The Commodity Futures Trading Commission Act of 1974: Regulatory Legislation for Commodity Futures Trading in a Market-Oriented Economy

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THE COMMODITY FUTURES TRADING COMMISSION ACT OF 1974: REGULATORY LEGISLATION FOR COMMODITY FUTURES TRADING IN A MARKET-ORIENTED ECONOMY*

By GRAHAM PURCELL** and ABELARDO LOPEZ VALDEZ***

In response to increased participation in commodity markets, Congress enacted the Commodity Futures Trading Commission Act of 1974. The fundamental purpose of the Act is to insure fair practice and honest dealing, and to provide some control over excessive speculative activity which causes injury to producers, consumers and the exchanges. To enforce the Act's provisions, Congress created a new independent regulatory agency. This article examines several of the critical issues which the Commission will face in the first years of its existence, among them the scope of its jurisdiction, dispute settlement procedures and a definition of bona fide hedging.

INTRODUCTION

The shift to a market-oriented economy during this decade has emphasized the increasingly important role of commodity futures markets in the pricing and marketing of the nation's agricultural and other commodities. This is evidenced by the recent dramatic increase in the volume of futures trading, which totalled $598 billion in 1975,[1] the substantial increases in open contracts, and the increased volatility of commodity prices witnessed in the last five years. During this period the trading of commodity futures has also expanded to include trading in a number of nonagricultural commodities, such as Treasury bills, Government-backed housing mortgages, precious metals like gold and silver, and propane gas. This expansion in trading activity has caused Congress to broaden the scope of government regulation in order to guard the investing public and the consumer from trading abuses, as well as to con-

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1. *Hearings Before the Subcomm. on Agricultural Research and General Legislation of the Senate Comm. on Agriculture and Forestry*, 94th Cong., 2d Sess. 5 (1976) (testimony of William T. Bagley, Chairman of the CFTC).

tinue the traditional protection which has been accorded agricultural interests by commodity futures regulatory legislation since the passage of the Grain Futures Act of 1922.[2]

In former years the federal government had large stocks of the major agricultural commodities, which had a stabilizing effect on the prices of those commodities.[3] Whenever economic conditions threatened to cause sharp price increases, the government would release these stocks in order to reverse or limit such price movement.[4] So long as this was the situation, there was only a modest need for hedging the risks of fluctuating prices in the futures markets. Merchandisers and processors could make forward fixed-price sales commitments without much fear of a sharp rise in prices before they obtained the commodities to fulfill their contractual commitments.

In the last few years, however, the shift to a market-oriented economy has caused merchandisers and processors to make greater use of the futures markets to hedge their risks against substantial price rises. Similarly, producers desiring to obtain the maximum price for their commodities have increased their participation in the futures markets. Increasingly, banks have become reluctant to provide loans to producers, merchandisers and processors on unhedged production or inventories.[5]

These trends have also encouraged greater public participation in the futures markets. A growing number of speculators have been attracted to the futures markets by the wide price swings and the possibility of large profits.[6] Such speculative activity is highly important to the proper functioning of the futures markets; for without adequate liquidity, futures transactions become extremely hazardous for traders and the public. At the same time, such increased speculation has given rise to deep concern about the adverse price effects on producers and consumers which might result from manipulation of the futures markets by groups of speculators.[7]

When functioning properly, futures markets can have the beneficial effect of holding down consumer prices by reducing the costs of the inevitable middleman. On the other hand, futures markets can have the opposite result when not operating properly. Congress has determined that careful and efficient regulation of the markets is essential to assure that these markets operate properly in accordance with the forces of supply and demand. In response

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2. Act of Sept. 21, 1922, ch. 369, 42 Stat. 998.
3. *See* S. Rep. No. 93-1131, 93d Cong., 2d Sess. 18 (1974) [hereinafter cited as SENATE REPORT].
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*

to public criticism[8] that the federal regulation of commodity futures markets, which relied on legislation originally passed in 1936,[9] was too narrow in scope and inadequate to meet the challenges of the recent spectacular increase in trading volume and the accompanying potential for unethical practices and price manipulation, Congress passed the Commodity Futures Trading Commission Act of 1974 (CFTC Act).[10] The CFTC Act completely overhauled the Commodity Exchange Act, and established a new, independent Commission to regulate all aspects of futures trading commencing April 21, 1975.

Before discussing the provisions of the Act and the authority and responsibilities of the new Commission, it is worthwhile to briefly consider in the next two sections some background on commodity futures trading, including its history of development and regulation by the federal government, and the economic function of futures markets.

