and corn, the Chicago exchanges, together, will trade some nine million futures contracts a day. Futures contracts give investors the right to buy or sell something later at a set price. Thus, they are used to hedge risk, allowing investors to enjoy smoother growth of their assets without the bumps that come with simpler investments on, say, a portfolio of stocks.

"Chicago used to be known as the hog butcher of the world. The city now will be known as the world's risk manager," said John F. Sandner, a Chicago Merc board member.

Futures have also become tools for making investment bets: on commodities such as wheat or oil, on trends in the economy and on broad measures of the stock and bond markets. Futures contracts can be tied to price movements of stock indexes, bonds, interest rates and foreign currencies. Commodities now make up only about 2% of the CME's trading and around 18% of the CBOT's.

Though futures are little understood outside professional circles, a wide array of investors trade them, including hedge funds, pension funds, some individuals and even mutual funds that manage money for millions of people. In recent years, hedge funds and investment banks' own trading desks have used new technology and trading methods to fire in rapid trades to exchanges across the world, leading to a surge in trading volumes. Some exchanges, including the CME, have responded by catering directly to hedge funds, a sign of the growing power of some exchanges versus Wall Street firms in serving sophisticated investors.

The business of the Chicago exchanges

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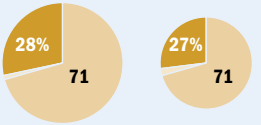
Windy City Coupling

A look at Chicago's biggest exchanges, which have agreed to merge:

Traders *at the Chicago Mercantile Exchange* UPI/Landov

	Chicago Mercantile Exchange	Chicago Board of Trade
Founded	1898	1848
Market cap	$17.75 billion	$8.03 billion
Most heavily traded futures products	Interest-rates, stock, currencies, cattle and lean hogs	Treasury bonds, corn, soybeans and wheat
Average daily volume, 3Q 2006	5.4 million contracts	3.2 million contracts

Trading by venue



Source: the companies

Derivative Effects

Entrepreneur Puts Himself Up for Study In Genetic 'Tell-All'

* * *

Dr. Venter Wants to Be First To Have His DNA Mapped; Risk of Blindness Revealed

By Antonio Regalado

J. Craig Venter, a biologist and brash entrepreneur, started a recent day with a

Futures Shock: Chicago Mercantile Exchange to Buy Board of Trade

Continued From First Page

thus is exploding, especially as they ramp up electronic trading. Doing so has enabled them to compete with European rivals that long ago moved away from the older model of a big floor on which traders jostle and shout. Last year almost 10 billion derivatives contracts, including futures, were bought or sold on the world's exchanges—in a business that barely existed 20 years ago. Trading has grown by an average of almost 18% a year between 2002 and 2005, according to the World Federation of Exchanges.

The Chicago deal illustrates the increasingly rapid pace at which financial exchanges world-wide are consolidating to lift profits by cutting costs. Exchanges have morphed from member-owned clubs into profit-hungry publicly traded companies. This gives them an incentive to make acquisitions and also a currency, their stock, with which to do so.

Distinct Styles

The Chicago exchanges' styles are distinct even though they're just a few blocks apart. The CBOT has long operated in a 45-story Art Deco building topped by a statue of Ceres, the Roman goddess of grain. The CME occupies modern sand-colored towers stacked above its trading floor—a hectic scene of arm-waving, boisterous traders. The CME's largest contracts are Eurodollars. At the CBOT, grain remains important but has been eclipsed by Treasury-bond futures.

Both exchanges also trade options, which convey the right, but not the obligation, to buy or sell an asset later at a set price.

The two Chicago markets have a combined market value of $26 billion, and the underlying value of contracts they trade daily is a massive $4.2 trillion. Now, "it's going to be one big animal," said Steve Rodosky, head of U.S. government-bond trading at Pacific Investment Management Co., or Pimco, a large mutual-fund management company. "It will be a massive part of what the markets rely on every day and the only exchange to use for fixed-income derivatives."

The exchanges had talked occasionally about aligning for decades, but were deterred by rivalries between their floor traders, who owned the markets before they became public companies. This time, serious talks began before the CBOT went public in the fall of 2005. The talks revived about a month ago when CME executives contacted the CBOT, said people familiar with the matter. A flurry of meetings followed, including a dinner between the CME Chairman Terry Duffy and his CBOT counterpart, Charles Carey, at Gene & Georgetti, a famous Chicago steakhouse. About a week ago, the exchanges' executives shook hands on a deal.

The Chicago markets sealed their agreement as the New York Stock Exchange and Nasdaq Stock Market continue separate bitter fights to close their own deals—international transactions they hope will push them into Europe and take advantage of robust stock trading overseas.

NYSE Group Inc. announced a merger deal in June with Euronext NV, which trades both stocks and derivatives. But the Big Board is in a fierce battle to close the deal as Germany's Deutsche Börse pursues its own proposal to merge with Euronext in an all-European combo.

