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## **An Agricultural Law Research Article**

# **Trading in Futures Under the Commodity Exchange Act**

by

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# TRADING IN FUTURES UNDER THE COMMODITY EXCHANGE ACT

*Donald A. Campbell\**

## I. INTRODUCTION

Mr. Justice Holmes observed that "people will endeavor to forecast the future and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain."<sup>1</sup>

The speculative proclivity referred to by Mr. Justice Holmes resulted in the development of futures trading coeval with the development of organized exchanges in this country. The Chicago Board of Trade, the first exchange in the United States to recognize futures trading, was organized in 1848,<sup>2</sup> and futures trading evolved from the system of "time contracts" developed during that era. The obligation of the seller in a time contract was to deliver a designated

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\* Attorney, United States Department of Agriculture, appellate litigation unit. LL.B., George Washington University 1949. The author wishes to express his appreciation to Mr. Rodger R. Kauffman, Administrator, Commodity Exchange Authority, and to the members of his staff for their counsel in connection with the preparation of this article. The views expressed herein are not intended to be inconsistent with the official views of the United States Department of Agriculture, but nothing herein is to be construed as expressing any official views of the Department.

<sup>1</sup> Board of Trade v. Christie Grain & Stock Co., 198 U.S. 236, 247-248 (1905).

<sup>2</sup> II REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 70-76 (1920); I TAYLOR, HISTORY OF THE BOARD OF TRADE OF THE CITY OF CHICAGO 136 (1917). The exchange system of trading in commodities is of ancient origin. Trading in organized markets existed in China as early as 1200 B.C., and earlier markets in India, Arabia, and Egypt had some of the characteristics of exchange trading. As early as the fourth century, B.C., the city-state of Athens supervised its markets to assure food supplies and to prevent manipulation of prices. J. M. MEHL, THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE 324. See also, BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 3-5 (1949).

amount of a commodity to a warehouse within a specified period, varying from about 1 day to 1 year, at the contract price. The buyer in a time contract frequently sold the commitment to another trader and such transferences at changing prices resulted in the present system of futures trading.<sup>3</sup>

Sales of grain by means of time contracts were stimulated by the Crimean War (1853-1856), and the Civil War gave further impetus to such trading.<sup>4</sup> In 1865, the Chicago Board of Trade recognized trading in grain futures as a distinct commercial practice and passed the first futures trading regulations.<sup>5</sup>

Futures contracts, at present, are standardized contracts—with respect to the purchase and sale of a commodity to be delivered in a specified month<sup>6</sup>—in which the terms, except for the price, are fixed by the exchanges. A futures contract may be executed during the hours of trading fixed by the exchanges at any time prior to the close of trading in a future. The beginning of trading in different futures contracts varies greatly with respect to different commodities, *e.g.*, in some commodities trading begins 18 months prior to the specified delivery month whereas in other commodities trading begins only 2 months before the delivery month.

The seller, or “short,” in the present day futures contracts, agrees to deliver in a specified month a definite quantity of a commodity, and the purchaser, or “long,” agrees to accept and pay for the commodity when it is delivered. If, for example, a May wheat futures

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<sup>3</sup> HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 104-106 (1932); U.S. DEPT OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 1-2 (1937); II REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 107 (1920); V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 27-28 (1920); I TAYLOR, HISTORY OF THE BOARD OF TRADE OF THE CITY OF CHICAGO 146-147 (1917). It seems that futures trading developed “because of the need to find a more convenient and orderly mechanism for speculating in commodities than the time contract afforded” (J. M. MEHL, THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE 325), although the view has also been expressed that exchange trading was established as a new instrument for performing insurance functions in commodity markets. BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 12 (1949).

<sup>4</sup> I TAYLOR, HISTORY OF THE BOARD OF TRADE OF THE CITY OF CHICAGO 146, 192, 317 (1917).

<sup>5</sup> *Id.* at 331-332. Under different conditions from grain, but with a similar pattern of development, unorganized trading in time contracts in cotton developed in the 1870's into organized futures trading on cotton exchanges in New York, New Orleans, and Liverpool. IRWIN, EVOLUTION OF FUTURES TRADING 83-85 (1954).

<sup>6</sup> The exchanges determine the delivery months for trading in commodities. For example, wheat futures contracts require delivery of the cash commodity during the months of March, May, July, September, or December.

contract is executed during the month of February, the short has agreed that he will deliver 5,000 bushels of wheat on any business day during the month of May. The corresponding long has agreed that when the wheat is delivered he will accept and pay for the wheat. The price is determined either by the short accepting a bid to buy at a certain price or the long accepting an offer to sell at a certain price. After the purchase and sale on the exchange have been executed, a portion of the contract price (referred to as the initial margin) is deposited by each party with the Clearing House of the exchange, and the Clearing House of the exchange substitutes itself as the seller to the buyer and the buyer to the seller.<sup>7</sup>

A short who delivers the cash (*i.e.*, actual) commodity on his futures contract has consummated the contract and his position in the futures market is thereby liquidated, *i.e.*, he is no longer in the market. The long who accepts and pays for the commodity has also consummated his contract thereby liquidating his position in the market. In practice, however, actual delivery of the commodity seldom occurs; about 99% of the contracts are offset on the exchange by making an opposite futures transaction,<sup>8</sup> *i.e.*, the short in the example becomes the purchaser of a May wheat futures contract and the long becomes a seller of a May wheat futures contract thereby liquidating their positions.<sup>9</sup> The contractual provisions for delivery are, nonetheless, a necessary factor in establishing and maintaining

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<sup>7</sup> Daniel v. Board of Trade of City of Chicago, 164 F.2d 815, 817-819 (7th Cir. 1947); BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 33, 164-187, 297-300 (1949); Loman, *Commodity Exchange Clearing Systems*, ANNALS OF THE AM. ACAD. OF POL. AND SOC. SCI., May 1931, pt. 1, at 100-109.

<sup>8</sup> United States v. Coffee Exchange, 263 U.S. 611, 616 (1924); Chicago Board of Trade v. Olsen, 262 U.S. 1, 36 (1923); State v. J. Rosenbaum Grain Co., 115 Kan. 40, 222 Pac. 80, 84 (1924); BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 138 (1949); Hoffman, *Future Trading and the Cash-Grain Markets* 7 (U.S. Dep't of Agriculture Circular No. 201, 1932); Hoffman, *Governmental Regulation of Exchanges*, ANNALS OF THE AM. ACAD. OF POL. AND SOC. SCI., May, 1931, pt. 1, at 43-48; Irwin, *Legal Status of Trading in Futures*, 32 ILL.L.REV. 155, 156-157 (1937); Kauffman, *Recent Developments in Futures Trading Under the Commodity Exchange Act* 18 (U.S. Dep't of Agriculture Information Bulletin No. 155, Commodity Exchange Authority, June 1956); J. M. MEHL, THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE 327; Merrill Lynch, Pierce, Fenner and Beane, *How to Buy and Sell Commodities* 16-19 (rev. ed.); V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 185-187, 291-347 (1920); Taylor, *Trading in Commodity Futures—A New Standard of Legality?* 43 YALE L.J. 63, 89 (1933); U.S. DEP'T OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 12 (1937); WHITE AND BEACH, SELLING: THE TRANSFER OF OWNERSHIP, MARKETING, 1954 YEARBOOK OF AGRICULTURE 307.

<sup>9</sup> See 17 CFR § 1.46 (1949).

the relationship between futures prices and the prices of the cash commodities.<sup>10</sup>

In general, the principal terms of a futures contract provide for<sup>11</sup> (1) a standard unit of trading, e.g., 5,000 bushels of wheat, (2) any one of a number of grades of the commodity to be deliverable in fulfillment of the contract at premiums or discounts from a basic grade,<sup>12</sup> (3) the commodity to be deliverable only from an approved storage facility, (4) the commodity to be graded and weighed by licensed inspectors, (5) the commodity to be deliverable only during a specified month, and (6) the seller to have the option as to the grade delivered and the day of the month on which delivery is made.

Futures trading has developed into a vital part of the agricultural marketing system in the United States. It is implicit in the congressional findings as to the Commodity Exchange Act that the "commodity exchanges are part of our agricultural marketing system."<sup>13</sup> The exchanges provide a continuous market to buyers and sellers of agricultural commodities.<sup>14</sup> "The sales on the Chicago Board of Trade are just as indispensable to the continuity of the flow of wheat from the West to the mills and distributing points of the East and Europe, as are the Chicago sales of cattle to the flow of stock toward

<sup>10</sup> U.S. DEP'T OF AGRICULTURE, NEED FOR MULTIPLE DELIVERY POINTS IN GRAIN FUTURES MARKETS 1 (1947).

<sup>11</sup> U.S. DEP'T OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 4 (1937); HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 101-104 (1932). Not every commodity is suitable for futures trading. Commodities adaptable to futures trading must be homogeneous, susceptible of standardized grading, and sufficiently durable to last throughout the life of a future, ordinarily about one year. In addition, trading must be in sufficiently large volumes to support the cost of the facilities required, supply and demand must be uncertain thereby resulting in price fluctuations, the market must not be controlled by a few large operators, and the market must be sufficiently wide to be utilized by more than regional interests. U.S. DEP'T OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 4 (1937); BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 110-125 (1949); HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 451-453 (1932); V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 24-27 (1920).

<sup>12</sup> Some of the premiums are fixed at a level to encourage the delivery of the basic grade, but other premiums are fixed to put the buyer and seller on equal terms regardless of what grade is delivered. HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 277-305 (1932); BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 137-139 (1949).

<sup>13</sup> J. M. MEHL, FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954, at 27 (U.S. Dep't of Agriculture, 1954). See also, Taylor, *Trading in Commodity Futures—A New Standard of Legality?* 43 YALE L.J. 63, 63-94 (1933).

<sup>14</sup> Huebner, *The Insurance Service of Commodity Exchanges*, ANNALS OF THE AM. ACAD. OF POL. AND SOC. SCI., May 1931, pt. 1, at 1; U.S. DEP'T OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 4 (1937).

the feeding places and slaughter and packing houses of the East."<sup>15</sup> Trading in futures also provides a pricing basis for commodities sold throughout the country, and serves as a hedging facility permitting merchants and manufacturers to transfer the risk of price changes to speculators.<sup>16</sup>

Speculation in commodity futures has, at times, been invectively attacked,<sup>17</sup> but without speculators there would not be sufficient

<sup>15</sup> Chicago Board of Trade v. Olsen, 262 U.S. 1, 36 (1923).

<sup>16</sup> United States v. Coffee Exchange, 263 U.S. 611, 616, 619 (1924); HOFFMAN, FUTURE TRADING AND THE CASH-GRAIN MARKETS 35 (U.S. Dep't of Agriculture Circular No. 201, 1932); Irwin, *Legal Status of Trading in Futures*, 32 ILL.L.REV. 155, 157-160 (1937); J. M. MEHL, FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954, at 1; J. M. MEHL, THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE 324; WHITE AND BEACH, SELLING: THE TRANSFER OF OWNERSHIP, MARKETING, 1954 YEARBOOK OF AGRICULTURE 306-307. It was recognized as early as 1889 that the Chicago Board of Trade "has become of vast commercial influence, and fixes the market values of grain and agricultural products for a large territory, and the fluctuations in prices upon its floors powerfully affect the market prices of the necessaries of life throughout the country and the world." *New York & C. Grain and Stock Exch. v. Board of Trade*, 127 Ill. 153, 161, 19 N.E. 855, 858 (1889). "Those who have studied the economic effect" of futures contracts "generally agree that they stabilize prices in the long run instead of promoting their fluctuation." *United States v. Coffee Exchange*, 263 U.S. 611, 619 (1924). See also, *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 38 (1923).

<sup>17</sup> The sale of a commodity for future delivery of which the seller was not in possession at the time of the sale has been particularly criticized at various times. For example, it is stated in a congressional report relating to "options," defined as a futures contract in which delivery is not required, and "futures," defined as the sale of a commodity not owned by the seller at the time of the sale, that "obviously those who deal in 'options' and 'futures' contracts, which is mere gambling, no matter by what less offensive name such transactions may be designated, neither add to the supply nor increase the demand for consumption, nor do they accomplish any useful purpose by their calling; but on the contrary, they speculate in fictitious products. The wheat they buy and sell is known as 'wind wheat,' and doubtless for the reason that it is invisible, intangible, and felt or realized only in the terrible force it exerts in destroying the farming industry of the country.

"While the farmer labors from day to day, contending with flood and drought to produce his crop, and by reason of its small value when produced is compelled to deny himself and family the needful comforts of life, the producers of this other, a competing crop—this crop of mere 'wind' finds 'all seasons summer,' and 'toil not, neither do they spin,' and yet gather a golden harvest." H.R. REP. No. 1321, 51st Cong., 1st Sess. 2 (1890). See also, BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 77-82 (1949); H.R. REP. No. 969, 52nd Cong., 1st Sess. 1-14 (1892). The sale of a commodity for future delivery of which the seller was not in possession at the time of the sale was condemned in England by Sir John Barnard's Act in 1734 (7 Geo. II, c.8), which was repealed in 1860. HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 353-354 (1932). In 1864, the Congress enacted a law making it unlawful to make any contract for the sale and delivery of gold coin or bullion if the person making the contract was not, at the time of making the contract, in actual possession of the coin or bullion. Act of June 17, 1864, c.127, 13 Stat. 132. The Act was, however, repealed two weeks later. Act of July 2, 1864, c.209, 13 Stat. 344. Similarly, an Illinois statute enacted in 1867 made it a criminal offense to sell grain for future delivery unless the seller was in actual possession of the grain, but the statute was repealed in the next session of the legislature. I TAYLOR, HISTORY OF THE BOARD OF TRADE OF THE CITY OF CHICAGO 350-353 (1917). After an exhaustive study, the Federal Trade Commission reported, with respect to selling a commodity in the futures market not owned by the

traders to assume the hedging risks.<sup>18</sup> Mr. Rodger R. Kauffman, Administrator, Commodity Exchange Authority, testified at a recent congressional hearing that "speculation, as you, of course, well know, is essential to the operation of a futures market. A commodity futures market without speculation would be a thing of death; it would not amount to anything. It would serve no economic utility. So there must be speculation, of course."<sup>19</sup>

Substantial changes have occurred in the last 20 or 30 years in the volume of trading in particular commodities. The major agricultural commodities traded on the exchanges during the middle 1930's were wheat, cotton, and corn which accounted for approximately 95% of all futures trading.<sup>20</sup> However, in the year ending June 30, 1957, they accounted for only 43.5% of the total transactions.<sup>21</sup> The vol-

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seller, that no "evidence that it has any long-run depressive influence upon prices has been found. The commission believes that its suppression is not called for, though its regulation may be desirable." VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 282 (1926). When effectively used, such selling tends to broaden and stabilize futures markets. HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 423 (1932).