HISTORY OF FUTURES TRADING AND FEDERAL REGULATION

Commodity exchanges have existed in the United States since the colonial period.[11] Their predecessors in other parts of the world were the medieval trade fairs which were first established in the twelfth century.[12] The practice of selling commodities for subsequent delivery pursuant to contracts specifying standards for quality were developed at these fairs and were subsequently codified into the Law Merchant. Those contracts for subsequent delivery, which today are referred to as "forward contracts,"[13] were the forerunners of present day futures contracts.[14]

Forward contracting was introduced in the United States around the middle of the nineteenth century, after its development

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8. *See* Anthan, Mollenhoff & Risser, *Lax Commodity Regulation*, Des Moines Register, Feb. 18, 1973, at 1, col. 8 (first of a series of six articles). *See also* BARRON'S, May 28, 1973, at 11; Des Moines Register, June 5, 1973, at 1, col. 6; Wall Street Journal, June 5, 1973, at 1, col. 6; Anthan, Des Moines Register, Mar. 8, 1973, at 1, col. 3; Washington Star News, Sept. 26, 1973, at A-2, col. 1; Fialka, *The Food Speculators: Pricing Policemen Found Looking the Other Way*, Washington Star News. Sept. 25, 1973, at A-1, col. 1 and A-12, col. 1; Fialka, *The Food Speculators*, Washington Star News, Sept. 23, 1973, at A-1, col. 1; Fialka, *The Food Speculators: 'Paper' Beans Soar*, Washington Star News, Sept. 4, 1973, at A-1, col. 1 and A-12, col. 2.

9. The Commodity Exchange Act of 1936, ch. 545, 49 Stat. 1491.

10. Pub. L. No. 93-463, 88 Stat. 1389 (1974). Certain time deadlines in the Act were extended by Congress in 1975. Act of April 21, 1975, Pub. L. No. 94-16, 89 Stat. 77. While a number of agricultural commodities had been regulated in varying degrees since 1922, many important commodities were completely unregulated until passage of the CFTC Act of 1974. The unregulated commodities had experienced large increases in trading volume in recent years.

11. SENATE REPORT, *supra* note 3, at 11.

12. *Id.*

13. A forward contract is a commodity contract for deferred delivery of the actual commodity. For further explanation, *see* text accompanying notes 42-44 *infra*.

14. SENATE REPORT, *supra* note 3, at 11.

in England, to deal with the problems of a chaotic agricultural marketing system which often resulted in glutted commodity markets because the short-term needs of packers and millers were much less than the available supply of meats and grain.[15] These problems were in large measure due to the lack of adequate storage and road and water transportation. Forward contracting helped solve these basic problems of supply and demand; however, it did not alleviate the financial risk of loss that could occur due to rapid price fluctuations brought about by crop failures, losses of ships, inadequate storage and transportation, and the recurring economic crises of nineteenth century America.

The system of futures trading on organized commodity exchanges developed in the United States in the period between 1850 and 1900 in response to this rapidly increasing need for centralized marketing and large-scale risk bearing in agricultural marketing.[16] This developmental period coincided with the great expansion of farm production following the introduction of railroads, the telegraph, and more efficient farm equipment. Since the 1930's, and especially in this decade, rising public speculation in the futures markets has caused them to become major public investment institutions, and increased their importance to the marketing of agricultural and other commodities. This evolution has also been reflected in the greatly expanded scope of government regulation authorized by Congress since the first regulatory legislation was enacted in 1922.

The background of government regulation in many ways parallels the growth of the futures system of marketing.[17] Speculative excesses and abuses of the system of futures trading caused widespread resentment and opposition by farmers in the early years of commodity futures trading. State legislatures reacted to such irresponsible trading with repeated efforts to abolish futures trading.[18] The first bill in Congress to prohibit futures trading was introduced in 1844, and it was followed by many similar bills introduced over the next 50 years.[19]

Speculative excesses on the grain exchanges during the post-World War I period, which was characterized by falling prices and farm depressions, led to congressional enactment of the Futures Act of 1921.[20] This Act was based on the taxing power of the Constitution and was subsequently declared unconstitutional by the Supreme Court.[21] In 1922 the measure was reintroduced as