Chicago exchange officials pointed to the consolidation overseas as a catalyst for their own deal. "If you look at the discussions of consolidation, this is the best alternative for us," said Mr. Carey, a third-generation grain trader whose grandfather and uncle preceded him as chairman. All of them once worked the floors.

Craig Donohue

The proposed combination represents another triumph for electronic trading over pit trading. The Chicago Board of Trade started so-called open-outcry trading in 1848, and three years later traded its first corn-futures contract, for delivery of 3,000 bushels.

The Merc's value has surged, driven by the growth of its electronic trading system, called Globex. By 2001 the CME had passed the CBOT to become the largest U.S. futures exchange by number of contracts traded. The CBOT delayed embracing of electronic trading and then relied on an outside technology vendor to develop a system that was partially owned by a European competitor.

As part of the deal, the CME will close its trading floor and move the remaining trading in its pits to the CBOT, probably in late 2008. That will cut the number of major exchange trading floors in the U.S. to two: the CBOT's and the New York Stock Exchange's. The NYSE's, too, is endangered, owing to increased electronic trading there. Most exchanges in Europe and Asia rely fully on computers to match investors' orders to buy or sell.

The CBOT's Mr. Carey said the deal wouldn't have happened without the Board of Trade's 2005 initial public offering. Before the offering, the CME offered to buy the CBOT for the equivalent of less than $60 a share, according to people familiar with the matter. But the CBOT elected to go public first, and investors drove its shares up steeply from the start. It closed yesterday at $151.99 a share, up $17.48, or 13%, on the day. CME shares—which are up tenfold from their December 2002 debut—rose $13.25, or 2.63%, to $516.50.

The CME's Mr. Duffy is to become chairman of the combined firm, and CME Chief Executive Craig Donohue is slated to be CEO. Mr. Carey of the CBOT will be vice chairman. The deal effectively pushes aside the CBOT's chief executive, Bernard Dan, who will serve as special adviser for a year after the deal closes in mid-2007. The new company will have a large and potentially unwieldy board of 29 members, including 20 named by the CME.

The partners will save some $125 million annually on a pretax basis starting 12 months after the deal closes, according to Mr. Donohue. The savings will come from losing one trading floor, combining the technology platforms of the two companies and much of their staff.

The savings could be used to reduce fees for customers, though that might be small comfort to some investors: Both the CBOT and the CME have raised fees in recent years—empowered by regulations that give them exclusive trading rights to their contracts. Stock exchanges, by contrast, face much more competition because shares can trade on different exchanges.

These exclusive rights, along with the Chicago exchanges' sheer size, will provide a formidable bulwark against the NYSE and other markets that are trying to get into the futures business. Successful futures contracts are lucrative for exchanges. This is especially so for the CME, because in addition to matching trades, it "clears" trades—that is, guarantees that both sides of every trade get what they bargained for, either money or a viable contract. For several years, the CME has handled clearing for the CBOT.

Both exchanges have come a long way in recent years. They were put on the defensive at the time of the 1987 stock-market crash, as many argued that computerized futures trading exacerbated the losses, enabling stock declines to feed on themselves. Then a few years later, a Federal Bureau of Investigation sting operation exposed fraud on both Chicago trading floors.

As the stock market roared in the 1990s, giving the NYSE and Nasdaq record trading volumes, the Chicago exchanges struggled to compete with growing derivatives trading done off exchange, or over the counter. Big banks privately negotiated their own contracts and didn't need the financial guarantee provided by an exchange clearing house.

Those trends reversed in this decade, giving far more power to the exchanges that trade derivatives. In the early 2000s, stock trading faced a bear market and U.S. recession. But the Chicago exchanges' business proved resilient, as a tide of hedge funds continued placing bets in markets that were doing well—bonds, foreign currencies and commodities.

The Chicago exchanges got another boost after the collapse of energy giant Enron Corp. in the early 2000s underscored the danger of private deals that would prove worthless if a company defaulted on its obligations.

By 2002, the Chicago Merc's business had improved to the point where it sold its shares to the public. The stock soon soared. By 2005, the CME was worth well more than the NYSE, long the world's marquee exchange.

The NYSE copied the CME's strategy, announcing a public offering and following this year with its deal to buy Euronext—thus getting into futures trading through that exchange's Euronext.liffe platform. The NYSE wants to use Euronext.liffe to grow into the futures business in the U.S. It doesn't intend to compete on products the Chicago exchanges already dominate. Instead, the NYSE will compete in new products that allow investors to bet on corporate credit risk, weather or economic indicators such as inflation.

The Chicago merger means fewer competitors in the futures industry, raising questions over whether the previously scrappy rivals will continue to innovate as effectively. That may be small comfort for the NYSE's designs on the futures business, because the Big Board now faces a much stronger competitor. Its market value would be larger than a combined NYSE-Euronext by about $3 billion.