<sup>18</sup> BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 53-54, 73 (1949); VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 13-15 (1926).

<sup>19</sup> *Hearings Before the Subcommittee on Domestic Marketing of the Committee on Agriculture, House of Representatives*, 85th Cong., 1st Sess., on H.R. 376, H.R. 1933, H.R. 1935, H.R. 3418, H.R. 5236, and H.R. 5732, at 10 (1957).

<sup>20</sup> U.S. DEP'T OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 4 (1937). In a survey of the wheat and corn futures markets, conducted in 1934, there were traders from every State in the United States holding futures contracts on the Chicago Board of Trade and, also, there were a large number of traders in Canada, Europe, and the Orient. Farmers constituted the largest group of traders, with housewives ranking second. The traders represented nearly every occupation or line of endeavor. Bagnell, *Analysis of Open Commitments in Wheat and Corn Futures on the Chicago Board of Trade*, September 29, 1934, at 8, 16 (U. S. Dep't of Agriculture Circular No. 397, 1936).

<sup>21</sup> The following table shows the estimated number of futures transactions in the

Commodity	Number of transactions		Value	
	Thousands	Percent	Million dollars	Percent
Wheat	2,355	26.7	10,934	30.4
Corn	1,037	11.7	3,080	8.6
Oats	268	3.0	481	1.3
Rye	443	5.0	1,276	3.6
Soybeans	2,189	24.8	10,979	30.6
Cotton	446	5.1	3,798	10.6
Eggs	738	8.4	1,863	5.2
Potatoes	274	3.1	148	.4
Onions	179	2.0	75	.2
Cottonseed oil	152	1.7	713	2.0
Soybean oil	419	4.7	1,580	4.4
Lard	122	1.4	326	.9
Soybean meal	125	1.4	295	.8
All others	90	1.0	370	1.0
Total	8,837	100.0	35,918	100.0

ume of wheat traded in futures contracts during some years of the 1920's was 15 to 25 times the size of the wheat crop produced in the United States, but more recently it has been only 3 to 5 times the size of the crop.<sup>22</sup>

The present significance of futures trading is reflected in the volume and value of futures trading on the exchanges regulated under the Commodity Exchange Act. During the last decade, there have been more than eight million futures transactions a year in the commodities regulated under the Act, with an annual value of from thirty billion to fifty billion dollars.<sup>23</sup>

## II. EARLY LEGISLATIVE PROPOSALS AND ENACTMENTS

In 1884, the first bill providing, *inter alia*, for the regulation of futures trading in agricultural commodities was introduced in Congress,<sup>24</sup> and by 1922 more than 200 bills had been introduced to regulate or prohibit futures trading.<sup>25</sup> The first comprehensive regulatory statute with respect to trading in agricultural commodities, the Future Trading Act,<sup>26</sup> was enacted in 1921, but the principal provisions of the Act were immediately declared invalid in *Hill v. Wallace*<sup>27</sup> on the ground that the Act was an attempt to regulate by means of the taxing power. In its decision invalidating the Future Trading

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commodities regulated under the Commodity Exchange Act, purchases plus sales, in terms of contract units of trading, and the value of the trading in the commodities, purchases only. (Source: U.S. Department of Agriculture, Commodity Futures Statistics, July 1956-June 1957, at 4-5.)

<sup>22</sup> J.M. MEHL, *FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954*, at 10.

<sup>23</sup> J.M. MEHL, *THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE* 328. In the year ending June 30, 1954, the value of futures trading under regulation by the Commodity Exchange Act was approximately twice the value of transactions in stocks and bonds on the registered securities exchanges. J.M. MEHL, *FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954*, at 7.

<sup>24</sup> H.R. 5007, 48th Cong., 1st Sess. (1884).

<sup>25</sup> J.M. MEHL, *THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE* 324. See also, HOFFMAN, *FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS* 364-368 (1932).

<sup>26</sup> Act of August 24, 1921, c.86, 42 STAT. 187. The Future Trading Act was applicable to trading in wheat, corn, oats, barley, rye, flaxseed, and grain sorghums. The first statute applicable to time contracts was enacted during the Civil War, and related to contracts for the purchase or sale of gold or silver coin not maturing within three days. Act of March 3, 1863, c.74, §§ 4 and 5, 12 STAT. 719. The following year, an Act was passed prohibiting trading in gold coin or bullion which was to be delivered on any day subsequent to the day of making the contract and prohibiting entirely any contract for the sale of gold coin or bullion of which the person making the contract was not in possession at the time of making the sale. Act of June 17, 1864, c.127, 13 STAT. 132, repealed by the Act of July 2, 1864, c.209, 13 STAT. 344.

<sup>27</sup> 259 U.S. 44, 63-69 (1922).



Act, the Court stated that "sales for future delivery on the Board of Trade are not in and of themselves interstate commerce. They can not come within the regulatory power of Congress as such, unless they are regarded by Congress, from the evidence before it, as directly interfering with interstate commerce so as to be an obstruction or a burden thereon."<sup>28</sup>

Shortly after the decision in *Hill v. Wallace*, *supra*, the Congress enacted the Grain Futures Act, which was similar to the Future Trading Act, but based on the commerce clause of the Constitution.<sup>29</sup> The Act regulated futures trading in grain, *i.e.*, wheat, corn, oats, barley, rye, flaxseed, and grain sorghums.<sup>30</sup> The Act invalidated any futures transaction in grain except "(a) where the seller is at the time of the making of such contract the owner of the actual physical property covered thereby, or is the grower thereof, or in case either party to the contract is the owner or renter of land on which the same is to be grown, or is an association of such owners, or growers of grain, or of such owners or renters of land; or (b) where such contract is made by or through a member of a board of trade which has been designated by the Secretary of Agriculture as a 'contract market' . . . ."<sup>31</sup>

The Secretary was directed to designate a board of trade as a contract market if it met specified conditions.<sup>32</sup> A commission composed of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General was authorized to suspend or revoke the designation of a contract market,<sup>33</sup> and the Commission also was authorized to require all contract markets to refuse trading privileges to a person who was violating the Act or who was attempting to manipulate the price of grain.<sup>34</sup> In addition, the Secretary was authorized to make investigations relating to futures trading and to conditions affecting the grain markets, and to publish the results of his investigations.<sup>35</sup>

<sup>28</sup> *Id.* at 69. Other provisions of the Future Trading Act were invalidated in *Trusler v. Crooks*, 269 U.S. 475, 482 (1926).

<sup>29</sup> 42 STAT. 998 (1922), as amended, 7 U.S.C. § 1-17a (1952). The constitutionality of the Grain Futures Act under the commerce power was sustained in *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 31-40 (1923).

<sup>30</sup> 42 STAT. 998 (1922), as amended, 7 U.S.C. § 2 (Supp. IV, 1956).

<sup>31</sup> 42 STAT. 999-1000 (1922), as amended, 7 U.S.C. § 6 (1952).

<sup>32</sup> *Id.* § 7.

<sup>33</sup> *Id.* § 8.

<sup>34</sup> *Id.* § 9.

<sup>35</sup> *Id.* § 12, 12-1. The regulatory program under the Grain Futures Act is ex-

### III. THE COMMODITY EXCHANGE ACT

The Grain Futures Act was substantially strengthened by amendatory legislation in 1936 and renamed the Commodity Exchange Act.<sup>36</sup> The fundamental purpose of the Commodity Exchange Act "is to insure fair practice and honest dealing on the commodity exchanges and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves."<sup>37</sup> Another objective of the Act is to foster "the primary function of the exchanges which is to furnish a market for the commodities themselves."<sup>38</sup>

The regulatory ambit of the Grain Futures Act was extended by the 1936 legislation to include cotton, rice, mill feeds, butter, eggs, and Irish potatoes, in addition to the commodities previously subject to regulation, *i.e.*, wheat, corn, oats, barley, rye, flaxseed, and grain

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plained in HOFFMAN, *FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES* 368-375 (1932); U.S. DEP'T OF AGRICULTURE, *REPORT OF GRAIN FUTURES ADMINISTRATION* 2-26 (1924). Various other enactments which affected futures trading are the United States Cotton Futures Act, 39 STAT. 476 (1916), 26 U.S.C. §§ 1920-1935 (1952), which provides for a tax on each cotton futures contract unless, *inter alia*, the contract is in writing and contains specified provisions as to grade; the United States Grain Standards Act, 39 STAT. 482 (1916), 7 U.S.C. §§ 71-87 (1952), which provides for the Secretary to fix standards for grain, and upon their promulgation, requires shipments of grain in interstate commerce sold by grade to be sold on the basis of such standards; the United States Cotton Standards Act, 42 STAT. 1517 (1923), 7 U.S.C. §§ 51-65 (1952), which provides, *inter alia*, for the specification of cotton standards with the requirement that cotton be sold on the basis of such standards or by sample; and the United States Warehouse Act, 39 STAT. 486 (1916), 7 U.S.C. §§ 241-273 (1952), which authorizes the Secretary to license warehouses and to specify grades and standards for agricultural products by which their quality or value may be judged or determined. The United States Warehouse Act pre-empts the regulatory field and supersedes all State regulation as to any matter touched by the federal Act unless the State regulation is expressly authorized by the federal Act. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 220-238 (1947). The wide range of federal and state regulation with respect to the marketing of farm products is discussed in BROOKS, *THE WIDE RANGE OF REGULATION, MARKETING, 1954 YEARBOOK OF AGRICULTURE* 255-265.

<sup>36</sup> 42 STAT. 998 (1922), as amended, 49 STAT. 1491 (1936), as amended, 7 U.S.C. §§ 1-17a (1952), as amended, 68 STAT. 913 (1954), 69 STAT. 375 (1955), 70 STAT. 630 (1956), 69 STAT. 535 (1955), 69 STAT. 160 (1955), 7 U.S.C. §§ 2, 6a(3)(C), 12a(4), and 15 (Supp. IV, 1956). The constitutionality of the Commodity Exchange Act was sustained in *Nelson v. Secretary of Agriculture*, 133 F.2d 453, 455 (7th Cir. 1943); *Board of Trade v. Milligan*, 90 F.2d 855, 857-860 (8th Cir.), *cert. denied*, 302 U.S. 710 (1937); *Moore v. Chicago Mercantile Exchange*, 90 F.2d 735, 736-741 (7th Cir.), *cert. denied*, 302 U.S. 710 (1937). All trading in futures contracts is within the reach of the commerce power. *Corn Products Refining Company v. Benson*, 232 F.2d 554, 565 (2d Cir. 1956). See also, H.R. REP. No. 421, 74th Cong., 1st Sess. 3 (1935).

<sup>37</sup> H.R. REP. No. 421, 74th Cong., 1st Sess. 1 (1935).

<sup>38</sup> *Ibid.*

sorghums.<sup>39</sup> Wool tops were added in 1938, and fats and oils, cottonseed meal, cottonseed, peanuts, soybeans, and soybean meal were added in 1940. Wool was added in 1954, and the Act was made applicable to onions in 1955.<sup>40</sup>

The Act provides for trichotomous regulation of futures trading by the Secretary of Agriculture, the Commodity Exchange Commission, and the boards of trade. The Secretary of Agriculture, *inter alia*, licenses boards of trade,<sup>41</sup> futures commission merchants, and floor brokers,<sup>42</sup> suspends or revokes the licenses of futures commission merchants and floor brokers,<sup>43</sup> suspends the trading privileges of persons who violate the Act,<sup>44</sup> requires reports from traders who maintain positions equal to or in excess of limits fixed by the Secretary,<sup>45</sup> investigates and reports with respect to the operations of boards of trade and marketing conditions of commodities and commodity products and by-products,<sup>46</sup> and issues rules and regulations which are reasonably necessary, in his judgment, to effectuate any of the

<sup>39</sup> 49 STAT. 1491 (1936), as amended, 7 U.S.C. § 2 (Supp. IV, 1956).

<sup>40</sup> 52 STAT. 205 (1938), 54 STAT. 1059 (1940), 68 STAT. 913 (1954), 69 STAT. 375 (1955), 7 U.S.C. § 2 (Supp. IV, 1956). The Under Secretary of Agriculture stated, in his recommendation to Congress to include onions, that in "view of the perishable nature of the commodity and its susceptibility to wide price fluctuations, both before and since the advent of futures trading in onions, regulation of such trading under the Commodity Exchange Act could not reasonably be expected to prevent the wide seasonal price swings traditional in the marketing of onions.

"Enactment of the bill would, however, enable the Department to obtain the facts as to what takes place in the onion futures market and to deny trading privileges thereon to any person found, after notice and opportunity for hearing, to have engaged in manipulative trading or other unlawful trade practices. Also, information developed through investigations and reports required under authority of the Commodity Exchange Act could provide a factual basis for determining whether futures trading in onions serves the public interest or whether the Congress should consider legislation looking to the drastic curtailment or prohibition of such trading." H.R. REP. No. 285, 84th Cong., 1st Sess. 2 (1955); S. REP. No. 766, 84th Cong., 1st Sess. 2 (1955). Hearings have recently been conducted on various bills which would prohibit all futures trading in onions. *Hearings Before the Subcommittee on Domestic Marketing of the Committee on Agriculture, House of Representatives*, 85th Cong., 1st Sess., on H.R. 376, H.R. 1933, H.R. 1935, H.R. 3418, H.R. 5236, and H.R. 5732 (1957).