15. *Id.*
16. *Id.* at 12.
17. *See* SENATE REPORT, *supra* note 3, at 13. *See also* R. TEWELES, C. HARLOW & H. STONE, THE COMMODITY FUTURES GAME: WHO WINS? WHO LOSES? WHY? 11-14 (1974) [hereinafter cited as TEWELES].
18. SENATE REPORT, *supra* note 3, at 13.
19. *Id.*
20. Act of Aug. 24, 1921, ch. 86, 42 Stat. 187.
21. Hill v. Wallace, 259 U.S. 44 (1922).

the Grain Futures Act,[22] and was based on the interstate commerce clause of the Constitution. On this basis the Grain Futures Act was held to be constitutional.[23] The primary objective of the Grain Futures Act was to regulate the commodity exchanges rather than the individual traders.[24] The Act required the exchanges to be federally licensed and designated as "contract markets." A basic requirement to obtain such designation was that the exchanges themselves should take the main responsibility for preventing price manipulation by their members, although the Act did provide for government action against such manipulation.[25]

The Grain Futures Act proved ineffectual in preventing trading abuses[26] because of certain loopholes and limitations. Specifically, it did not provide the necessary legal authority to prevent excessive speculation by large traders and for regulating commodity brokerage activities to prevent cheating, fraud and other unethical practices. The Grain Futures Act was amended in 1936 and renamed the Commodity Exchange Act.[27] The new Act extended regulatory coverage to cotton and other specified commodities as well as grains. It provided broad authority to deal with market abuses by traders as well as exchange members, to prosecute price manipulation as a criminal offense, and to curb excessive speculation by large market operators. In order to protect the investing public, the Act extended regulation for the first time to commodity brokerage. Several amendments were made to the Commodity Exchange Act between 1936 and 1968, primarily to add additional commodities to the list of regulated commodities.[28] In 1968, Congress amended the Act substantially to require futures commission merchants to meet certain minimum financial standards. The amendment also increased the penalities for such violations as manipulation and embezzlement, authorized the issuance of cease and desist orders, required contract market enforcement of trading rules and contract terms, and added livestock products and frozen concentrated juice to the list of regulated commodities.[29] The Act was not amended again until passage of the Commodity Futures Trading Commission Act of 1974.

THE ECONOMIC FUNCTION OF FUTURES MARKETS

The Hedging Process

It has long been claimed that the primary function of futures markets is to enable producers, dealers, and processors of various

22. Act of Sept. 21, 1922, ch. 369, 42 Stat. 998.
23. Board of Trade v. Olson, 262 U.S. 1 (1923).
24. *See* SENATE REPORT, *supra* note 3, at 13.
25. *Id.*
26. *Id.* at 14.
27. *Id.*
28. *Id.*
29. *Id.*

commodities to shift the risk of price fluctuations to speculators through the process of hedging.[30] While the theory of hedging is fairly simple, there is considerable disagreement as to what hedging constitutes in practice, with some economists presently maintaining that hedging contains a significant speculative element and rejecting the claim that hedging is purely a risk-shifting activity.

Theoretically, hedging allows producers, dealers, and processors to make contracts in advance for the sale of their goods and to protect themselves against price fluctuations by buying or selling futures contracts for an equal quantity of their product or of material of manufacture. This reduction in risk permits the producer to sell and the processor to buy at lower prices, which, theoretically, benefits the consumer because this lowers the price of the finished product. The speculator, on the other hand, is willing to accept the risk of price fluctuation for the sake of possible gain. The speculator buys in anticipation of higher prices or sells in anticipation of lower prices.

A hedge is a futures transaction or position for which the trader has an offsetting position in the cash market for the same commodity.[31] In its simplest conception, hedging appears to be a process by which a farmer, producer, or purchaser shifts the risk of price fluctuations from himself to a speculator. Under this concept the hedger is considered a neutral trader, uninterested in speculating.[32] The purchaser of a futures contract protects himself from a price rise occurring before delivery date; the seller protects himself from a price decline. The speculator's profit or loss depends upon his ability to estimate price movements.

Two hedging concepts which are variations from the simplistic theory of hedging are "arbitrage hedging" and "anticipatory hedging." Arbitrage hedging[33] is a more sophisticated concept that emphasizes expected returns rather than simply reduction of risk. It is claimed that "in most circumstances hedging is merely a form of speculation—speculation on the basis.[34] The hedger differs from the speculator only because the variation in his outcome is generally less. What the hedger accomplishes is the specialization in risk,

30. For a discussion of hedging, *see* T. HIERONYMOUS, ECONOMICS OF FUTURES TRADING FOR COMMERCIAL AND PERSONAL PROFIT 106-28 (1971) [hereinafter cited as HIERONYMOUS]; TEWELES, *supra* note 17, at 32-51. The theory of hedging is fairly simple, but in practice it is a complicated process. The Commission has been confronted with the problem of defining hedging and distinguishing "bona fide hedging" in its administration of the Act. *See* text accompanying notes 45-62 *infra*.