Battle for Dominance

The Chicago exchanges have battled for dominance in the U.S. futures industry for decades—each lobbying for an upper hand in regulations, competing for customers and vying to create and launch the next new blockbuster product. The rivalry thawed a few years ago, when the German-Swiss futures market Eurex made a run at the CBOT's Treasurys-bond futures contracts and Euronext.liffe took on the CME Eurodollar contract. The moves prompted the Chicago exchanges to cut fees and embrace electronics to keep their edge. The CBOT also agreed to have its contracts cleared by the Chicago Merc to save costs.

Since then, the per-trade prices that exchanges charge have crept back up. The result could be some antitrust concern. There also may be regulatory concerns about the combined company's ability to handle so much business on one technology platform. The deal faces regulatory reviews by the Commodity Futures Trading Commission, the Securities and Exchange Commission and Justice Department antitrust lawyers. Current and former federal officials yesterday said it isn't likely to be derailed.

"The Justice Department is going to want to look over any overlap in products and services, and whether the deal will avert potential competition, especially in electronic-trading platforms," said Steven Sunshine, a former antitrust enforcer now with Cadwalader Wickersham & Taft. "I don't see any major hang-ups" given strong global competition. A U.S. official agreed, because the two exchanges specialize in different types of futures and don't overlap.

Exchange officials said there will still be plenty of competition—the large volume of derivative trades done privately through commercial and investment banks. Mr. Donohue said, "We're not expecting any significant regulatory obstacles. We're in an increasingly competitive environment. The market is globalizing. The OTC market is much larger." CME officials maintain that greater efficiencies and cost-cutting would benefit customers and that its trading systems can handle the added stresses of the merger.

Terry Duffy

The combined exchange will tie together products on one platform that make sense to trade together—the CME interest-rate futures with the CBOT's bonds, for example, and the CME's livestock contracts with CBOT's corn, wheat and soybean contracts. The exchanges also compete with New York commodity exchanges. The CBOT launched electronic metals trading in recent years, and the CME provided technology for electronic trading of the New York Mercantile Exchange's booming energy futures contracts.

The deal calls for a swap of each CBOT Class A share for 0.3006 share of CME Class A common. CBOT shareholders can elect to receive cash, but the cash portion of payment for CBOT will be limited to $3 billion. The CME could issue up to 15.9 million new shares as part of the deal. Of the up to $3 billion in cash it could spend, it would raise about $2 billion in new debt.

The Chicago Merc will own from 69% to about 80% of the combined company—to be called CME Group Inc.—depending on CBOT shareholders' decision on whether to accept cash or stock.

The historic deal comes as other U.S. exchanges have encountered some trouble completing their own deals. Nasdaq has built a 25.3% stake in London Stock Exchange PLC but is still being rebuffed by London, which rejected Nasdaq in an earlier approach in March. In all, LSE has had four approaches from potential buyers in two years.

And Deutsche Börse, in trying to block the NYSE from buying Euronext, has played the political card, lobbying European politicians and regulators to back a Europe-wide exchange group. The NYSE deal will be put before Euronext shareholders in December, but it is far from certain they will approve. Euronext operates stock exchanges in Paris, Amsterdam, Brussels and Lisbon as well as the Euronext.liffe derivatives exchange in London. Deutsche Börse operates the Frankfurt Stock Exchange and the Eurex derivatives exchange and trades products similar to those the CME and CBOT trade.

The CME looked at doing a deal in Europe, holding preliminary talks with Euronext and Deutsche Börse, but got nowhere, say people familiar with the matter.

Analysts said that the CME and CBOT merger won't immediately present a threat to Europe's derivatives trading platforms because it's hard for even large exchanges to take away business from an efficient electronic exchange in its home market.

In fact, the CME and CBOT tie-up could act as a stimulant to Europe's own lethargic consolidation race. It also could appease antitrust concerns in Europe about a possible combination of Deutsche Börse and Euronext, both big derivatives players. "The emergence of an even larger global competitor will be taken into account" when European antitrust regulators review deals that in the past concerned them, said Marc Reysen, a Brussels-based lawyer.

Asia has been largely absent from the global consolidation so far. Yesterday at the World Federation of Exchanges annual gathering in São Paulo, Brazil, exchanges focused on alliances in fast-growing emerging markets, not full-blown mergers. Euronext announced a plan to cooperate with Taiwan Stock Exchange Corp. And a host of Western exchanges, including the London Stock Exchange, are angling to sign agreements with the Bombay Stock Exchange that may include an investment.

The NYSE and Euronext have expressed interest in Asian exchanges once they complete their own deal. Some analysts said that after the Chicago exchanges finish their merger, the CME Group will be among the best positioned to expand internationally.

Lehman Brothers Holdings and William Blair advised the CME, which also had legal advice from Skadden, Arps, Slate, Meagher & Flom. J.P. Morgan Chase and attorneys from Mayer, Brown, Rowe & Maw LLP advised the CBOT. Lazard Ltd. and Latham & Watkins advised a CBOT board panel on the deal's merits.