<sup>41</sup> 42 STAT. 1000 (1922), 7 U.S.C. § 7 (1952).

<sup>42</sup> 49 STAT. 1495 (1936), 7 U.S.C. § 6f (1952).

<sup>43</sup> 49 STAT. 1496, 1498, 1500 (1936), 7 U.S.C. § § 6g, 9, and 12a(3) (1952).

<sup>44</sup> 42 STAT. 1002 (1922), as amended, 7 U.S.C. § 9 (1952).

<sup>45</sup> 49 STAT. 1496 (1936), 7 U.S.C. § 6i (1952). The information obtained from individual reports is zealously guarded by the Commodity Exchange Authority. J.M. MEHL, FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954, at 28; *Bartlett Frazier Co. v. Hyde*, 65 F.2d 350, 352 (7th Cir.), *cert. denied*, 290 U.S. 654 (1933).

<sup>46</sup> 42 STAT. 1003 (1922), 61 STAT. 941 (1947), 49 STAT. 1501 (1936), 7 U.S.C. § § 12, 12-1, and 12a(6) (1952). See DORSEY, REPORTS AND STATISTICAL SERVICES OF THE COMMODITY EXCHANGE AUTHORITY, 1957 COMMODITY YEARBOOK 19-26.

provisions of the Act or to accomplish any of the purposes of the Act.<sup>47</sup> The Secretary has established the Commodity Exchange Authority as an agency in the United States Department of Agriculture to assist in the administration of the Act. The Divisions of the Commodity Exchange Authority are the Compliance and Trade Practice Division, the Segregated Funds Division, the License and Rules Division, and the Trading and Reports Division. The Authority has field offices in Chicago, Kansas City, Mo., Minneapolis, New Orleans, and New York.<sup>48</sup>

The Commodity Exchange Commission is a commission consisting of the Secretary of Agriculture, as chairman, the Secretary of Commerce, and the Attorney General.<sup>49</sup> The Commission (1) fixes trading limits,<sup>50</sup> (2) suspends or revokes the licenses of boards of trade,<sup>51</sup> (3) reviews the action of the Secretary refusing to license a board of trade,<sup>52</sup> (4) determines whether a board of trade may exclude a producer cooperative from membership in and trading privileges on the board of trade,<sup>53</sup> and (5) issues cease and desist orders against boards of trade or any officer, agent, or employee thereof.<sup>54</sup>

The Act recognizes the right of the exchanges (*i.e.*, boards of trade) to issue rules and regulations and to enforce their requirements.<sup>55</sup> The "authority of the exchanges to govern the conduct of their own members, and the responsibility therefor, is not impaired

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<sup>47</sup> 49 STAT. 1501 (1936), 7 U.S.C. § 12a(5) (1952). The "Secretary is given broad rule-making powers." *Rice v. Board of Trade*, 331 U.S. 247, 252 (1947).

<sup>48</sup> COMMODITY EXCHANGE AUTHORITY, U.S. DEP'T OF AGRICULTURE, ORGANIZATION AND PROCEDURES MANUAL 8-19 (1951).

<sup>49</sup> 7 U.S.C. § § 2, 8 (1952). The Commission has no separate administrative or regulatory staff of employees and, therefore, "virtually all of the technical labors incident to the discharge of the Commission's functions" are performed by the employees of the Commodity Exchange Authority. *SELLERS, ADMINISTRATIVE PROCEDURE AND PRACTICE IN THE DEPARTMENT OF AGRICULTURE UNDER THE COMMODITY EXCHANGE ACT 79-80* (U.S. Dep't of Agriculture, 1939).

<sup>50</sup> 49 STAT. 1492 (1936), 7 U.S.C. § 6a (1952).

<sup>51</sup> 7 U.S.C. § § 7b and 8 (1952).

<sup>52</sup> 42 STAT. 1001 (1922), 7 U.S.C. § 8 (1952).

<sup>53</sup> 49 STAT. 1499 (1936), 7 U.S.C. § 10a(1) (1952).

<sup>54</sup> 49 STAT. 1500 (1936), 7 U.S.C. § 13a (1952).

<sup>55</sup> 7 U.S.C. § § 7 and 7a (1952). The regulatory responsibility of the exchanges is similar to that of stockyard owners under the Packers and Stockyards Act, 42 STAT. 165 (1921), 7 U.S.C. § 208 (1952), and exchanges under the Securities Exchange Act of 1934, 48 STAT. 885 (1934), 15 U.S.C. § 78f (c) (1952). Congress did not, however, undertake to put behind the rules of the exchanges civil or criminal sanctions and, therefore, we "have no attempt here to endow private groups with law-making functions." *Rice v. Board of Trade*, 331 U.S. 247, 253, n.4 (1947). See also, *United States v. Grady*, 225 F.2d 410, 412-414 (7th Cir.), *cert. denied*, 350 U.S. 896 (1955).

or rendered uncertain by the act.”<sup>56</sup> “The Commodity Exchange Act leaves the exchanges virtually undisturbed in their powers to admit members and select officers, to discipline offenders and expel members, to determine delivery months and contract terms, to fix price-fluctuation limits, margin requirements, and brokerage fees and commissions, and to exercise many other important prerogatives.”<sup>57</sup> The exchanges regulate such important matters as “margins and price fluctuation limits, even though these may constitute effective means of curbing excessive speculative activity and unwarranted price movements.”<sup>58</sup> The Act also imposes on the exchanges, “under the supervision of the Secretary, . . . some responsibility for standardizing deliverable warehouse receipts and assuring their integrity.”<sup>59</sup> In addition, the exchanges have the power to compel members and their customers, in an emergency, to cease trading and to accept a reasonable settlement of their contracts.<sup>60</sup>

#### *A. Regulative Provisions With Respect to Contract Markets.*

All futures contracts with respect to the commodities regulated under the Commodity Exchange Act must be executed by or through a member of a board of trade which has been designated by the Secretary of Agriculture as a “contract market.”<sup>61</sup> A board of trade

<sup>56</sup> U.S. DEP'T OF AGRICULTURE, *Report of Grain Futures Administration* 5 (September 9, 1924).

<sup>57</sup> J.M. MEHL, *THE FUTURES MARKETS, MARKETING, 1954 YEARBOOK OF AGRICULTURE* 331.

<sup>58</sup> U.S. DEP'T OF AGRICULTURE, *Twenty-five Years of Futures Trading under Federal Regulation* 8 (1950). Most of the minimum initial margins prescribed by exchanges as of March 29, 1957, on speculative futures transactions were from 5% to 10% of the contract price of the commodity, with a high of 32.5%. *Hearings Before the Subcommittee on Domestic Marketing of the Committee on Agriculture, House of Representatives, 85th Cong., 1st Sess., on H.R. 376, H.R. 1933, H.R. 1935, H.R. 3418, H.R. 5236, and H.R. 5732, at 21 (1957)*. Limitations on daily price fluctuations were first imposed as a result of violent fluctuations in cotton futures prices caused by rumors with respect to the First World War. The limitations are to “allow market operators to obtain a more objective perspective on the underlying factors which have precipitated the heavy fluctuations, to prevent panic among either buyers or sellers, to permit the exchange commission houses, as well as the clearing house itself to prepare additional calls for market variation margins, and to enable exchange traders to prepare to meet such calls.” BAER AND SAXON, *COMMODITY EXCHANGES AND FUTURES TRADING* 157 (1949).

<sup>59</sup> *Rice v. Board of Trade*, 331 U.S. 247, 251 (1947).

<sup>60</sup> *Daniel v. Board of Trade*, 164 F.2d 815, 818-819 (7th Cir. 1947); *Crowley v. Commodity Exchange*, 141 F.2d 182, 185 (2d Cir. 1944); *Cargill, Inc. v. Board of Trade*, 164 F.2d 820, 822-823 (7th Cir. 1947), *cert. denied*, 333 U.S. 880 (1948). The decision of an exchange as to the price at which terminated contracts are to be settled is not price-fixing in violation of the Sherman Act. *Cargill, Inc. v. Board of Trade*, 164 F.2d 820, 823 (7th Cir. 1947), *cert. denied*, 333 U.S. 880 (1948).

<sup>61</sup> 7 U.S.C. § 6, 6h(1) (1952).

desiring to be designated as a contract market must apply to the Secretary for such designation,<sup>62</sup> and the Secretary is directed to designate any board of trade when it complies with and carries out the following conditions and requirements:<sup>63</sup>

<sup>62</sup> 42 STAT. 1001 (1922), 7 U.S.C. §8 (1952).

<sup>63</sup> 42 STAT. 1000 (1922), as amended, 7 U.S.C. §7 (1952). The following boards of trade are presently designated as contract markets by the Secretary (Source: U.S. Dep't of Agriculture, Contract Market Designations 1-2, October 15, 1957).

<i>Market</i>	<i>Designated</i>	<i>Effective</i>	<i>For</i>
Board of Trade of the City of Chicago	5/3/23	5/3/23	grain*
	9/14/36	9/13/36	cotton
	11/26/40	12/8/40	soybeans, lard, and cottonseed oil
	6/30/50	6/30/50	soybean oil
	8/22/51	8/22/51	soybean meal
Chicago Mercantile Exchange	9/11/36	9/13/36	butter, eggs, and Irish potatoes
	8/22/55	9/24/55	onions
Chicago Open Board of Trade	10/24/22	10/24/22	grain*
	12/7/40	12/8/40	soybeans
Duluth Board of Trade	5/11/23	5/11/23	grain*
Board of Trade of Kansas City	5/5/23	5/5/23	grain*
	9/14/36	9/13/36	millfeeds
	9/10/56	9/10/56	soybeans
Memphis Board of Trade Clearing Association	12/7/40	12/8/40	cottonseed meal and soybean meal
	8/20/53	8/20/53	soybeans
Milwaukee Grain Exchange	10/24/22	10/24/22	grain*
Minneapolis Grain Exchange	5/2/23	5/2/23	grain*
	9/11/50	9/11/50	soybeans
New Orleans Cotton Exchange	9/8/36	9/13/36	cotton
	11/26/40	12/8/40	cottonseed oil
New York Cotton Exchange	9/11/36	9/13/36	cotton
New York Mercantile Exchange	9/11/36	9/13/36	butter and eggs
	11/28/41	12/1/41	Irish potatoes
	5/5/49	5/5/49	rice
	8/17/55	9/24/55	onions
New York Produce Exchange	7/21/26	7/21/26	grain*
	11/26/40	12/8/40	cottonseed oil, soybean oil, and tallow
Portland Grain Exchange	4/30/29	4/30/29	wheat
San Francisco Grain Exchange	4/19/39	4/19/39	wheat and barley
Seattle Grain Exchange	1/29/26	1/29/26	wheat
Wool Associates of the New York Cotton Exchange, Inc.	6/1/38	6/1/38	wool tops
	10/14/54	10/27/54	wool

\* wheat, corn, oats, barley, rye, flaxseed, and grain sorghums.

(1) when the board is located at a terminal market where the cash commodity of the kind specified in the futures contracts is sold in sufficient volume and under such conditions as fairly to reflect the general value of the commodity and the differences in value between the various grades of the commodity, and where there is available official inspection service approved by the Secretary; or if the board is not so located, if the board provides for the delivery of commodities at a delivery point or points and upon terms and conditions approved by the Secretary;

(2) when the board provides for the making and filing by the board or any member thereof of adequate records and reports as prescribed by the Secretary;

(3) when the board provides for the prevention of dissemination by the board or any member thereof of false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of regulated commodities;

(4) when the board provides for the prevention of manipulation of prices and the cornering of commodities by dealers or operators upon the board;

(5) when the board does not exclude from membership in and all privileges on the board any duly authorized representative of any lawfully formed and conducted cooperative association of producers having adequate financial responsibility which is engaged in any cash commodity business, if such association has complied, and agrees to comply, with such terms and conditions as are or may be lawfully imposed on other members of the board,<sup>64</sup> except that no rule shall forbid the return on a patronage basis by the cooperative association to its bona fide members of moneys collected in excess of the expense of conducting the business of the association;<sup>65</sup> and

(6) when the board provides for making effective the orders of the Secretary suspending the registration of floor brokers or futures commission merchants under the Act or ordering contract markets to refuse trading privileges to any person.

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<sup>64</sup> See, *Board of Trade v. Olsen*, 262 U.S. 1, 40-42 (1923); *Board of Trade v. Wallace*, 67 F.2d 402 (7th Cir. 1933), *cert. denied*, 291 U. S. 680 (1934). See also, 49 STAT. 1499 (1936), as amended, 7 U.S.C. § 10a (1952).

<sup>65</sup> Boards of trade have long had rules preventing the rebate of commissions by members, but the return of profits by a cooperative association on a patronage basis does not conflict with the policy against commission rebates. S. REP. No. 390, 69th Cong., 1st Sess. 2 (1926).

Each contract market is required to furnish promptly to the Secretary copies of all bylaws, rules, regulations, and resolutions, and of all changes and proposed changes therein; to allow inspection at all times of all of its records by any authorized representative of the government; and to require the operators of warehouses in which or out of which commodities are deliverable on futures contracts to make such reports, keep such records, and permit such warehouse visitation as the Secretary may prescribe.<sup>66</sup> Contract markets must also require the party making delivery of any commodity on any futures contract to furnish the party obligated to accept delivery written notice of the date of delivery at least one business day prior to delivery, or such longer period as is prescribed by the Secretary;<sup>67</sup> and if directed by the Secretary, the contract market must provide for a period, after trading in futures contracts in a delivery month has ceased, during which the futures contracts may be satisfied by the delivery of the actual cash commodity.<sup>68</sup> In addition, contract markets are directed to require that all futures contracts provide for the delivery of commodities of grades conforming to United States standards, if they have been officially promulgated, and to require that receipts issued under the United States Warehouse Act shall be accepted in satisfaction of any futures contract without discrimination and notwithstanding that the warehouseman issuing such receipts is not also licensed as a warehouseman under the laws of any State or enjoys other or different privileges than under State law: "*Provided, however, that such receipts shall be for the kind, quality, and quantity of commodity specified in such contract and that the warehouse in which the commodity is stored meets such reasonable requirements as may be imposed by such contract market on other warehouses as to location, accessibility, and suitability for warehousing and delivery purposes.*"<sup>69</sup>

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<sup>66</sup> 49 STAT. 1497 (1936), 7 U.S.C. § 7a(1), (2), and (3) (1952).