31. TEWELES, *supra* note 17, at 33.

32. Note, *Abuse in the Commodity Markets: The Need for Change in the Regulatory Structure*, 63 GEO. L.J. 751, 767 (1975) [hereinafter cited as *The Need for Change*]; TEWELES, *supra* note 17, at 33; HIERONYMOUS, *supra* note 30, at 105.

33. TEWELES, *supra* note 17, at 36.

34. "Basis" is the difference between the current price of the cash commodity and the price of a designated future contract for that commodity.

not the elimination of it."[35] "Selective" hedging and "anticipatory" hedging interpret the hedging process in terms of expectation.[36] Selective hedging is partial hedging based on the hedger's subjective determination of price movement during a given period.[37] If he expects a price decline, he will hedge all of his inventory, but may hedge none of it if he expects a price increase.[38] Anticipatory hedging is purchasing or selling futures in anticipation of a formal merchandizing commitment to be made later and carrying an open position in the futures market without an offsetting cash commitment.[39]

Many economists now believe that hedging contains a significant speculative element. They reject the idea that hedging is purely a risk-shifting device that affords the commercial operator price protection and leaves him unaffected by and uninterested in price levels.[40] Commercial traders have been found to hedge for at least four reasons, and reduction of business risks is the least important.[41]

Basic Instruments for Hedging: Cash and Futures Contracts

There are two basic instruments used in the hedging process—futures contracts and cash or forward contracts. Both contain the same basic terms regarding price, quantity, quality, time, place of delivery, terms of payments, and recourse in the event of default. There are, however, some basic differences between futures and cash contracts. A commodity futures contract is an agreement between a buyer and a seller to deliver a specific quantity of a specific commodity at a specific price during an identified month in the future.[42] Payment is not due until the delivery takes place. Except for price, the principal terms of futures contracts are standardized in the rules of the exchanges on which they are traded.[43] The price is negotiated competitively by brokers for the parties on the exchange floor, and no written instrument needs to be transferred between the parties. Moreover, futures contracts may be traded only in accordance with the highly formalized rules of organized exchanges which have been designated "contract markets," by the CFTC. Cash or forward contracts, on the other hand, may provide for immediate or deferred delivery of the com-

35. TEWELES, *supra* note 17, at 35.
36. *Id.* at 36.
37. *Id.*
38. *Id.*
39. *Id.* at 37.
40. *Id.* at 35; *The Need for Change*, *supra* note 32, at 767; HIERONYMOUS, *supra* note 30, at 147-50; 52 AM. ECON. REV. 431, 440-42 (1962); Working, *Futures Trading and Hedging*, 43 AM. ECON. REV. 314, 420 (1953).
41. Working, *Hedging Reconsidered*, 35 J. FARM ECON. 560-61 (1953); TEWELES, *supra* note 17, at 32-43.
42. TEWELES, *supra* note 17, at 22-24; HIERONYMOUS, *supra* note 30, at 28-30.
43. For a discussion of hedging *see* HIERONYMOUS, *supra* note 30, at 106-28; TEWELES, *supra* note 17, at 32-51.

modity and are traded on informal, decentralized markets which are generally not subject to CFTC jurisdiction except to prevent price manipulation. Such contracts are used for merchandizing purposes, while futures contracts are used for speculative or hedging purposes.[44] Thus, the principal difference between cash contracts and futures contracts is in their use.

A simplistic example of hedging, which follows the price-neutral theory, is helpful to illustrate how cash and futures contracts are interrelated in the hedging process. Suppose that a processor holds 100,000 bushels of wheat at $3 a bushel under a cash contract, and is fearful of a price decline. To protect himself from such a decline in price, he immediately sells 100,000 bushels of futures contracts at $3 and he is thereby short hedged. If the feared decline occurs and wheat drops to $2.85 a bushel, the profit on the short sale of futures exactly offsets the loss on the cash wheat. In this way the hedging process eliminates the risk of price fluctuation.

While this simplistic illustration is helpful to understand how the hedging process might ideally work, real life hedging is much more complicated. In accordance with the mandate of the CFTC Act, the new Commission is studying the hedging process and will promulgate a new definition of bona fide hedging in the near future.