—John Wilke contributed to this article.

WSJ.com **Online Today:** *WSJ.com subscribers can read the full text of CBOT's announcement and its conference call transcript, and see analysts' reactions, plus a chart of the world's biggest derivatives exchanges, at* **WSJ.com/OnlineToday**. *CME chairman Terrence Duffy and CBOT chairman Charles Carey discuss the deal* **WSJ.com/OnlineToday**.

Chicago Exchanges Combine Thunder

Merger May Set the City's Status As the Derivatives Showplace, Ending a Century-Old Rivalry

By Susan Carey
And Joseph T. Hallinan

Chicago

BY SETTING ASIDE decades of rivalry, the downtown trading pits here have secured the Windy City's place as derivatives market to the world.

Chicago Mercantile Exchange Holdings Inc.'s planned $8 billion purchase of **CBOT Holdings** Inc., parent of the Chicago Board of Trade, would pair two exchanges that are leaders in global trading of futures and options, with combined average daily trading volume of nine million contracts, or about $4.2 trillion in notional value. The deal needs approval by regulators and shareholders.

"It's a great day for Chicago," said Robert Hamada, former dean of the University of Chicago's Graduate School of Business and a public director of the CBOT for 12 years. "If they had continued divvying up the market as they had been, they would have beaten each other to the ground," he says, paving the way for rivals to surpass and buy them.

Plus
Who might be next, and a timeline of the two markets.
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Said John F. Sandner, a Chicago Merc board member: "Chicago used to be known as the hog butcher to the world. The city now will be known as the world's risk manager."

The move comes during an explosion in trading of futures, options and other derivatives as hedge funds and Wall Street firms develop more complex ways to make financial bets. The exchanges also have benefited from greater trading in physical commodities—where the two exchanges are also leaders.

Though the two exchanges employ just 2,200, they have helped to keep the city a financial center even as its home-grown banking industry has steadily been bought out by larger rivals. The exchanges have also spawned numbers of trading firms.

New York has long overshadowed Chicago as a financial capital. But the CME has exploited electronic trading to dominate the markets in derivatives and futures in recent years. Futures contracts represent the right to buy or sell a commodity or financial instrument at a set time and price; derivatives are contracts whose values are derived from an underlying security or other asset. The deal could accelerate the trend toward electronic trading.

Traders who duck away from the trading floor to play ice hockey in the afternoon live in handsome homes along Lake Michigan and make seven-figure contributions to schools, theaters and other charities. One successful trader who now manages a trading firm said, only half-jokingly, "My job now is to convince 27-year-olds that it's OK to make only $2 million a year."

CME and CBOT have been bitter competitors for decades. But within the past 10 years or so, the relationship has thawed a little in the face of global trading threats from other exchanges and over-the-counter trading of derivatives. The path for this deal was paved in 2003, when the two agreed to combine their "clearing," or trade-processing, operations. The idea gained steam once the CBOT went public last year. CME became a for-profit organization and began trading in 2002.

Chicago has other famous rivals, most notably baseball's White Sox and Cubs. But the rivalry between the blue-blooded CBOT and the upstart CME "was much, much more intense and acrimonious and deeper because it's about making money," said Mr. Hamada. "The Cubs and Sox rivalry is a phantom."

James McCann, who trades Eurodollar futures at the CME, says the bad blood between the two exchanges is "overdone." But the 36-year-old, who

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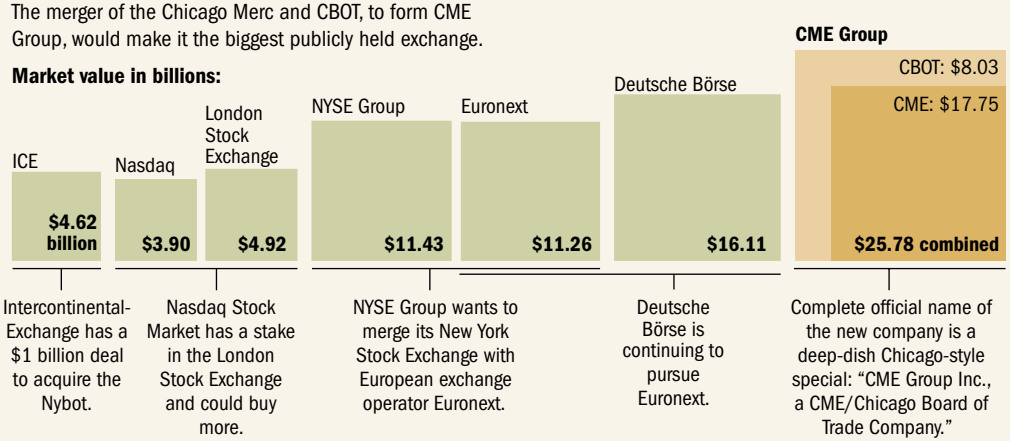
Some of Chicago's Razzle Dazzle

The merger of the Chicago Merc and CBOT, to form CME Group, would make it the biggest publicly held exchange.