<sup>67</sup> *Id.* § 7a(5).

<sup>68</sup> *Id.* § 7a(4). The cessation of trading prior to the end of a delivery period is designed to "prevent market congestion near the end of a delivery month," H.R. REP. No. 421, 74th Cong., 1st Sess. 7 (1935), but in the event of a corner or other tight market situation, the existence of a cease trading period "does not prevent the occurrence of small artificial price movements within a range where the short prefers to pay a small penalty rather than go to outside points for the acquisition of grain [or other commodities]." U.S. DEP'T. OF AGRICULTURE, NEED FOR MULTIPLE DELIVERY POINTS IN GRAIN FUTURES MARKETS 10 (1947).

<sup>69</sup> 49 STAT. 1498 (1936), 7 U.S.C. § 7a(6) and (7) (1952). Although the United States Warehouse Act preempts the field and excludes all state regulation of the subjects touched by the Act not expressly authorized by the Federal Act, *Rice v. Santa*



The Commodity Exchange Commission is authorized to suspend for a period not to exceed six months or to revoke the designation of a board of trade as a contract market if the board has failed to comply with the requirements imposed under the Act or is not enforcing its rules of government made a condition of its designation.<sup>70</sup> In lieu of a suspension or revocation order, the Commission may issue a cease and desist order if any board of trade, or any director, officer, agent, or employee of a board of trade violates any provisions of the Act or of the Secretary's regulations, or any order issued by the Commission pursuant to the Act. Violation of the cease and desist order is punishable by a fine of not less than \$500 nor more than \$10,000, or imprisonment for not less than six months nor more than one year, or both, and each day during which the failure to obey the cease and desist order continues is deemed a separate offense.<sup>71</sup>

*B. Regulative Provisions With Respect to Futures Commission Merchants and Floor Brokers.*

All persons who engage in business as futures commission merchants or floor brokers are required to register annually with the Secretary, and it is unlawful to act in either capacity without being registered.<sup>72</sup> The term "futures commission merchant" means all "individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of

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Fe Elevator Corp., 331 U.S. 218, 220-238 (1947), the Commodity Exchange Act does not preempt the field with respect to the standards for warehouses whose receipts are acceptable in satisfaction of futures contracts. *Rice v. Board of Trade*, 331 U.S. 247, 248-256 (1947).

<sup>70</sup> 49 STAT. 1498 (1936), 42 STAT. 1001 (1922), 7 U.S.C. § § 7b and 8 (1952). The suspension of a contract market has been ordered on only one occasion, and that was to compel the exchange to grant full membership and clearing privileges to a federally sponsored cooperative association—not to close the market. J.M. MEHL, *THE FUTURES MARKETS, MARKETING*, 1954 YEARBOOK OF AGRICULTURE 327. On appeal from the suspension order, the court upheld the statutory suspension provisions, but remanded the case to the Commission for further evidence. *Board of Trade v. Wallace*, 67 F.2d 402, 403-409 (7th Cir. 1933), *cert. denied*, 291 U.S. 680 (1934). The exchange, however, receded from its position without further litigation. J.M. MEHL, *THE FUTURES MARKETS, MARKETING*, 1954 YEARBOOK OF AGRICULTURE 327.

<sup>71</sup> 49 STAT. 1500 (1936), 7 U.S.C. § 13a (1952). Other criminal penalties are also set forth in the Act. 42 STAT. 1003 (1922), amended by 49 STAT. 1501 (1936), 7 U.S.C. § 13 (1952).

<sup>72</sup> 49 STAT. 1494-1495 (1936), 7 U.S.C. § § 6d, 6e, and 6f (1952). As of January 31, 1957, 530 persons were registered as futures commission merchants with 1,960 principal and branch offices, and 839 persons were registered as floor brokers. U.S. DEPARTMENT OF AGRICULTURE, ADMINISTRATIVE MEMORANDUM TO CEA FIELD OFFICES 1 (April 5, 1957).

any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.”<sup>73</sup> The term “floor broker” means “any person who, in or surrounding any ‘pit,’ ‘ring,’ ‘post,’ or other place provided by a contract market for the meeting of persons similarly engaged, shall engage in executing for others any order for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market, and who for such services receives or accepts any commission or other compensation.”<sup>74</sup>

A futures commission merchant is required to “treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held. . . .”<sup>75</sup>

It is unlawful<sup>76</sup> for any member of a contract market,<sup>77</sup> or for any correspondent, agent, or employee of any member, in or in connection with any futures transactions for any person—

- (A) to cheat or defraud or attempt to cheat or defraud such person;
- (B) willfully to make or cause to be made to such person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;
- (C) willfully to deceive or attempt to deceive such person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in

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<sup>73</sup> 49 STAT. 1491-1492 (1936), 7 U.S.C. § 2 (1952).

<sup>74</sup> *Id.* § 2.

<sup>75</sup> 49 STAT. 1494-1495 (1936), 7 U.S.C. § 6d(2) (1952). Additional provisions with respect to the depositing or investing of such money are set forth in the Act, *ibid.*, and in the Secretary’s regulations. 17 CFR § § 1.20-1.30 (1949).

<sup>76</sup> 49 STAT. 1493 (1936), 7 U.S.C. § 6b (1952).

<sup>77</sup> All floor brokers are members of a contract market, and almost all futures commission merchants are members of a contract market. However, some persons may be members of a contract market, *e.g.*, trading solely for themselves, and not be registered either as a futures commission merchant or as a floor broker.

regard to any act of agency performed with respect to such order or contract for such person; or

(D) to bucket such order,<sup>78</sup> or to fill such order by offset against the order or orders of any other person,<sup>79</sup> or willfully and knowingly and without the prior consent of such person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

It is also unlawful<sup>80</sup> for any person<sup>81</sup> to offer to enter into, or confirm the execution of, any futures transaction—

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a “wash sale,” “cross trade,” or “accommodation trade,” or is a fictitious sale;<sup>82</sup>

(B) if such transaction is, is of the character of, or is commonly

<sup>78</sup> Bucketing is the practice of taking the opposite side of a customer's trade instead of executing it in the open market. U.S. DEPT OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 18 (1937).

<sup>79</sup> The “matching of opposite buying and selling orders by a futures commission merchant in his office is off-setting. . . . The effect of matching orders in the office is that they are not offered openly and competitively on the market, which was the customer's rightful expectation, and the customer does not obtain an exchange contract as a result of such matching.” *Nichols & Co. v. Secretary of Agriculture*, 136 F.2d 503, 505 (1st Cir. 1943). Such offsetting on the exchange floor is likewise unlawful. *Id.* at 504. However, a member of a contract market having in hand at the same time buying and selling orders of different principals may execute such orders for and directly between such principals at the market price if he complies with the requirements of the Secretary's regulations, which provide that the transactions must be in conformity with written rules of the contract market which specifically apply to such cases and which require, *inter alia*, that such orders be first offered openly and competitively by open outcry in the trading pit or ring and that neither the futures commission merchant nor the floor broker handling the orders has any interest therein, directly or indirectly, except as a fiduciary. 17 CFR § 1.39 (1949).

<sup>80</sup> 49 STAT. 1494 (1936), 7 U.S.C. § 6c (1952).

<sup>81</sup> The discussion in this article of statutory provisions under a particular heading—*e.g.*, “Regulative provisions with respect to futures commission merchants and floor brokers”—which provisions apply, *e.g.*, to “any person,” is not meant to imply that the statutory provisions should be limited, but is solely in the interest of brevity.

<sup>82</sup> “The essential and identifying characteristics of a ‘wash sale’ seems to be the intent not to make a genuine, bona fide trading transaction in . . . commodities.” *In re Jean Goldwurm*, 7 A.D. 265, 274 (1948). Such sales are unlawful irrespective of whether they are for a manipulative purpose. *Ibid.* The Commodity Exchange Authority has advised futures commission merchants and floor brokers that “the use of the futures markets must be confined to bona fide purchases and sales of futures contracts. Transactions which are designed to give the appearance of being purchases and sales but at the same time avoid any actual change of ownership will be considered ‘wash’ or ‘fictitious’ sales within the meaning of Sec. 4c(A) of the Commodity Exchange Act. This view will be held regardless of whether such transactions are for the purpose of affecting tax liability, creating a false impression of market activity, avoiding or delaying delivery in fulfillment of futures contracts, or for any other purpose.” Letter dated April 26, 1948, from J.M. Mehl, Administrator, Commodity Exchange Authority, to all futures commission merchants and floor brokers.

known to the trade as, a "privilege," "indemnity," "bid," "offer," "put," "call," "advance guaranty," or "decline guaranty,"<sup>83</sup> or

(C) if such transaction is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.

Futures commission merchants and floor brokers are required to keep specified books and records and to file reports required by the Secretary.<sup>84</sup> As an incident to federal regulation, the Congress may require the keeping of adequate books and records and the submission of reports appropriate for the governmental supervision of the program, and such requirements do not violate the unreasonable search or seizure provisions of the fourth amendment to the Constitution or the self incrimination or due process provisions of the fifth amendment to the Constitution.<sup>85</sup>

The Secretary of Agriculture is authorized to suspend for a period not to exceed six months or to revoke the registration of a futures commission merchant or floor broker for violating any of the provisions of the Act or of the Secretary's regulations.<sup>86</sup> Criminal sanctions are also provided for certain violations of the Act by futures commission merchants and floor brokers.<sup>87</sup>

### C. Manipulation—and Anti-manipulative Provisions.

#### 1. Manipulation

One of the primary purposes of the Commodity Exchange Act is to prevent the manipulation of prices.<sup>88</sup> Manipulations "exert a vicious influence and produce abnormal and disturbing temporary fluctuations of prices that are not responsive to actual supply and demand and discourage not only . . . justifiable hedging but disturb

<sup>83</sup> Privileges and indemnities, etc., give to the buyer the right of exercising the option to sell or to buy a futures contract at a definite specified price within a definite period of time. *Trusler v. Crooks*, 269 U.S. 475, 481-482 (1926); Paul Mehl, *Trading in Privileges on the Chicago Board of Trade 2* (U.S. Dept of Agriculture Circular No. 323, 1934).

<sup>84</sup> 42 STAT. 999-1000 (1922), as amended, 7 U.S.C. § 6 (1952); 49 STAT. 1495, 1496 (1936), 7 U.S.C. §§ 6f and 6g (1952); 17 CFR §§ 1.18-1.19a, 1.27, and 1.31-1.39 (1949 and Supp. 1956); *Irving Weis & Co. v. Brannan*, 171 F.2d 232, 234-235 (2d Cir. 1948).

<sup>85</sup> *United States v. Morton Salt Co.*, 338 U.S. 632, 647-654 (1950); *Shapiro v. United States*, 335 U.S. 1, 32-35 (1948); *Davis v. United States*, 328 U.S. 582, 589-591 (1946); *Wilson v. United States*, 221 U.S. 361, 380 (1911); *Bartlett Frazier Co. v. Hyde*, 65 F.2d 350, 351-352 (7th Cir.), *cert. denied*, 290 U.S. 654 (1933).

<sup>86</sup> 49 STAT. 1496, 1498, 1500 (1936), 7 U.S.C. §§ 6g, 9, and 12a(3) (1952).

<sup>87</sup> 42 STAT. 1003 (1922), as amended, 49 STAT. 1501 (1936), 7 U.S.C. § 13 (1952)

<sup>88</sup> H.R. REP. NO. 421, 74th Cong., 1st Sess. 1 (1935).

the normal flow of actual consignments.”<sup>89</sup> “If hedgers find that they are frequently forced to buy back their short contracts at a price far above true supply and demand as dictated by a sufficiently powerful holder of long contracts, the market will lose its usefulness as a hedging medium.”<sup>90</sup>

Although the term manipulation is not defined in the Commodity Exchange Act, the term is not so vague and indefinite that the statute is void.<sup>91</sup> An artificial or manipulated price is created whenever the manipulator makes the market price of a commodity, or of a futures contract, behave in some manner in which it would not behave if left to adjust itself to uncontrolled or uninspired supply and demand.<sup>92</sup>

<sup>89</sup> Chicago Board of Trade v. Olsen, 262 U.S. 1, 39 (1923).

<sup>90</sup> COMMODITY EXCHANGE AUTHORITY, U.S. DEP'T OF AGRICULTURE, INVESTIGATION OF THE OCTOBER 1949 EGG FUTURES CONTRACT ON THE CHICAGO MERCANTILE EXCHANGE 27 (1950); U.S. DEPARTMENT OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 14 (1938). Actual delivery by hedgers caught in a corner is not generally possible or feasible. The hedgers who have short positions in the market—and who are, therefore, subject to being cornered—are frequently processors who own and need the cash commodity, which they have hedged by the sale of futures contracts, in their manufacturing operations. Other hedgers may be merchants who similarly own and need the cash commodity, which they have hedged, for distribution to their customers. See BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 197-250 (1949); HOFFMAN, FUTURE TRADING UPON ORGANIZED COMMODITY MARKETS IN THE UNITED STATES 377-418 (1932). Unless the price dictated as a result of a manipulative activity becomes too great, they are compelled to buy back their short contracts on the exchange at an artificially high price. In addition, in many instances the cash commodity which has been hedged may not be legally deliverable under the exchange rules. SHEPHERD, MARKETING FARM PRODUCTS 123 (2d ed. 1947). For example, with respect to December refrigerator egg futures contracts, the Chicago Mercantile Exchange is the primary exchange in the United States for trading in egg futures contracts, and persons from all over the country hedge their eggs on the Chicago Mercantile Exchange. However, in order to be deliverable under the exchange rules, the refrigerator eggs must be stored in an approved warehouse during the months of February through June and not moved from the storage point where they were originally stored. In addition, the lots of eggs must meet specific grade, weight, and packaging requirements. Gov. Exs. 9 and 10, Petitioners' Appendix 2055-2058, Miller v. United States (7th Cir. No. 11959), oral argument submitted November 22, 1957. It was found in a study of the October 1949 egg market that only 69,523 cases out of a total of 378,958 cases of eggs stored in approved warehouses outside of Chicago could have been delivered. U.S. DEP'T OF AGRICULTURE, INVESTIGATION OF THE OCTOBER 1949 EGG FUTURES CONTRACT ON THE CHICAGO MERCANTILE EXCHANGE 6 (1950). Also, the eggs stored in warehouses not approved for delivery could not, of course, be delivered, and the hedgers who have legally deliverable eggs are subjected to additional expense if they deliver eggs stored outside of Chicago. Gov. Exs. 9 and 10, Petitioners' Appendix 2055-2058, Miller v. United States, *supra*.