CFTC Definition of Bona Fide Hedging

The legislative history of the Act reflects the congressional intent that the Commission should broaden the definition of bona fide hedging to allow hedging of "contract" bushels of seed and to require that the Commission extend anticipatory hedging privileges to certain businessmen, such as bakers, who use the products of traded commodities rather than the commodity itself.[45] The legislative history also reflects the congressional intent that hedging not be defined in such a manner as to deny traditional legitimate users of the futures market an opportunity to continue to hedge.[46]

The Commission recently adopted an interim definition[47] which now permits the hedging of stocks or fixed-price purchases of a commodity in the futures market for that commodity's products or byproducts.[48] Also, bakers are now permitted to hedge

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44. Futures commission merchants are individuals, associations, partnerships, corporations, and trusts engaging in soliciting or accepting orders for the purchase or sale of any commodity futures delivery on and subject to the rules of any contract market.
45. *See* S. Rep. No. 93-1194, 93d Cong., 2d Sess. 40-41 (1974) [hereinafter cited as SENATE CONFERENCE REPORT].
46. *See* SENATE REPORT, *supra* note 3, at 26.
47. *See* SENATE CONFERENCE REPORT, supra note 45, at 40-41; 40 Fed. Reg. 48,688-89 (1975).
48. 40 Fed. Reg. 48,689 (1975).

unfulfilled annual anticipated requirements of flour in wheat futures, and manufacturers or processors are now permitted to hedge unfulfilled anticipated requirements on dry corn milling products in corn futures.[49] Seed corn and sweet corn processors are now permitted to hedge the bushel value equivalent of their unfulfilled annual anticipated requirements of seed corn and sweet corn, respectively, in corn futures.[50] Certain long positions of feeders of livestock and poultry which are currently exempted from speculative limits on corn and other grain futures, are exempted by the interim definition,[51] and such anticipatory hedging provisions for livestock and poultry feeders have been extended to soybean meal.[52] Also, newly regulated world commodities will not be subject to speculative limits until the Commission adopts its more permanent definition of bona fide hedging.[53]

The Commission has assigned the responsibility for making appropriate recommendations to it regarding a more permanent definition of bona fide hedging and speculative limits to its recently established Advisory Committee on the Economic Performance of Contract Markets.[54] The Committee will be studying the legitimate commercial uses of futures contracts in arriving at its recommendations. It will also assess the need for and the effectiveness of position and trading limits in eliminating or preventing the "excessive speculation" which is proscribed by the Commodity Exchange Act.

The Commission's definition of the term "bona fide hedging"[55] will be extremely important for two reasons. First, the Commodi-

49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *See id.*
54. *See id.* at 32,866.
55. The Commission has adopted an interim definition which generally follows the definition promulgated by the Secretary of Agriculture pursuant to 7 U.S.C. § 6a(3) and has given notice of its intent to adopt a permanent rule after receiving the recommendations of its Advisory Committee on the Economic Performance of Contract Markets. Their recommendations will probably be submitted to the Commission in early 1976. In the meantime, the Commission has decided not to impose speculative limits on the newly regulated commodities because of the special problems presented by these commodities. 40 Fed. Reg. 48,688 (1975). For the Commission's recently adopted interim definition, *see id.* at 48,689.

In formulating its more permanent definition of bona fide hedging, the Commission is also authorized to define the term "international arbitrage." 7 U.S.C. § 6a(1) (Supp. 1974), *amending* 7 U.S.C. § 6a (1970). The CFTC Act provides that the Commission may exempt from speculative trading limits "transactions normally known to the trade as 'spreads' or 'straddles' or arbitrage." Furthermore, it provides that "the word 'arbitrage' in domestic markets shall be defined to mean the same as 'spread' or 'straddle'." *Id.*

A "spread" is the purchase of one futures contract against the sale of another contract in a different future, a different commodity, or a different market or the price difference between two futures in the same or different markets.

A "straddle" is the usually simultaneous purchase of one futures month and the sale of another either in the same or different commodity or exchange.

ty Exchange Act provides that speculative trading limits established by the Commission shall not "apply to transactions or positions which are shown to be bona fide hedging transactions or positions as such terms . . . [are] defined by the Commission."[56] Second, the definition will be the basis for accumulating statistics on hedging in the markets. The industry, the public, and the Commission will find these statistics useful in judging the economic utility of the respective contract markets.[57] The Commission has requested its Advisory Committee on the Economic Performance of Contract Markets to research and recommend a definition.[58]

The purpose of establishing trading or speculative limits is to diminish, eliminate or prevent "excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity . . . ."[59] The primary object of such regulation is to assure that commodity futures prices are established by the forces of supply and demand in a competitive environment. Restraints must certainly affect anyone who upsets that mechanism, whether he bears the name of hedger or speculator.[60] On the other hand, the Commodity Exchange Act requires that

56. 7 U.S.C. § 6a(3) (Supp. 1974), *amending* 7 U.S.C. § 6a (1970).