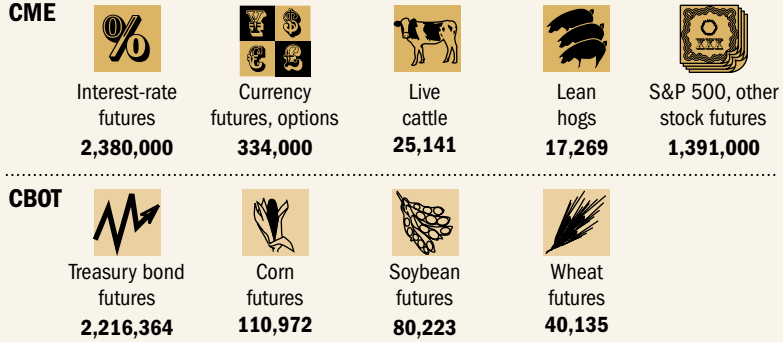
Market value in billions:



What They Trade

A sampling of major investments traded at the Chicago Mercantile Exchange and Chicago Board of Trade.

Average number of daily contracts traded last year:



Sources: the companies; Dow Jones Indexes

CME's Acquisition of CBOT Will Affect Big Pool of Investors; Direction Fees Will Go Is Unclear

By Peter A. McKay
And Ann Davis

FOR MOST INVESTORS, futures trading conjures images of pork-belly contracts, or Eddie Murphy betting on the price of frozen orange juice in the 1983 movie "Trading Places."

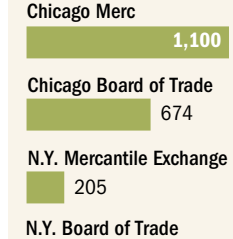
But the impact of yesterday's $8 billion announced acquisition of **CBOT Holdings** Inc., parent of the Chicago Board of Trade, by **Chicago Mercantile Exchange Holdings** Inc. will be felt by a huge pool of investors, many of whom know nothing about these products. It could result in higher fees for everything from mutual funds and pension funds to endowments and hedge funds, which may end up paying more fees and then passing those costs along to investors. There are two schools of thought on whether fees will rise. One camp believes the efficiencies created by the marriage will actually drive fees down. Others say the powerhouse exchange that may be created will drive out competition and increase prices.

The exchanges say the deal is good news for investors. It will save more than $125 million in costs per year on a pretax basis—funds that potentially could be used to reduce fees for customers. That would be a switch, given that both CME and CBOT—which posted strong earnings yesterday—have raised fees in recent years, enabled by regulations giving them exclusive trading rights to their contracts. The impact the deal will have on the exchanges' trading customers will be top of mind for the Justice Department when it looks at the anticompetitive issues surrounding the deal, which is slated to close in 2007.

So far, the jury is mixed. Dan Basse, presi-

HEARD ON THE STREET

Contracts traded at four U.S. futures exchanges, in millions



Note: For 2005, includes futures and options
Source: the companies

Chicago Solidifies Status in Derivatives Market

Continued From Page C1

has worked at the CME for 12 years, recalls that "the last time I was at the Board of Trade, I was 10."

The deal calls for the CBOT to move its electronic trading to the CME's Globex electronic trading platform. The CME will move its "open outcry" trading pits to the CBOT about five blocks away. Those pits, where runners and traders do their business with loud voices and hand signals, are a shrinking part of the business.

The CBOT, founded in 1848, started out handling "to arrive" or "forward" contracts for flour, hay and corn. In 1930 the CBOT moved into its current 45-story building, an Art Deco Chicago landmark topped by a golden statue of Ceres, the goddess of grain—a nod to the CBOT's origins as a place to trade cash grain. Today, though, most trading involves financial instruments such as U.S. Treasury securities. Some 82% of all of the contracts traded at the CBOT during 2005 were either financial futures or options on financial futures contracts.

The CME was founded as the Chicago Butter and Egg Board in 1898 and evolved into the Chicago Mercantile Exchange in 1919, focusing on agricultural futures. It moved in 1983 into 487,000 square feet of office space in a 40-story building overlooking the Chicago River and across the street from the Lyric Opera. That lease expires in 2008.

The exchange also occupies 70,000 square feet of trading floor that it leases from the CME Trust. A spokesman said the CME intends to move its trading floor activities into the CBOT's owned building a few blocks away, but hasn't decided what to do with its leased space. He said no decision has been made about where the merged entity will be located. In 1992, the Merc launched the first global electronic futures trading platform. Originally for after-hours trading, Globex now enables electronic trading 23 hours a day, five days a week.