<sup>91</sup> Bartlett Frazier Co. v. Hyde, 65 F.2d 350, 354 (7th Cir.), *cert. denied*, 290 U.S. 654 (1933).

<sup>92</sup> DICE AND EITEMAN, THE STOCK MARKET 305 (3d ed. 1952); Frey, *Federal Regulation of the Over-the-Counter Securities Market*, 106 U. PA.L.REV. 19 (1957); Irwin, *The Nature of Risk Assumption in the Trading on Organized Exchanges*, 27 AM. ECON. REV. 267-278 (1937); JONES AND LOWE, *Manipulation, The Security Markets* 444-445, 503-504 (1935); VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 242-274 (1926).

### Manipulation is—

... any and every operation or transaction or practice, the purpose of which is not primarily to facilitate the movement of the commodity at prices freely responsive to the forces of supply and demand; but, on the contrary, is calculated to produce a price distortion of any kind in any market either in itself or in its relation to other markets. If a firm is engaged in manipulation it will be found using devices by which the prices of contracts for some one month in some one market may be higher than they would be if only the forces of supply and demand were operative; or using devices by means of which the price or prices of some month or months in a given market may be made lower than they would be if they were freely responsive to the forces of supply and demand. Any and every operation, transaction, [or] device, employed to produce those abnormalities of price relationship in the futures markets, is manipulation.<sup>93</sup>

Manipulation may cause the price to go up or down, or manipulation may apply a “brake” on the price movement which would have normally occurred, thereby causing the price to remain static or preventing the price from moving to the extent that it would normally have moved.<sup>94</sup> This latter type of manipulation is sometimes referred to “as stabilization. But in terms of market operations stabilization is but one form of manipulation. And market manipulation in its various manifestations is implicitly an artificial stimulus applied to (or at times a brake on) market prices, a force which distorts those prices, a factor which prevents the determination of those prices by free competition alone.”<sup>95</sup> Such “manipulation . . . undertaken purely

<sup>93</sup> Testimony of Mr. Arthur R. Marsh, formerly President of the New York Cotton Exchange, in *Cotton Prices, Hearings Before a Subcommittee of the Committee on Agriculture and Forestry, U.S. Senate, 70th Cong., 1st Sess., pursuant to S. Res. 142, at 201-203 (1928).*

<sup>94</sup> See the authorities cited in notes 92, 93, and 95.

<sup>95</sup> *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940). The *Socony-Vacuum Oil Co.* case arose under section 1 of the Sherman Act, which renders illegal any contract, combination, or conspiracy “in restraint of trade or commerce among the several States, or with foreign nations. . . .” 26 STAT. 209 (1890), 15 U.S.C. § 1 (1952). The Sherman Act does not contain the terms manipulation or stabilization and, therefore, the Court, in the *Socony-Vacuum Oil Co.* case, was undoubtedly using the terms in their ordinary meaning. Additional support for the position that “stabilization” is included within “manipulation” is found in the Securities Exchange Act of 1934. The federal regulation of commodity exchanges under the Commodity Exchange Act is comparable to the regulation of security exchanges under the Securities Exchange Act of 1934, *United States v. Grady*, 225 F.2d 410, 411 (7th Cir.), *cert. denied*, 350 U.S. 896 (1955), and the Congress has expressly included in the Securities Exchange Act of 1934, under the heading of manipulation, the “pegging, fixing, or stabilizing” of security prices unless authorized by administrative regula-

for the purpose of 'protecting the market,' probably occurs only at times of serious crises when large financial interests have too much at stake to permit the market to become completely demoralized."<sup>96</sup>

In the past several years, price manipulation has been attempted on a large scale in several commodities including eggs, soybeans, oats, and potatoes.<sup>97</sup> Some of the main forms of manipulation are (i) corners,<sup>98</sup> (ii) buying or selling in a manner calculated to produce an abnormal effect upon prices, frequently in a concentrated fashion and in relatively large lots,<sup>99</sup> and (iii) issuing false reports of conditions that affect or tend to affect prices.<sup>100</sup>

## 2. Corners

Corners constitute a menace to speculative markets and do not serve any useful social function. . . . They tend to disrupt the machinery of legitimate speculation and cause the greatest injustice to short sellers. Short selling is a vital necessity to any organized

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tions. 48 STAT. 890 (1934), 15 U.S.C. § 78i(a)(6) (1952). The House Committee Report on the bill which became the Securities Exchange Act of 1934 expressly refers to "pegging and stabilizing operations" as "manipulation." H.R. REP. NO. 1383, 73d Cong., 2d Sess. 10 (1934). The Securities and Exchange Commission has stated that it is "unanimous in recognizing that stabilizing is a form of manipulation." Securities and Exchange Commission, Securities Exchange Act of 1934 Release No. 2446, at 2, March 18, 1940. Whether or not the price of a commodity or of a commodity futures contract, which is stabilized or pegged at a certain level, was normal prior to the stabilization is irrelevant inasmuch as a normal price becomes abnormal—even though remaining static—if uncontrolled or uninspired supply and demand would have changed the price. *United States v. Socony-Vacuum Oil Co.*, *supra*, 310 U.S. at 221-223. "Those who fixed reasonable prices today would perpetuate unreasonable prices tomorrow, since those prices would not be subject to . . . readjustment in light of changed conditions." *Id.* at 221. See also, the authorities cited in notes 92 and 93, and notes, 60 YALE L.J. 822, 840-843 (1951); 97 U. PA.L.REV. 572 (1949). *Contra*, *General Foods Corporation v. Brannan*, 170 F.2d 220, 229-231 (7th Cir. 1948).

<sup>96</sup> JONES AND LOWE, *Manipulation, THE SECURITY MARKETS* 504 (1935).

<sup>97</sup> KAUFFMAN, RECENT DEVELOPMENTS IN FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT 7, U.S. DEP'T OF AGRICULTURE INFORMATION BULLETIN No. 155 (1956).

<sup>98</sup> *E.g.*, *Great Western Food Distributors v. Brannan*, 201 F.2d 476, 478-479 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953). See also, *In re G. H. Miller and Co.*, 15 A.D. 1015 (1956), *appeal pending* (7th Cir. No. 11959), oral argument submitted November 22, 1957.

<sup>99</sup> Irwin, *The Nature of Risk Assumption in the Trading on Organized Exchanges*, 27 AM. ECON. REV. 269 (1937); S. REP. NO. 212, 67th Cong., 1st Sess. 4 (1921). It has frequently been observed that large scale trading *per se* affects prices. *Ibid.* See also, VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 293-294 (1926); Paul Mehl, *Trading in Privileges on the Chicago Board of Trade*, *supra* note 83 at 78; U.S. DEP'T OF AGRICULTURE, REPORT OF THE CHIEF OF THE COMMODITY EXCHANGE ADMINISTRATION 8 (1937); U.S. DEP'T OF AGRICULTURE, TWENTY-FIVE YEARS OF FUTURES TRADING UNDER FEDERAL REGULATION 5 (1950); S. DOC. NO. 123, 71st Cong., 2d Sess. Part 2, 7-9 (1930).

<sup>100</sup> *E.g.*, *Moore v. Brannan*, 191 F.2d 775 (D.C. Cir.), *cert. denied*, 342 U.S. 860 (1951). See also, EMERY, *SPECULATION ON THE STOCK AND PRODUCE EXCHANGES OF THE UNITED STATES* 176 (1896); CLARK AND CLARK, *PRINCIPLES OF MARKETING* 537 (3d ed. 1942); VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 256-258, 273 (1926).

market, and the public derives many benefits therefrom. Deliberately to mulct the shorts is nefarious, and the sooner deliberate corners are treated as unsocial acts the better.<sup>101</sup>

Corners are prohibited by the Commodity Exchange Act,<sup>102</sup> but the Act does not define the term. It is clear, however, that the term "corner," as applied to a futures market, "is simply an abbreviation of the more comprehensive expression of 'cornering the shorts'."<sup>103</sup> The shorts have contracted to deliver the cash commodity during a specified month, and if the cornerer acquires such control over the shorts trading in the futures market that he is able to and does compel the shorts to settle their contracts with him at a manipulated price, a corner results.<sup>104</sup> A relatively small corner is also sometimes referred to as a squeeze.<sup>105</sup>

<sup>101</sup> Huebner, *Corner, Speculative*, 4 ENCYCLOPEDIA OF THE SOCIAL SCIENCES 409 (1937). See also, notes 89 and 90 *supra*, with respect to the disruptive effect of corners on hedging.

<sup>102</sup> 42 STAT. 1002, 1003 (1922), as amended, 7 U.S.C. §§ 9 and 13 (1952). The practice of cornering the shorts trading on a futures market is coetaneous with futures trading on the exchanges. The year 1868 was referred to as "the year of corners"—"there was a corner a month, three on wheat, two on corn, one on oats, one attempted on rye, and the year threatened to go out with a tremendous one on pork products." I TAYLOR, HISTORY OF THE BOARD OF TRADE OF THE CITY OF CHICAGO 370 (1917). As a result of the corners, the Board passed a resolution in 1868 in which it was resolved "that the practice of 'corners,' of making contracts for the purchase of a commodity, and then taking measures to render it impossible for the seller to fill his contract, for the purpose of extorting money from him, has been too long tolerated by this and other commercial bodies in the country to the injury and discredit of legitimate commerce, that these transactions are essentially improper and fraudulent, and should any member of this board hereafter engage in any such transactions, the Directors should take measures for his expulsion, under the provisions of Rule 5, for the prevention of improper and fraudulent practices." *Id.* at 371. An Illinois statute effective in July 1874 made it a criminal offense to spread false rumors or corner the market, but there was almost a corner a month for the rest of the year. *Id.* at 502.

<sup>103</sup> HUEBNER, THE STOCK MARKET 332 (1922). With respect to manipulations, corners, and certain other provisions of the Act, the statutory provisions are applicable to transactions in the cash commodity in interstate commerce as well as to futures transactions, but the scope of this article is limited to futures transactions.

<sup>104</sup> *Great Western Food Distributors v. Brannan*, 201 F.2d 476, 478-479 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); *United States v. Patten*, 226 U.S. 525, 539-540 (1913); BAER & SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 82-83 (1949); BRACE, THE VALUE OF ORGANIZED SPECULATION 35, 105-107 (1913); Emery, *Futures in the Grain Market*, IX ECONOMIC JOURNAL 54 (1899); EMERY, SPECULATION ON THE STOCK AND PRODUCE EXCHANGES OF THE UNITED STATES 173 (1896); GOLDSTEIN, MARKETING: A FARMER'S PROBLEM 127 (1928); HUBBARD, COTTON AND THE COTTON MARKET 392-396 (2d ed. 1927); Huebner, *Corner, Speculative*, 4 ENCYCLOPEDIA OF THE SOCIAL SCIENCES 408 (1937); HUEBNER, THE STOCK MARKET 339-340 (1922); V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 322-329 (1920); SMITH, ORGANISED PRODUCE MARKETS 112-116 (1922); WELD, THE MARKETING OF FARM PRODUCTS 321-322 (1916).

<sup>105</sup> BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 83 (1949); WORKING, *Price Relations Between May and New-Crop Wheat Futures at Chicago Since 1885*, X WHEAT STUDIES OF THE FOOD RESEARCH INSTITUTE 184, n. 1 (1934).



"The methods of manipulators are legion but certain patterns frequently emerge."<sup>106</sup> The cornerer generally acquires a large long futures position thereby obligating the shorts to deliver a large quantity of the cash commodity during a certain month—usually a month in which the supplies of the cash commodity are at a low level. The cornerer then frequently acquires control over part of the cash commodity, either by purchases in the cash market or by receiving delivery on his long futures contracts, so that the shorts are unable to find sufficient quantities of the cash commodity to deliver and are compelled to liquidate their futures contracts either in offsetting transactions on the exchange with the cornerer or by purchasing the cash commodity from the cornerer for the purpose of making delivery. Irrespective, however, of the method employed by the cornerer, if a controlling position<sup>107</sup> is obtained in the futures market so that the shorts are forced to settle their contracts with the cornerer at a manipulated price, a corner has been achieved.<sup>108</sup>

One of the difficulties conjoined with a cornering operation is the disposal of the cash commodity acquired as a result of the corner. The price of the cash commodity available for delivery on the futures contracts is raised concomitantly with the price of the futures contracts inasmuch as the cash commodity is "temporarily in extraordinary demand for the sole and only purpose of using it to meet future contracts."<sup>109</sup> The price of the cash commodity generally falls precipitously as soon as the extraordinary demand is satisfied.<sup>110</sup>

<sup>106</sup> Frey, *Federal Regulation of the Over-the-Counter Securities Market*, 106 U. PA. L. REV. 19 (1957).

<sup>107</sup> A controlling position is obtained even if the shorts can, by incurring additional expense, obtain the cash commodity for delivery. *Great Western Food Distributors v. Brannan*, 201 F.2d 476, 480-481 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); *In re G. H. Miller and Co.*, 15 A.D. 1015, 1047 (1956), *appeal pending*, *Miller v. United States* (7th Cir. No. 11959). See also, *Gamco, Inc. v. Providence Fruit & Produce Bldg.*, 194 F.2d 484, 487 (1st Cir.), *cert. denied*, 344 U.S. 817 (1952). The cornerer seeks to raise the price just high enough so that the shorts will buy from him (futures contracts or cash supplies) rather than incur other expense, *e.g.*, by bringing the cash commodity into a delivery point from some other source. BRACE, *THE VALUE OF ORGANIZED SPECULATION* 105-107 (1913); EMERY, *FUTURES IN THE GRAIN MARKET*, IX *ECONOMIC JOURNAL* 54 (1899); HUBBARD, *COTTON AND THE COTTON MARKET* 396 (2d ed. 1927); SMITH, *ORGANIZED PRODUCE MARKETS* 113 (1922).