57. 40 Fed. Reg. 34,628 (1975).

58. *Id.* at 32,866. The Committee will be studying the legitimate commercial uses of futures contracts in arriving at its recommended definition of bona fide hedging. It will also assess the need for and the effectiveness of position and trading limits in eliminating or preventing the "excessive speculation" which is proscribed by the Commodity Exchange Act.

A "position" is to be either "long" (having bought one or more future contracts) or "short" (having sold one or more future contracts) in the market. A position limit is the number of future contracts one can hold under the rules previously established by the Commodity Exchange Authority and now established by the Commission.

The "trading limit" is the maximum price movement, up or down, permitted on one trading session under the rules of an exchange.

59. 7 U.S.C. § 6a(1) (1970). The Commission's jurisdiction is predicated on the assumption that such speculation creates a burden on interstate commerce.

60. Speculative limits are set in order to limit those trades and positions which affect price because of their size. Trades are "large" relative to the size of the futures market, the liquidity of the market, and the deliverable supply of the cash commodity. The Commodity Exchange Commission (CEC) first established such limits in 1937. Today, CEC limits apply to 10 commodities and exchange-set limits apply to 18 others. There are no speculative limits for most of the commodities brought under regulation by the CFTC Act in 1974.

A recent Commodity Exchange Authority (CEA) staff study showed that speculative limits established in the past by the CEA were determined more by subjective than empirical data. Speculative limits were set near the outer limits of the observed distributions of speculative positions and daily trades. Only the largest market participants' activities were constrained. The market was still allowed to adjust to changes in supply and demand, providing the liquidity hedgers needed. The CEA set both trading and position limits at the same level as speculative limits. Those exchanges which established their own speculative limits, however, generally did not adopt this policy. They either set trading limits which were higher than position limits, or they placed no limits on trading. *See* CFTC PROGRAM STUDY GROUP, REPORT FOR THE COMMODITY FUTURES TRADING COMMISSION: SPECULATIVE LIMITS, Project #201-d, Mar. 21, 1975 (Exhibit D).

the Commission set speculative limits only if there is "excessive speculation" in the trading of a commodity. Moreover, the Commission may not have to establish limits if it believes that such limits will not effectively curb excessive speculation.

Some commentators claim that speculators, who are subject to speculative limits, are at a disadvantage vis-a-vis the large commercial operators, who can take large positions under the guise of hedging and are restricted only by the bona fide hedging requirement and the antimanipulation provisions of the Commodity Exchange Act. Therefore, they claim that the commercial operators can manipulate the market, because the speculators are the only force that can effectively counter their influence.[61] Beyond this, hedgers do have two advantages over speculators. First, their margin requirements are considerably less.[62] Second, they can obtain loans to cover margins more easily than speculators.

The Commission could use two distinct approaches in deciding whether to impose speculative limits. First, it may assume that the Commodity Exchange Act is aimed at excessive speculation per se, and formulate rules to limit it. Second, the Commission may assume that the legislature intended to strike at unreasonable price changes resulting from monopolistic activities or practices, whether speculative or not, and draft the rules to prevent such market power.

The first approach suggests that only speculators acting "excessively" cause unreasonable price changes, and that hedgers do not. Further, it assumes that individual activity is relevant only to the speculative sector of the market.

The second approach assumes that the activities of hedgers and speculators can have equally monopolistic effects. The Commodity Exchange Act exempts hedgers from speculative limits. Therefore, any limit on hedgers would require an amendment, or alternatively, an interpretation of the mandate that hedging be conducted in an orderly manner, that allows some control over hedgers.

The Advisory Committee on the Economic Performance of Contract Markets has been studying this issue since late 1975 and has held several public hearings. It will submit its recommendations to the CFTC by mid-1976.