Leo Melamed, chairman of the CME from 1969 to 1977, says yesterday's agreement to join forces has been a dream of his since the 1970s. "We are so much stronger together," he said. "Chicago will be the big beneficiary and the center of gravity for derivatives and risk management." The combination "makes a much more formidable force world-wide and a magnet of business in our industry."

—Jon Kamp and Ann Davis contributed to this article.

CME's Acquisition of CBOT Will Affect Big Pool of Investors; Direction Fees Will Go Is Unclear

By Peter A. McKay
And Ann Davis

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So far, the jury is mixed. Dan Basse, president of AgResource Co. in Chicago, an agricultural- and economic-forecasting firm, said big trading customers of the two exchanges are worried that the combined firm won't have an incentive to lower trading fees because it wouldn't have significant competition. "There's no natural predator out there for the combined Board of Trade and Mercantile Exchange," Mr. Basse said. Therefore, "in terms of fees for all of us, I'm not sure they're going down."

Futures are contracts to buy or sell an underlying asset at a fixed price on a certain expiration date. The contracts launched more than a century ago by the two Chicago exchanges were initially used as hedging tools for farmers to guard against sudden price drops in their crops, but contracts now can be used to hedge or speculate on a variety of things, from currencies to stock indexes. Options are similar to futures, except they convey only the right to buy or sell the underlying asset, not the obligation. Commodities make up about 2% of the CME's trading and about 20% of the CBOT's trading.

In recent years, smaller investors increasingly have dabbled in investments like these following the dot-com bust as they searched for alternative investments to stocks. In 2005, combined volume

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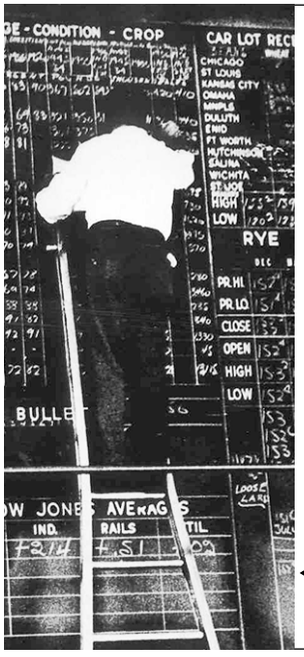

Trading, the Chicago Way

History of Chicago Board of Trade and the Chicago Mercantile Exchange

1848 **The Chicago Board of Trade** officially forms, comprising 82 merchants.

1851 The earliest "forward" contract, for 3,000 bushels of corn, is recorded.

1926 Board of Trade Clearing Corp. is founded to guarantee trades made on the CBOT.

1936 CBOT launches soybean futures contracts.

1973 Members of the CBOT start Chicago Board Options Exchange.

1977 CBOT launches the U.S. Treasury bond futures contract; it becomes most actively traded contract in the world.

2005 Exchange goes public: CBOT Holdings Inc. does an IPO.

2006 Merger with CME is announced.

1898 The Chicago Butter and Egg Board is founded and in 1919 evolves into **Chicago Mercantile Exchange.**

1961 A frozen pork-belly futures contract is traded. Live-cattle futures follow in 1964.

1972 The first financial-futures contract is launched, for foreign currencies.

1982 S&P 500 stock futures are introduced.

1992 CME Globex, global electronic futures trading platform, is launched.

2002 CME goes public, listed on the New York Stock Exchange.

2006 Merger with CBOT is announced.

◀ **Posting prices** *the old way at the Chicago Board of Trade*

Corbis

◀ **Traders** *in the '70s at the Chicago Merc*

CBOT's *Bernard Dan, left, and Charles Carey, second from right, with CME's Terrence Duffy and Craig Donohue, at yesterday's announcement*

Reuters

CME's Acquisition of CBOT Will Affect a Huge Number of Investors

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at the CBOT and CME jumped more than 25% to a high of 1.7 billion futures and options contracts.

Unlike Mr. Basse, Tom Price, owner of the Price Group of Cos. in Chicago, which offers futures brokerage and money-management services, is optimistic the deal will ultimately result in lower trading fees and better prices for investors. "I think it will increase efficiency, and if you increase efficiency, you should certainly not increase costs," he said.

HEARD ON THE STREET

He added that improved electronic trading at the two Chicago markets in recent years has helped customers to get quick execution of their trades—a trend that should continue if both exchanges move all of their products to a single system operated by the CME, as planned under the deal.

Other investors were also enthusiastic. "The bull case is that there are so many synergies with the technology, platform and clearing that they can be more aggressive in their pricing to increase volume," says Matt Andresen, president of Citadel Execution Services.

Others are taking a wait-and-see approach. John Damgard, president of the Futures Industry Association, which represents a variety of financial institutions that sell futures or clear futures transactions, said the organization's members would be watching to determine whether customers of the two exchanges would benefit. "Are there questions about the concentration of such a large share of futures trading on a single exchange? Yes, of course there are, and our members will be looking at that, as will the regulators," he said. He added: "Consolidation usually leads to greater efficiencies."