<sup>108</sup> See the authorities cited in note 104, *supra*.

<sup>109</sup> V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 323 (1920).

<sup>110</sup> The precipitous drop in the price of the cash commodity after the corner is concluded is one of the evidentiary bases for determining that a corner has occurred. EMERY, *SPECULATION ON THE STOCK AND PRODUCE EXCHANGES OF THE UNITED STATES* 174 (1896); V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 323 (1920); VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 245-248 (1926); SMITH, *ORGANISED PRODUCE MARKETS* 113 (1922).

Hence the cornerer is frequently faced with the prospect of having to suffer serious losses in the disposal of the cash commodity, *i.e.*, in "burying the corpse" of the corner.

It is said that the late P. D. Armour was once told that there was a large speculative short interest in December pork and was asked why he did not "corner" that delivery. He is said to have replied, "To commit murder is very simple, the trouble is to bury the corpse." The latter phrase is so appropriate to the difficulties of a commodity corner that it has been universally adopted and today you will hear it said that a cotton corner does not pay because it costs too much to "bury the corpse."<sup>111</sup>

Thus the problem of "burying the corpse" may present a dilemma to the cornerer. He is frequently forced to acquire, either by purchase or by receiving delivery through the Clearing House of the exchange, a large part of the available cash supplies of the commodity involved in the corner. He would like to dispose of the cash commodity without suffering a serious loss on his cash transactions, but if the shorts are able to obtain sufficient supplies of the cash commodity for delivery on their contracts, they can, by delivering the cash commodity, escape from the corner. If the cornerer sells the cash commodity to the shorts, the shorts will redeliver the cash commodity to the cornerer, through the Clearing House of the exchange, and the shorts will be free from the corner, but the cornerer will still be faced with the problem of "burying the corpse." Hence the cornerer generally demands from the shorts about the same price for the cash commodity as the price at which he will liquidate his futures position on the exchange.

In the case of a group cornering enterprise, an additional reason for not selling the cash commodity at a price below the agreed upon price for liquidating the futures positions is to prevent the agreed upon price from being jeopardized. The whole price structure of cash and futures is artificially high as a result of the corner, and if any of the manipulators permit the shorts to escape at less than the agreed upon price, each manipulator may be fearful that the manipulative scheme will fail, and each manipulator may then permit the shorts to escape—either by sales of cash supplies or by offsetting futures transactions—at successively lower prices in order to obtain

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<sup>111</sup> HUBBARD, COTTON AND THE COTTON MARKET 393 (2d ed. 1927).

the maximum liquidation of his own position at the highest possible price. Any "price cutting" by any of the joint manipulators which permits the shorts to escape from the corner at less than the agreed upon price could, therefore, be ruinous to the venture.<sup>112</sup>

#### Corners or squeezes—

. . . are at least occasionally so handled that their financial success does not depend on effecting a price increase. Because the character of corners and squeezes is not generally well understood, such cases of abnormal market influence have sometimes, perhaps often, gone unrecognized or been regarded more lightly than they deserved by people not well versed in interpretation of the market.

The indications are that successful corners or squeezes in wheat may sometimes have been "hedged." For example, purchases of May wheat made as part of a plan for squeezing the market may be accompanied or shortly followed by sales of later deliveries, perhaps July. These sales of the later futures would not only provide an assured means of disposing of such deliveries on May contracts as may have to be accepted, but leave the "squeezer" indifferent to the development of bearish price influences which may wholly offset the bullish effects of his operations in May wheat. With a corner or squeeze thus hedged, he need be in nowise concerned with the actual changes in price of May wheat, since his profits depend merely on his ability to force a widening of the spread between May and July wheat of which he can take advantage. Indeed he may welcome a tendency toward general wheat price decline as an aid in obscuring the effects of his operations.<sup>113</sup>

That type of a "hedged" corner of the December 1947 egg futures market was involved in *Great Western Food Distributors v. Bran-*  
*nan*.<sup>114</sup> Great Western Food Distributors, Inc., purchased large quan-

<sup>112</sup> If, however, joint cornerers are able to dispose of supplies of the cash commodity in channels which do not make the supplies available to the shorts, they might be expected to dispose of the supplies at the fair market price. In the case of *Miller v. United States* (7th Cir. No. 11959), oral argument submitted November 22, 1957, the respondents in the administrative proceeding liquidated most of their large and controlling futures positions on December 23, 1952, the last day of trading in December 1952 egg futures contracts, and they liquidated at 47.50-47.55 cents per dozen. However, on the following day, four of the respondents disposed of their deliverable eggs at 39.75 cents per dozen in channels which did not permit their use by the shorts who still had futures positions to liquidate by the last business day of the month. Gov. Ex. 19, Petitioners' Appendix 2070-2075, *Miller v. United States*, *supra*.

<sup>113</sup> WORKING, PRICE RELATIONS BETWEEN MAY AND NEW-CROP WHEAT FUTURES IN CHICAGO SINCE 1885, X WHEAT STUDIES OF THE FOOD RESEARCH INSTITUTE 184 (1934). See also, VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 77, 245-248 (1926).

<sup>114</sup> 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

tities of December egg futures contracts and sold large quantities of January egg futures contracts so that Great Western's profit was dependent upon widening the spread between the prices of the December and January egg futures contracts.<sup>115</sup> The price of December egg futures contracts was falling during most of the period of Great Western's corner, but as a result of the cornering activities of Great Western, the decline in the December futures price was not as great as would have occurred in the absence of the corner.<sup>116</sup> The January futures price, however, fell to its normal level, widening the spread between the December and January futures prices, thereby resulting in a substantial profit to Great Western.<sup>117</sup>

The question of manipulative intent is relevant in determining whether a corner has been consummated in violation of the Act inasmuch as in rare instances an unintentional corner develops when the longs actually want delivery of the cash commodity and there is not enough of the cash commodity available for delivery on the

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<sup>115</sup> Gov. Ex. 4, Transcript of Record 1117, Great Western Food Distributors v. Brannan, *supra* note 107. If a person corners the December egg futures market— with an accompanying short January egg futures position—during a period when December and January egg futures prices would normally have declined, he can make a substantial profit if the December price is held at its existing level or even if the December price is permitted to decline, but to a lesser extent than would have occurred in the absence of the manipulation. For example, if a trader purchases December egg futures at 50 cents per dozen and sells January egg futures at 48 cents per dozen, the initial spread between the two futures is 2 cents per dozen. If the December futures price drops to 49 cents per dozen, while the January futures price drops to 45 cents per dozen, there is now a 4-cent spread between the two futures and the trader has profited by 2 cents per dozen, which is the amount that the spread has widened since the trader entered the market. In this example, the trader can offset his long December contracts, under which he was a purchaser at 50 cents per dozen, by selling on the exchange at 49 cents per dozen. This results in offsetting the trader's December position in the market at a loss of 1 cent per dozen on the December contracts. However, the trader can offset his short January contracts, under which he was a seller at 48 cents per dozen, by becoming a purchaser on the exchange at 45 cents per dozen. This offsets the trader's January position in the market at a profit of 3 cents per dozen which, when combined with his 1 cent per dozen loss on the December futures transactions, still leaves the trader a profit of 2 cents per dozen. If the December price had been held exactly at 50 cents per dozen, the spread would have been widened by an additional cent thereby resulting in a profit of 3 cents per dozen on the transaction. Although the entire profit in this illustration is reflected in the January futures transactions, the entire profit was caused, of course, by the manipulation of the December price. The trader may also "bury the corpse" of the December corner on part of his short January position, *i.e.*, the trader may deliver the eggs, acquired as a result of the December corner, on part of his short January futures position. The delivery of large quantities of cash refrigerator eggs on the January contracts may have the effect of seriously depressing the January futures price thereby permitting the trader to reap a greater profit from buying back the remainder of his short position on the exchange.

<sup>116</sup> Gov. Exs. 24 and 25, Transcript of Record 1228-1229, Great Western Food Distributors v. Brannan, *supra* note 107.

<sup>117</sup> Gov. Exs. 22 and 25, Transcript of Record 1217, 1229, Great Western Food Distributors v. Brannan, *supra* note 107.

contracts.<sup>118</sup> However, even if a large long position is originally established because the long interest wants to receive delivery of the cash commodity, the "long interest, no matter how built up, that allows itself to be tempted into exploiting the situation in a way to involve acute disturbance of the market becomes a cornering interest."<sup>119</sup> Moreover, in any corner case, the requisite intent is merely a general intent, rather than a "specific" intent,<sup>120</sup> and the intent may be inferred from the actions of the cornerer. Persons "will be presumed to have intended the natural consequences of their acts. . . ." <sup>121</sup>

### 3. *Suspension of Trading Privileges*

The Secretary is authorized to suspend the trading privileges of any person who corners the market or otherwise manipulates prices, or who violates any of the provisions of the Act.<sup>122</sup> In permitting a person to buy and sell futures contracts on contract markets, the

<sup>118</sup> HUEBNER, *THE STOCK MARKET* 339, note 9 (1922); VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 243-244 (1926).

<sup>119</sup> VII REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 244 (1926).

<sup>120</sup> The issue as to proof of intent in the case of a corner is identical to the issue as to proof of intent in the case of a monopoly in violation of the Sherman Act. A corner is a monopolistic enterprise which violates the Sherman Act as well as the Commodity Exchange Act. *United States v. Patten*, 226 U.S. 525, 540-544 (1913); *Peto v. Howell*, 101 F.2d 353, 354-362 (7th Cir. 1939). Judge Learned Hand stated for the court in *United States v. Aluminum Co. of America*, 148 F.2d 416, 432 (2d Cir. 1945), that in "order to fall within § 2 [of the Sherman Act], the monopolist must have both the power to monopolize, and the intent to monopolize," but to "read the passage as demanding any 'specific,' intent, makes nonsense of it, for no monopolist monopolizes unconscious of what he is doing." That holding was expressly approved in *Times-Picayune v. United States*, 345 U.S. 594, 626 (1953), and *United States v. Griffith*, 334 U.S. 100, 105 (1948).

<sup>121</sup> *United States v. Anderson*, 101 F.2d 325, 330 (7th Cir.), *cert. denied*, 307 U.S. 625 (1939); *accord*, *Crews v. United States*, 160 F.2d 746, 750 (5th Cir. 1947). Persons "must be held to have intended the necessary and direct consequences of their acts and cannot be heard to say the contrary." *United States v. Patten*, 226 U.S. 525, 543 (1913); *United States v. Masonite Corp.*, 316 U.S. 265, 275 (1942). See also, *R.J. Koeppe & Co. v. Securities and Exchange Commission*, 95 F.2d 550, 552-553 (7th Cir. 1938); *Branda, Manipulation of the Stock Markets Under the Securities Laws*, 99 U. PA.L.REV. 651, 664 (1951).

<sup>122</sup> 42 STAT. 1002 (1922), amended by 49 STAT. 1498-1499 (1936), as amended, 7 U.S.C. § 9 (1952). Criminal penalties are also applicable if any person, *inter alia*, corners the market or otherwise manipulates prices. 42 STAT. 1003 (1922), amended by 49 STAT. 1501 (1936), 7 U.S.C. § 13 (1952). The Secretary's decision must be based on the evidence received at an administrative hearing (42 STAT. 1002 (1922), as amended, 7 U.S.C. § 9 (1952) held before a "referee," *i.e.*, a Hearing Examiner appointed under section 11 of the Administrative Procedure Act. 60 STAT. 244 (1946), as amended, 5 U.S.C. § 1010 (1952); 17 CFR § 0.2 (m) and (p) (1949). The rules of practice applicable to disciplinary proceedings under the Commodity Exchange Act are in 17 CFR §§ 0.3-0.22 (1949). The Judicial Officer of the United States Department of Agriculture acts for the Secretary of Agriculture in all disciplinary proceedings under the Act pursuant to a delegation of authority from the Secretary.

government has in effect granted him a privilege. "Suspension of such a privilege for failure to comply with the statutory standard is merely withdrawal by the Government of permission to engage in a business affected with a national public interest in which the person has no inherent right to engage, but in which he may participate only upon compliance with conditions imposed by Congress in the exercise of its power over commerce."<sup>123</sup> The Secretary has wide latitude in the choice of the administrative sanction or remedy, and the courts will not interfere except where the remedy selected has no reasonable relation to the unlawful practices found to exist.<sup>124</sup>

In *Cutten v. Wallace*,<sup>125</sup> and *Moore v. Brannan*,<sup>126</sup> the issue was presented as to whether the authority was granted to suspend a person's trading privileges for a past attempt to manipulate futures prices. The *Cutten* case was decided under the Grain Futures Act, which authorized the Commission to suspend the trading privileges of any person who "is violating any provisions of this Act, or is attempting to manipulate the market price of any grain. . . ." <sup>127</sup> The court of appeals held that inasmuch as Cutten was charged with a past violation of the reporting requirements of the Act and a past attempt to manipulate the price of grain, the Commission did not have authority to suspend his trading privileges.<sup>128</sup> The Supreme Court affirmed the decision of the court of appeals holding that the language of the statute cannot be changed "for the purpose of making punishable action which, on the face of the statute, is merely to be prevented."<sup>129</sup>

Pending the outcome of the review of the *Cutten* case by the Supreme Court, H.R. 6772 (which became the Commodity Exchange Act amendments of 1936) was introduced, *inter alia*, to correct the "manifest mistake" in the Grain Futures Act disclosed by the *Cutten*

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<sup>123</sup> *Nelson v. Secretary of Agriculture*, 133 F.2d 453, 456 (7th Cir. 1943). A proceeding to suspend a registrant is not in the nature of a criminal proceeding. *Ibid*, *Nichols & Co. v. Secretary of Agriculture*, 131 F.2d 651, 659 (1st Cir. 1942); *Board of Trade v. Wallace*, 67 F.2d 402, 407 (7th Cir. 1933), *cert. denied*, 291 U.S. 680 (1934).