MAJOR PROVISIONS OF THE CFTC ACT OF 1974

The Commodity Futures Trading Commission Act of 1974 substantially amended the Commodity Exchange Act of 1936, and cre-

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61. *The Need for Change*, *supra* note 32, at 764.
62. *See* TEWELES, *supra* note 17, at 41.

ated a new independent regulatory agency. The fundamental purpose of the Act is to insure fair practice and honest dealing, and to provide some control over excessive speculative activity which causes injury to the producers, consumers and the exchanges.[63] The Act reflects the congressional desire that futures trading on contract markets should accurately reflect the forces of supply and demand.[64] The strong enforcement power provided by the Act also indicates that Congress felt that the major threats to the integrity of the institution of futures trading would come from fraud, misleading information, and attempts to manipulate the market.[65] The regulatory scheme was designed to prevent the occurrence of these abuses and to expose and punish all violators, and thereby preserve the integrity of and public confidence in commodity futures trading.[66]

Passage of the Act was also marked by a strong assertion of congressional will, which is reflected in three of its provisions. First, Congress included a provision that requires the concurrent submission of Commission budget requests to Congress and to the President or the Office of Management and Budget.[67] Secondly, it required concurrent submission of the Commission's legislative proposals.[68] Thirdly, Congress empowered the Commission to appoint an Executive Director by and with the advice and consent of the Senate.[69]

The President sharply criticized these encroachments on executive power, and promised to submit legislation to amend those three provisions.[70] Basically, the President attacked the budget provision on the grounds that it would undercut the provisions of the Budget and Accounting Act of 1932, which requires the President to submit to Congress a single coordinated budget, and that the provisions would make it more difficult to reduce spending in his review of all requests for appropriations in advance of submitting such requests to Congress. The President attacked the requirement for concurrent submission of the Commission's legislative proposals on the grounds that it was a bad precedent which, if extended to other agencies, would make it difficult for him to develop and present a coordinated legislative program. Finally, the President criticized the Act's provision relating to appointment of the Executive Director by the Commission with the advice and consent of the Senate on constitutional grounds, characterizing it as an encroachment on the separation of powers.

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63. *See* SENATE REPORT, *supra* note 3, at 14.
64. The Commodity Exchange Authority (CEA) was an agency of the Department chaired by the Secretary of Agriculture. *See* SENATE REPORT, *supra* note 3, at 21-22.
65. *Id.* at 20.
66. *Id.* at 21.
67. 7 U.S.C. § 4a(h)(1) (Supp. 1974).
68. *Id.* § 4a(h)(2).
69. *Id.* § 4a(d).
70. Statement by President Ford.

The Commodity Futures Trading Commission

The new Commission consists of a Chairman and four other Commissioners, appointed by the President with the advice and consent of the Senate.[71] The staff of the Commission includes an Office of General Counsel, the Executive Director, the Division of Trading and Markets, the Division of Enforcement, and the Office of Hearings and Appeals.

In considering the need for new legislation to regulate futures trading, the Senate and House initially disagreed sharply on the issue of whether a new independent agency was needed to implement the needed reforms. The Commodity Exchange Authority (CEA), which was then charged with regulating the futures trading industry, was an agency of the Department of Agriculture, subject to the policy guidance of the Commodity Exchange Commission which consisted of three Cabinet officers, chaired by the Secretary of Agriculture.[72] The House Agriculture Committee, while disposed to reforming the CEA, sought to keep futures regulatory policy-making within the Department of Agriculture.[73] The Senate Agriculture and Forestry Committee, on the other hand, favored removing the regulatory agency from the Department's jurisdiction on the grounds of conflict of interest, because it considered the Department's responsibility for promoting farm income as not necessarily consistent with the view that the futures markets should be passive instruments designed to reflect rather than influence food prices.[74]

The Committee of Conference considering the final version of the bill arrived at a compromise which removed the regulation of commodity futures trading from the Commodity Exchange Authority, and assigned the regulatory responsibilities to a new independent Commission.[75] At the same time, it provided for the establishment of a liaison office by the Commission in the Department of Agriculture to assure that the Department would have an input into the new agency's policies.[76]

In view of the need to restore public confidence in the commodity markets, the establishment of an independent agency with sufficient staff and legal authority was the best resolution of this issue. The Commodity Exchange Authority, which had been an agency of the Agriculture Department, had been criticized for its lax regulatory performance in recent years. The continuation of Department authority over the new Commission would have raised immediate doubts about its objective resolution of critical

71. 7 U.S.C. § 4a(a) (Supp. 1974).
72. *See* SENATE REPORT, *supra* note 3, at 21-22.
73. *Id.* at 20.
74. *Id.* at 21.
75. 7 U.S.C. § 4a (Supp. 1974).
76. *Id.* § 4a(g).

issues delegated to it in the Act and its willingness to take strong regulatory action when required. The Commission's liaison office will permit it to consider the Department's concerns but will not require that the Commission heed the policy line of Agriculture.