Both Chicago exchanges were launched in the 19th century, offering futures and options on wheat, eggs and other agricultural products on traditional trading floors. Since the 1970s, they pushed into the business of listing futures contracts tied to a wide array of financial assets, which now represent almost 93% of trading in Chicago.

The CBOT's most-active product is Treasury futures, which let investors bet on the direction of long-term interest rates. The CME's most-active contract covers U.S. currency on deposit in overseas banks, known as eurodollars. Those contracts are used to bet on short-term interest rates.

Facing increased competition from all-electronic markets based in Europe starting in the late 1990s, the Chicago markets have steadily beefed up their electronic offerings and begun offering "mini" versions of their most popular contracts, pegged to smaller amounts of the same underlying assets in order to attract everyday investors unable to pony up the same amount of cash as big Wall Street firms to start trading.

Efficiencies may cut fees, or competition may be driven out and prices increased.

Most industry watchers say they expect that the proposed deal will pass muster with regulators. Michael Manning, a former CBOT board member who is chief executive of futures brokerage Rand Financial Services, noted that the exchanges don't always compete directly, citing the stock-index market. The CBOT offers futures on the Dow Jones Industrial Average, while CME lists contracts on the Standard & Poor's 500-stock index.

"There will be competition over time, because wherever there's a void in the market, someone will step in to fill it" by offering new products or lower trading fees, he said.

—Henny Sender contributed to this article.

Chicago Solidifies Status in Derivatives Market

Continued From Page C1

has worked at the CME for 12 years, recalls that "the last time I was at the Board of Trade, I was 10."

The deal calls for the CBOT to move its electronic trading to the CME's Globex electronic trading platform. The CME will move its "open outcry" trading pits to the CBOT about five blocks away. Those pits, where runners and traders do their business with loud voices and hand signals, are a shrinking part of the business.

The CBOT, founded in 1848, started out handling "to arrive" or "forward" contracts for flour, hay and corn. In 1930 the CBOT moved into its current 45-story building, an Art Deco Chicago landmark topped by a golden statue of Ceres, the goddess of grain—a nod to the CBOT's origins as a place to trade cash grain. Today, though, most trading involves financial instruments such as U.S. Treasury securities. Some 82% of all of the contracts traded at the CBOT during 2005 were either financial futures or options on financial futures contracts.

The CME was founded as the Chicago Butter and Egg Board in 1898 and evolved into the Chicago Mercantile Exchange in 1919, focusing on agricultural futures. It moved in 1983 into 487,000 square feet of office space in a 40-story building overlooking the Chicago River and across the street from the Lyric Opera. That lease expires in 2008.

The exchange also occupies 70,000 square feet of trading floor that it leases from the CME Trust. A spokesman said the CME intends to move its trading floor activities into the CBOT's owned building a few blocks away, but hasn't decided what to do with its leased space. He said no decision has been made about where the merged entity will be located. In 1992, the Merc launched the first global electronic futures trading platform. Originally for after-hours trading, Globex now enables electronic trading 23 hours a day, five days a week.

Leo Melamed, chairman of the CME from 1969 to 1977, says yesterday's agreement to join forces has been a dream of his since the 1970s. "We are so much stronger together," he said. "Chicago will be the big beneficiary and the center of gravity for derivatives and risk management." The combination "makes a much more formidable force world-wide and a magnet of business in our industry."

—Jon Kamp and Ann Davis contributed to this article.

Deal Rekindles Exchange-Consolidation Talk

By Matt Chambers

As a flurry of consolidation envelops the world's futures exchanges, energy bourses **IntercontinentalExchange** Inc. and the **New York Mercantile Exchange** are the big targets left standing.

And they could even merge with each other, analysts say.

The **Chicago Mercantile Exchange**'s agreement to acquire smaller rival **CBOT Holdings** Inc.'s Chicago Board of Trade for $8 billion has sparked speculation over which futures exchange will be the next to be swept up in a wave of mergers that began earlier this decade.

COMMODITIES REPORT

Although small compared with the $25 billion exchange giant the CME is looking to create, Nymex and Atlanta-based ICE have been steadily boosting trading volumes thanks to an influx of fund money into volatile energy markets. ICE, which listed on the New York Stock Exchange in November, has been aggressively growing through both acquisitions and new products, while Nymex is planning an initial public offering this year, proceeds from which it plans to deploy toward acquisitions and development in an attempt to grab a bigger slice of the exchange sector.

"There's scarcity value" in ICE, said Richard Repetto, an equity analyst and principal at Sandler O'Neill & Partners LP in New York. As well as being Nymex's main rival in crude-oil futures trade, ICE pioneered the concept of using a clearing house to guarantee over-the-counter, or off-exchange, trades.

Nymex itself, and the combined CME and CBOT, are the most likely candidates for a merger with ICE, Mr. Repetto said.