<sup>124</sup> *Great Western Food Distributors, Inc. v. Brannan*, 201 F.2d 476, 484 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); *Irving Weis & Co. v. Brannan*, 171 F.2d 232, 235 (2d Cir. 1948); *American Power Co. v. Securities and Exchange Commission*, 329 U.S. 90, 112-118 (1946).

<sup>125</sup> 80 F.2d 140, 140-141 (7th Cir. 1935).

<sup>126</sup> 191 F.2d 775 (D.C. Cir.), *cert. denied*, 342 U.S. 860 (1951).

<sup>127</sup> § 6(b), c. 369, 42 STAT. 1002 (1922).

<sup>128</sup> 80 F.2d at 140-141 (7th Cir. 1935).

<sup>129</sup> *Wallace v. Cutten*, 298 U.S. 229, 237 (1936).

case.<sup>130</sup> Several Senators explained in detail on the floor of the Senate the grave defect that the *Cutten* case revealed in the Grain Futures Act which made plain the necessity for changing the statute.<sup>131</sup> Similarly, it is recognized in the report of the House Committee that the 1936 amendments are necessary to "clarify the language of § 6 of the act in its application to manipulations of and attempts to manipulate the market price of any commodity. . . ." <sup>132</sup>

Consequently, a legislative reversal of the result in the *Cutten* decision was enacted in the Commodity Exchange Act amendments of 1936. Section 6(b) of the Grain Futures Act was amended by the 1936 amendments to provide that the Secretary may suspend the trading privileges of any person if he "is violating or has violated any of the provisions of this chapter, or any of the rules and regulations made pursuant to its requirements, or has manipulated or is attempting to manipulate the market price of any commodity. . . ." <sup>133</sup> The 1936 amendments also added a provision in § 9 of the Grain Futures Act making it a violation of that section "to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any board of trade. . . ." <sup>134</sup> Hence a person who has attempted to manipulate the futures price of any commodity has violated the provisions of § 9 of the Act, and under section 6(b) of the Act the Secretary is authorized to suspend the person's trading privileges. In *Moore v. Brannan*, *supra*, the court affirmed the decision by the Judicial Officer, acting for the Secretary, suspending Mr. Moore's trading privileges for a past attempt to manipulate the price of lard futures contracts.<sup>135</sup>

#### 4. Trading Limits

The Commodity Exchange Commission is authorized to fix limits on the amount of trading which may be done by any person during any trading day or on the maximum position which any trader may

<sup>130</sup> 80 CONG. REC. 1451 (1936).

<sup>131</sup> *Id.* at 1451, 6159, 6160, 7847, 7852, 7853, 7858 (1936).

<sup>132</sup> H.R. REP. No. 421, 74th Cong., 1st Sess. 8 (1935).

<sup>133</sup> 42 STAT. 1002 (1922), amended by 49 STAT. 1498 (1936), 7 U.S.C. § 9 (1952).

<sup>134</sup> 42 STAT. 1003 (1922), as amended, 49 STAT. 1501 (1936), 7 U.S.C. § 13 (1952).

<sup>135</sup> 191 F.2d 775 (D.C. Cir.), *cert. denied*, 342 U.S. 860 (1951), *affirming In re Ralph W. Moore*, 9 A.D. 1299 (1950). See also, *Nichols & Co. v. Secretary of Agriculture*, 131 F.2d 651, 659 (1st Cir. 1942).

hold or control.<sup>136</sup> The "limits have proved to be an effective means of curbing large-scale operations of market 'plungers,' and forced liquidation of large positions causing sharp price fluctuations."<sup>137</sup>

All trading except "bona fide hedging transactions," as defined in the Act, is subject to the limits.<sup>138</sup> The statutory definition of "bona fide hedging" is, however, more meaningful if the customary trade principles of hedging are understood. Hedging, *e.g.*, in the grain trade—

. . . is the term commonly applied by the grain trade to the method employed by many dealers in cash grain of protecting themselves against losses due to market fluctuations by executing with cash purchases and sales practically simultaneous future transactions upon the opposite side of the market. This is done upon the assumption that the prices of cash and future grain will move up and down together and that as the trades are on opposite sides of the market the decline or advance of either will be compensated by a corresponding fluctuation in the other. While this theoretical harmony in the movement of cash and future prices is not always to be found and the coincidence of the two movements is often more or less seriously disturbed, it is none the less well established that, broadly speaking, the cash and future prices actually do move up and down together with considerable regularity if not in the same degree. Consequently this fact is often taken advantage of by country elevator merchandisers as well as other cash grain dealers, both of which classes frequently execute practically simultaneous cash and future trades on the opposite sides of the market, expecting, since cash and future prices move together, that gains or losses in cash or futures, bought or sold, will be compensated or offset by corresponding losses or gains in futures or cash sold or bought.<sup>139</sup>

It may be helpful to trace a typical hedging transaction. A flour miller makes a contract in July to deliver 5,000 barrels of a specific grade of flour in December at a fixed price. He will need a specific quantity of a specific quality of wheat for milling into flour in November. At the time the miller makes the contract for sale of the flour, he can simultaneously buy December futures contracts for the necessary *quantity* of wheat on the Chicago Board of Trade,

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<sup>136</sup> 49 STAT. 1492 (1936), 7 U.S.C. § 6a (1952).

<sup>137</sup> J.M. MEHL, FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954, at 31. See also, KAUFFMAN, RECENT DEVELOPMENTS IN FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT 6, U.S. DEPT OF AGRICULTURE INFORMATION BULLETIN No. 155 (1956).

<sup>138</sup> 49 STAT. 1492 (1936), 7 U.S.C. § 6a (1952); *Corn Products Refining Company v. Benson*, 232 F.2d 554, 558-561 (2d Cir. 1956).

<sup>139</sup> I REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 207 (1920).



or the Minneapolis or Kansas City grain exchange. In the interval between the time when the contract for the sale of the flour is made and November, when the miller will need the specific grades of wheat to mill the flour, the price of wheat rises, say, 2 cents per bushel. When November arrives he purchases in the spot market wheat of the quantity and *quality* he desires. He loses 2 cents per bushel by reason of the advance in the price of wheat on the physical market during the intervening four months, but at the time he obtains the spot wheat he simultaneously closes out his hedge transaction by selling the December exchange contracts. He makes thereby a corresponding profit of 2 cents per bushel on his exchange transaction. This profit on the exchange operations balances his loss on the purchase of the spot wheat and insures him his normal milling profit on the manufacture and sale of the flour at a small cost in commissions. The speculative price and credit risks were eliminated by the hedge.<sup>140</sup>

The term "bona fide hedging transactions," as defined in the Commodity Exchange Act, includes the sale of futures contracts to offset a risk resulting from the ownership of, or contract to purchase at a fixed price, an equal quantity of the same cash commodity or, conversely, the purchase of futures contracts to offset a risk resulting from a previous or simultaneous contract to sell an equal quantity of the same cash commodity at a fixed price. In addition, bona fide hedging includes the sale of futures contracts which would be a reasonable hedge against the ownership of, or contract to purchase at a fixed price, products or by-products of the commodity involved in the futures transaction or, conversely, the purchase of futures contracts which would be a reasonable hedge against a previous or simultaneous contract to sell at a fixed price any product or by-product of the commodity involved in the futures transaction. The term also includes (i) the sale of futures contracts with respect to the amount of such commodity the person is raising, or in good faith intends or expects to raise, within the next twelve months, on land (in the United States or its Territories) which the person owns or leases or (ii) the purchase of futures contracts in an amount not to exceed the person's "unfulfilled anticipated requirements for processing or manufacturing during a specified operating period not in excess of one year: *Provided*, That such purchase is made and liquidated in an orderly manner and in accordance with sound commercial practice

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<sup>140</sup> BAER AND SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 201-202 (1949).

in conformity with such regulations as the Secretary of Agriculture may prescribe.”<sup>141</sup>

Daily trading limits and position limits—not applicable to “bona fide hedging” transactions—have been established for trading in wheat, corn, oats, barley, flaxseed, rye, soybeans, cotton, eggs, cottonseed oil, soybean oil, lard, and onions.<sup>142</sup> The trading and position limits have made it more difficult for an individual large trader to corner the market or manipulate prices singlehandedly and, therefore, group manipulative activity will be increasingly important in the future administration of the Commodity Exchange Act.<sup>143</sup>

#### D. Judicial Review.

The Act provides for judicial review of six administrative determinations, *viz.* (1) the suspension or revocation by the Secretary of a person’s registration as a futures commission merchant or floor

<sup>141</sup> 49 STAT. 1493 (1936), 7 U.S.C. § 6a(3) (1952), as amended, 70 STAT. 630 (Supp. IV, 1956); *Corn Products Refining Company v. Benson*, 232 F.2d 554, 561-565 (2d Cir. 1956). The enlargement of the definition of hedging to include the purchase of futures contracts in an amount not to exceed the person’s unfulfilled anticipated manufacturing or processing requirements changed the result in *Corn Products Refining Company v. Benson*, 232 F.2d 554, 561-564 (2d Cir. 1956), but the United States Department of Agriculture was in favor of the amendatory bill provided that the manner of liquidation of the futures position was “surrounded by appropriate safeguards.” *Hearings Before the Subcommittee on Cotton of the House Committee on Agriculture, Cotton Futures Contracts*, 84th Cong., 2d Sess., on H.R. 9333, at 4 (1956). The term “hedging,” in general trade usage, is sometimes regarded as including the purchase or sale of futures contracts in a commodity to offset the risk resulting from a cash transaction in a different commodity or product which has a parallel price movement with the commodity involved in the futures transaction (see, *e.g.*, BAER AND SAXON, *COMMODITY EXCHANGES AND FUTURES TRADING* 211-212 (1949)), but the Commodity Exchange Act requires that the futures transaction be in the same commodity, or product or by-product thereof, involved in the cash transaction. 49 STAT. 1493 (1936), 7 U.S.C. § 6a(3) (1952). The criteria for determining whether a transaction is treated as “hedging” for tax purposes are also different from the criteria in the Commodity Exchange Act. Compare *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 48-54 (1955) with *Corn Products Refining Company v. Benson*, 232 F.2d 554, 561-565 (2d Cir. 1956). See also, Rich and Rippe, *Tax Aspects of Commodity Futures Transactions with a Business Purpose*, 2 TAX L. REV. 541, 546-556 (1947).

<sup>142</sup> 17 CFR §§ 150.1-150.3 (1949); 17 CFR §§ 150.4-150.9 (Supp. 1956). The limits with respect to cottonseed oil, soybean oil, and lard have been established, but they will not be effective until “such date as shall hereafter be announced by the Commodity Exchange Commission, by notice published in the Federal Register at least 30 days prior to such effective date.” 17 CFR §§ 150.6(f), 150.7(f), and 150.8(f) (Supp. 1956).

<sup>143</sup> J.M. MEHL, *THE FUTURES MARKETS, MARKETING*, 1954 Yearbook of Agriculture 330; J.M. MEHL, *FUTURES TRADING UNDER THE COMMODITY EXCHANGE ACT, 1946-1954*, at 36; see also, Frey, *Federal Regulation of the Over-the-Counter Securities Market*, 106 U. PA.L.REV. 1, 19 (1957). Group action to corner the December 1952 egg futures market is involved in *In re G. H. Miller and Company*, 15 A.D. 1015 (1956), appeal pending, *Miller v. United States* (7th Cir. No. 11959), oral argument submitted November 22, 1957.

broker,<sup>144</sup> (2) an order of the Secretary directing contract markets to refuse trading privileges to a person,<sup>145</sup> (3) the suspension or revocation by the Commodity Exchange Commission of a board of trade's designation as a contract market,<sup>146</sup> (4) the affirmance by the Commodity Exchange Commission of the Secretary's refusal to designate a board of trade as a contract market,<sup>147</sup> (5) an order of the Commodity Exchange Commission directing a board of trade, or any director, officer, agent, or employee of a board of trade to cease and desist from violating any of the provisions of the Act or of the Secretary's regulations,<sup>148</sup> and (6) an order of the Commodity Exchange Commission with respect to the right of a cooperative association of producers to retain membership in and privileges on a board of trade.<sup>149</sup> An appeal from a determination by the Secretary is to the United States court of appeals for the circuit in which the petitioner is doing business and an appeal from a determination by the Commission is to the United States court of appeals for the circuit in which the petitioner has his principal place of business.<sup>150</sup>

The courts of appeals are vested with jurisdiction to affirm, set aside, or modify the administrative determination, and the administrative findings of fact shall be sustained if supported by the "weight of evidence."<sup>151</sup> The "weight of evidence" criterion for judicial review is terminologically different from the customary substantial evidence criterion for judicial review,<sup>152</sup> but a determination as to

<sup>144</sup> 49 STAT. 1496, 1498 (1936), 7 U.S.C. §§ 6g, 9 (1952).

<sup>145</sup> 7 U.S.C. § 9 (1952).

<sup>146</sup> 7 U.S.C. §§ 7b, 8 (1952).

<sup>147</sup> 42 STAT. 1001 (1922), 7 U.S.C. § 8 (1952).

<sup>148</sup> 49 STAT. 1500 (1936), 7 U.S.C. § 13a (1952).

<sup>149</sup> 49 STAT. 1499-1500 (1936), 7 U.S.C. § 10a(1) (1952).

<sup>150</sup> See the statutory references cited in notes 144-149, *supra*. The appeal directly to the court of appeals is consonant with numerous statutory review provisions. See, e.g., 5 U.S.C. § 1032 (Supp. IV, 1956); 7 U.S.C. §§ 1115(b), 1600 (1952); 15 U.S.C. §§ 21, 45(c), 77(i), 79(x), 80a-42, 80b-13, 717(r) (1952); 16 U.S.C. § 825 l (b) (1952); 19 U.S.C. §§ 81r, 1641(b) (1952); 21 U.S.C. § 371(f) (1952); 29 U.S.C. §§ 160(f), 210(a) (1952 and Supp. IV, 1956); 39 U.S.C. § 576 (1952); 42 U.S.C. § 291 j (b) (1952 and Supp. IV, 1956); 45 U.S.C. § 355(f) (1952); 46 U.S.C. § 1181(b) (1952); 49 U.S.C. § 646(a) (1952); 50 U.S.C. §§ 793(a), 821(c) (1952 and Supp. IV, 1956).