"If you can consolidate CME and CBOT and there are significant synergies, you might be able to do the same thing with the Nymex and ICE," he said. Mr. Repetto declined to comment on whether Nymex is a potential takeover target because Sandler O'Neill & Partners are co-managers on the New York exchange's IPO. The firm was also an underwriter for ICE's initial public offering.

ICE would be an attractive prize for a futures exchange, having grabbed more than half the world's crude-oil futures volumes since buying London's International Petroleum Exchange in 2001 and adding a financial copy of Nymex's benchmark crude-oil contract to its electronic platform this year.

The 134-year-old Nymex, while slow off the mark to capitalize on electronic trading, has recently improved its IPO prospects by adding a competitive crude-trading system in partnership with CME and by chasing a deal to boost screen trade of metals traded on its Comex division.

Neither ICE nor Nymex would comment on the likelihood of being a takeover target.

In other commodity markets:

SUGAR: Prices on the New York Board of Trade rose to a one-month high, supported on buying interest as a supply gap is expected when Brazil is between sugar cane harvests from February to March. March gained 0.87 of a cent to 12.58 cents a pound.

NATURAL GAS: Futures lost their steam as a rally fueled by cold weather reports ended. Analysts said it is too early in the season for cold weather to sustain high prices. November natural gas futures on the New York Mercantile Exchange settled flat at $6.442 per million British thermal units.

Exchange Mixer

Top global securities and exchange mergers by value when announced, excluding debt of target

ANNOUNCED	ACQUIRER	TARGET	DEAL VALUE, IN BILLIONS	STATUS
May 22, '06	**NYSE Group**	Euronext	$10.18	Pending
May 23, '06	**Deutsche Börse**	Euronext	9.90	Pending
Oct. 17, '06	**Chicago Mercantile Exchange**	CBOT Holdings	7.99	Pending
Sept. 1, '06	**IntercontinentalExchange**	New York Board of Trade	1.07	Pending
April 21, '05	**New York Stock Exchange**	Archipelago Holdings	0.88	Completed
Oct. 29, '01	**Euronext**	LIFFE	0.80	Completed

Source: Dealogic

Commodity Indexes

Tuesday, October 17, 2006

	CLOSE	NET CHG	YR AGO
Dow Jones-AIG Commodity	166.848	– 1.005	174.790
Dow Jones-AIG Spot	283.846	– 1.709	252.974
Reuters U.K.	2123.39	+5.10	1747.25
Reuters/Jefferies CRB	308.16	–0.40	329.18

Futures listings appear on page B2.

Exchange Merger News Spurs Buying of CBOE Seats

By Mohammed Hadi

Speculation on the **Chicago Board Options Exchange** went from the trading floor to the members lounge Tuesday as investors bid the price of membership on the options exchange to a new record.

The unusually heavy trading in CBOE seats followed word that **CBOT Holdings** Inc. will be acquired by **Chicago Mercantile Exchange Holdings** Inc., which some figure will remove a major obstacle to the CBOE's conversion from a member-owned to a shareholder-owned entity.

OPTIONS REPORT

The price of seats on the CBOE rose to $1.5 million from $1.4 million Monday and several sold at the new price. In fact, with seven seats trading yesterday, activity was a minor frenzy in these.

The CBOE late yesterday was considering what the deal meant for its efforts to move toward an initial public offering of stock. In August, the CBOT sued the options exchange over CBOT members' ownership stake in the CBOE. The two sides dispute how large that stake would be in a public company, and values of CBOE memberships rose on speculation that the CME-CBOT combination would make it easier for CBOE to do its own stock offering.

"The market trading in CBOE seats is quite chaotic," noted Thomas Caldwell, chairman of Caldwell Financial Ltd. of Toronto, which holds several CBOE seats as well as stock in CBOT and the CME.

At $1.5 million, the cost of a membership to the Chicago Board Options Exchange is 71% higher than the highest price paid for these seats in 2005.

Mr. Caldwell attributed speculation to more than the generic consolidation buzz that drove up shares of publicly traded exchanges yesterday. Shares of CBOE rival **International Securities Exchange Holdings** Inc. rose $2.37, or 4.9%, to $51.02, on the New York Stock Exchange.

The CBOE told members that it wasn't consulted about the impact of the merger on the trading-rights issue, and that it doesn't expect to comment until the final terms of the proposed merger are known. During a conference call with investors to discuss the merger, CBOT Chairman Charles Carey said the merger doesn't change the CBOE trading-rights issue.

Buyers of CBOE seats also are speculating on what will follow the demutualization. Not only do many expect it to lead to a stock offering, but some, including Mr. Caldwell, hope to profit down the line as consolidation among exchanges continues.

CBOE Chairman William Brodsky wasn't available to comment, but has in the past noted that the demutualization will bring the CBOE's ownership structure in line with that of other exchanges and opens the door to various possibilities.

The exchange noted in its statement to members that it doesn't expect the proposed merger to alter its plans to demutualize.

Options listings appear on page C8.