<sup>151</sup> 7 U.S.C. §§ 8, 9 (1952).

<sup>152</sup> See *e.g.*, Administrative Procedure Act § 10(e), 60 STAT. 244 (1946), 5 U.S.C. § 1009(e) (1952); *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 477-491 (1951). The criterion for judicial review in the Commodity Exchange Act is similar to the standard for review of findings of fact by the Surgeon General with respect to Federal aid for hospitals, which findings of fact by the Surgeon General are conclusive "unless substantially contrary to the weight of the evidence. . ." 60 STAT. 1048 (1946), as amended, 42 U.S.C. § 291j(b)(2) (1952). Contrast the provisions

whether the effect of the standard is different requires interpretation or interpolation. For example, in *General Foods Corporation v. Branman*, the United States Court of Appeals for the Seventh Circuit interpolated the modificative phrase "preponderance or greater" in front of "weight of evidence."<sup>153</sup> If, however, "substantial" is interpolated instead of "greater," then the administrative findings are to be sustained if supported by the "substantial weight of evidence," which is the customary criterion for judicial review of administrative findings of fact.<sup>154</sup>

Assuming, however, that the "weight of evidence" means the "greater weight of evidence," the "line between 'substantial evidence' and 'weight of evidence' is not easily drawn—particularly when the court is confined to a written record, has a limited amount of time, and has no opportunity further to question witnesses on testimony which seems hazy or leaves some lingering doubts unanswered. 'Substantial evidence' may well be equivalent to the 'weight of evidence' when a tribunal in which one has confidence and which had greater opportunities for accurate determination has already so decided."<sup>155</sup> It seems that the United States Court of Appeals for the Seventh Circuit has recognized that view in *Great Western Food Distributors v. Branman*.<sup>156</sup>

In the *Great Western* case, the court noted that in the *General Foods* case it had interpreted the "weight of the evidence" to mean the "preponderance or greater weight," but the court held in the *Great Western* case that "while this court must examine the sufficiency of the evidence, and this may entail a careful consideration of the proof, . . . we should be mindful of the practical difficulties and pitfalls presented in attempting to redetermine, from an inanimate record alone, issues such as these here presented." The court

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in 49 STAT. 2038 (1936), 41 U.S.C. § 39 (1952) and 64 STAT. 1001 (1950), as amended, 50 U.S.C. § 793(a) (Supp. IV, 1956) which make the administrative findings conclusive only if supported "by the preponderance of the evidence. . . ."

<sup>153</sup> 170 F.2d 220, 224 (7th Cir. 1948).

<sup>154</sup> The provisions of H.R. 6772, 74th Cong., which became the Commodity Exchange Act amendments of 1936, are explained in H.R. REP. No. 421, 74th Cong., 1st Sess. (1935). The only discussion of the scope of judicial review in any congressional report is contained in the minority views with respect to the 1936 amendments, and dissatisfaction with the bill is expressed in the minority views because the bill provides for "only a very narrow scope of review by the courts." H.R. REP. No. 421, 74th Cong., 1st Sess. 19 (1935).

<sup>155</sup> FINAL REPORT OF THE ATTORNEY GENERAL'S COMMITTEE ON ADMINISTRATIVE PROCEDURE, S. DOC. No. 8, 77th Cong., 1st Sess. 91 (1941). See also, 37 GEO. L.J. 450, 450-452 (1949).

<sup>156</sup> 201 F.2d 476, 479-480 (7th Cir.), cert. denied, 345 U.S. 997 (1953).

concluded in the *Great Western* case that it "would seem, then, that the function of this court is something other than that of mechanically reweighing the evidence to ascertain in which direction it preponderates; it is rather to review the record with the purpose of determining whether the finder of the fact was justified, i.e. acted reasonably, in concluding that the evidence, including the demeanor of the witnesses, the reasonable inferences drawn therefrom and other pertinent circumstances, supported his findings."<sup>157</sup>

#### IV. APPLICABILITY OF STATE WAGERING STATUTES

The Supreme Court of the United States held in *Board of Trade v. Christie Grain & Stock Co.*<sup>158</sup> that state wagering statutes—which invalidate trading in futures contracts unless the parties intend, at the time of executing the contracts, to make and receive delivery of the cash commodity—do not invalidate futures transactions between the members of the boards of trade which are consummated by off-setting transactions on the exchange. The Court held that the off-setting of the contracts on the exchange "is in legal effect a delivery," and that "the fact that contracts are satisfied in this way by set-off and the payment of differences detracts in no degree from the good faith of the parties, and if the parties know when they make such contracts that they are very likely to have a chance to satisfy them in that way and intend to make use of it, that fact is perfectly consistent with a serious business purpose and an intent that the contract shall mean what it says."<sup>159</sup> "It seems to us an extraordinary and unlikely proposition that the dealings which give its character to the great market for future sales in this country are to be regarded as mere wagers or as 'pretended' buying or selling, without any intention of receiving and paying for the property bought, or of delivering the property sold, within the meaning of the . . . [state wagering statute]."<sup>160</sup>

The *Christie Grain & Stock Co.* case, *supra*, relates solely to the contracts between the members of the boards of trade and not to the contracts between the commission firms and their customers. It would seem, however, that the reasoning of the Court should apply

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<sup>157</sup> *Ibid.*

<sup>158</sup> 198 U.S. 236, 245-250 (1905).

<sup>159</sup> *Id.* at 248, 250.

<sup>160</sup> *Id.* at 249.

to the entire field of futures trading on legitimate boards of trade. If offsetting is "in legal effect a delivery," as between the members of the exchanges, the intent to offset should, in legal effect, be an intent to deliver with respect to any trader executing a futures contract on a legitimate board of trade. Hence state wagering statutes should be construed to apply only to trading in "bucket shops," *i.e.*, offices which are "ostensibly brokerage offices where, however, commodities and securities are neither bought nor sold in pursuance of customers' orders, the transactions being closed by the payment of gains or losses as determined by price quotations."<sup>161</sup>

Nonetheless, in some actions between commission firms and their customers with respect to contracts executed on legitimate boards of trade, it has been held that if it was understood that delivery was not actually intended, and that the contracts were to be offset on the exchange, the contracts were invalid under state wagering laws.<sup>162</sup> Such holdings, if widely applied, would, of course, vitiate or terminate all futures trading inasmuch as the "result would be that substantially all of the future contracts entered into on all the commodities exchanges of the nation are thereby invalidated."<sup>163</sup>

If the intention to offset futures contracts on the exchange is held—as between the commission firm and its customers—to render the contracts invalid under state wagering statutes, then the further issue must be resolved as to whether the state statutes, as thus construed, are superseded by the federal regulatory program.

Shortly after the enactment of the Grain Futures Act, the issue was presented as to whether the state wagering laws are superseded by the federal Act. The Supreme Court of Kansas held that "he who runs may read that Congress constitutionally assumed authority over trading in grain futures . . ." thereby superseding any state wagering statute applicable to futures trading on "contract markets."<sup>164</sup> The

<sup>161</sup> V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 329 (1920).

<sup>162</sup> See, *e.g.*, *Burke Grain Co. v. St. Paul-Mercury Indemnity Co.*, 94 F.2d 458, 464-467 (8th Cir.), *cert. denied*, 303 U.S. 661 (1938); VI WILLISTON ON CONTRACTS §§ 1668-1673 (Rev. ed. 1938); *see also*, V REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE 272-322 (1920).

<sup>163</sup> Taylor, *Trading in Commodity Futures—A New Standard of Legality?* 43 YALE L.J. 63, 89 (1933); *see also*, Irwin, *Legal Status of Trading in Futures*, 32 ILL.L.REV. 155-170 (1937); 45 HARV.L.REV. 912, 912-925 (1932). Such holdings—even if limited to speculators—would vitiate all futures trading inasmuch as speculation is "essential to the operation of a futures market." See Hearings, note 19, *supra*.

<sup>164</sup> *State v. J. Rosenbaum Grain Co.*, 115 Kan. 40, 222 Pac. 80, 83 (1924); *accord*, *Clark v. Murphy*, 142 Kan. 426, 49 P.2d 973, 974-975 (1935). *Contra*, *C.A. King & Co. v. Horton*, 116 Ohio St. 205, 156 N.E. 124, 126-131 (1927), *writ of error dismissed*, 276 U.S. 600 (1928).

Supreme Court of Missouri similarly held that its wagering statute was superseded by the Grain Futures Act with respect to transactions conducted on "contract markets,"<sup>165</sup> but the court subsequently reversed its decision<sup>166</sup> in view of the decision by the Supreme Court of the United States in *Dickson v. Uhlmann Grain Co.*<sup>167</sup>

The Court held in the *Uhlmann Grain Co.* case that "the Missouri Law is in no way inconsistent with the provision of the federal act. It does not purport to legalize transactions which the federal act has made illegal. It does not prescribe regulations for exchanges. Obviously, manipulation of prices will not be made easier, or the prevention of such manipulation be made more difficult, because the State has declared that certain dealings in futures are illegal and has forbidden the maintenance within its borders of places where they are carried on. Since there is nothing in the state law which is inconsistent with, or could conceivably interfere with the operation or enforcement of, the federal law, the statute of Missouri was not superseded."<sup>168</sup>

The decision in the *Uhlmann Grain Co.* case is not, however, a holding with respect to the issue of supersedure as applied to legitimate futures trading on federally regulated boards of trade and through federally licensed futures commission merchants inasmuch as in that case, the branch office of the brokerage firm was, *according to the Court*, conducting an operation in which the Company was merely betting against its customers, and the only purpose of executing contracts on the exchange was to secure the data to determine its customers' gains or losses.<sup>169</sup>

Moreover, the Court in the *Uhlmann Grain Co.* case referred only to the congressional purpose to prevent the manipulation of prices, and it is clear that state wagering laws which would abolish all futures trading would not defeat that objective. However, another objective of the federal Act is to foster the "primary function of the exchanges which is to furnish a market for the commodities themselves."<sup>170</sup> The Congress accepted the view that the commodity exchanges are

<sup>165</sup> *State v. Christopher*, 318 Mo. 225, 2 S.W.2d 621, 630 (1927).

<sup>166</sup> *Wolcott & Lincoln v. Humphrey*, 119 S.W.2d 1022, 1025 (Mo. 1938).

<sup>167</sup> 288 U.S. 188, 192-200 (1933).

<sup>168</sup> *Id.* at 199-200.

<sup>169</sup> *Id.* at 194-195. General expressions in any decision which go beyond the issues presented by the facts in the case are not controlling. *Armour & Co. v. Wantock*, 323 U.S. 126, 132-133 (1944); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 120, 179 (1821).

<sup>170</sup> H.R. REP. No. 421, 74th Cong., 1st Sess. 1 (1935).

“necessary and of definite value to our commercial and agricultural life.”<sup>171</sup> It would seem that state wagering statutes which would vitiate or terminate all futures trading on all exchanges in the United States cannot be reconciled with the congressional purpose to foster the exchanges as an important part of our agricultural marketing system.<sup>172</sup>

The fact that the volume of deliveries on the exchanges is relatively small does not detract from the importance of the exchanges as a part of our agricultural marketing system. The exchanges permit hedging by buyers and sellers, handlers and processors of agricultural commodities all of whom generally offset their contracts on the exchanges instead of making or taking delivery. Without the possibility of shifting the risk of price changes to the speculators, the hedgers would have to increase their margins of profit thereby widening the spread between the price received by the farmers for their products and the price paid by the ultimate consumers. In any event, however, the congressional purpose that the exchanges continue to function is clearly revealed, and any conflictive state statute is, therefore, superseded.

## V. CONCLUSION

Commodity futures exchanges are a vital part of the complex agricultural marketing system in the United States. The exchanges provide facilities for hedging by farmers, processors, and other persons engaged in handling agricultural commodities. In addition, the exchanges provide a continuous market for buyers and sellers of agricultural commodities and afford a basis for pricing agricultural commodities sold throughout the country. The economic utility of commodity exchanges is, however, dependent upon the determination of futures prices by legitimate supply and demand conditions. Manipulation of commodity futures prices is a nefarious practice which inflicts severe injustice on legitimate users of the futures markets and disrupts the normal flow of agricultural commodities.

The Commodity Exchange Act reflects the congressional purpose to foster the commodity exchanges as an important part of our agricultural marketing system and to free the exchanges from manipulation and other pernicious practices. Trading limits, registration, and

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<sup>171</sup> *Id.* at 2.

<sup>172</sup> See the authorities cited in note 163.



suspension of trading privileges are among the means used to effectuate that purpose.

In view of the trading limits established under the Act, which impede individual manipulative activities, the detection of joint manipulative ventures is of increasing importance in the administration of the Act. Persons engaged in a joint manipulative venture are generally skillful in concealing the existence of a conspiracy. "The picture of conspiracy as a meeting by twilight of a trio of sinister persons with pointed hats close together belongs to a darker age."<sup>173</sup>

Effective administration of the Act requires administrative alertness to unfair practices on commodity exchanges, and vigorous enforcement of the statutory provisions in administrative and judicial proceedings. A proceeding of this character generally has its foundation in intricate marketing transactions, and voluminous economic data must be carefully considered and evaluated by the administrative agency, and in the event of judicial review, by the courts. A significant objective of any disciplinary proceeding is the determent of subsequent violations. If manipulation and other unfair practices can be prevented, the exchanges will continue to perform a useful function in the agricultural marketing system of the nation.

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<sup>173</sup> *United States v. Morris*, 225 F.2d 91, 92 (7th Cir.), *cert. denied*, 350 U.S. 901 (1955), quoting from *William Goldman Theaters v. Loew's*, 150 F.2d 738, 743, n. 15 (3rd Cir. 1945).