Regulatory and Enforcement Authority

Under the old CEA's regulatory scheme, all regulated futures were traded on "contract markets" by registered futures commission merchants and brokers.[77] All exchanges had to satisfy certain statutory requirements intended to prevent fraud and manipulation before they could be designated "contract markets."[78] Once the CEA made the designation, the contract markets regulated themselves. The CEA intervened only if the exchanges failed to enforce their own rules,[79] and then the principal sanction it had was to suspend or revoke the "contract market" designation.[80] Since the CEA was reluctant to take such a drastic step, it followed a passive regulatory policy.

The CFTC Act gives the Commission the ability to take an active role in preserving the integrity of futures trading by extending its authority to cover what is traded, who may trade, where trading may occur, and the rules under which it may be conducted. The Commission is empowered to compile information concerning futures trading in order to identify and discourage market abuses and to encourage investor activity.[81] In marked contrast to the CEA, the Commission has broad enforcement power to seek injunctive relief in court, to take action in emergency circumstances to restore orderly trading, and to impose increased penalties to punish violations.

The Commission evaluates the terms of the standardized futures contracts against the yardstick of a public interest test.[82] In

77. 7 U.S.C. § 6f (1970), *as amended*, 7 U.S.C. § 6f (Supp. 1974).
78. 7 U.S.C. § 7 (1970), *as amended*, 7 U.S.C. § 7 (Supp. 1974).
79. 7 U.S.C. § 13(a) (1970), *as amended*, 7 U.S.C. § 13a (Supp. 1974).
80. *Id.*
81. 7 U.S.C. § 16a (Supp. 1974).
82. 7 U.S.C. § 7(g) (Supp. 1974), *amending* 7 U.S.C. § 7 (1970). The Commission has partially interpreted this as an economic justification requirement. *See* Commodity Futures Trading Comm'n, Guideline on Economic and Public Interest Requirements for Contract Market Designation, Guideline No. 1, May 13, 1975, CCH COMMODITY FUTURES L. REP. 20,617 (1975).

The test has been criticized by the exchanges as being irrelevant. Free marketers have contended that futures contracts serve an economic purpose when they sell and do not serve such purpose when they do not sell. The exchanges have claimed that it is extremely difficult to know in advance what the performance of a particular futures contract will be. They fear that some innovative contracts might not be allowed to be traded before they have the chance to establish a track record. On the other hand, the Commission is required to review commodity contracts to determine whether they serve the economic purposes of the nation, rather than simply provide a game for the traders. It requires that a contract be used, or can be used, either to set competitive prices or for hedging purposes. *See* Remarks by Commissioner Gary L. Seevers before the Commodity Futures Conference, Philadelphia, CFTC Release No. 23-75, July 9, 1975, at 2 (available at the Commission).

order to protect participants in the market and insure fair dealings,[83] the Commission may, after notice and hearing, require changes in the contract terms. In contrast to the registration requirement for securities under the securities laws,[84] the Act does not require that commodity future contracts be individually registered. Individual registration is not necessary because the contracts are standardized[85] and the Commission has the authority to regulate the terms.

The Commission protects the integrity of futures trading by carefully screening all commodity futures trading professionals,[86] including those who are not members of an exchange.[87] Upon registration or periodic re-registration, the Commission may require information that it considers necessary to protect the public.[88] The Commission may establish fitness standards and tests for those who solicit and handle customer trades,[89] and refuse applications for registration in case of failure to satisfy its standards.[90] The Commission is also authorized to determine whether dual trading by floor brokers and futures commission merchants may be allowed and, if allowed, under what conditions.[91]

The CFTC Act amends the Commodity Exchange Act most significantly in the area of exchange rules.[92] All rules, regula-

83. 7 U.S.C. § 12a(7) (Supp. 1974), *amending* 7 U.S.C. § 12a (1970).
84. Wolff, *Comparative Federal Regulation of the Commodity Exchanges and the National Securities Exchanges*, 38 GEO. WASH. L. REV. 223 (1969) [hereinafter cited as Wolff].
85. *See* note 42 *supra*.
86. 7 U.S.C. § 6k(1) (Supp. 1974), *amending* 7 U.S.C. § 6 (1970), provides for registration of all persons associated with a futures commission merchant. 7 U.S.C. §§ 6*l*-m (Supp. 1974), *amending* 7 U.S.C. § 6 (1970), require registration of commodity trading advisors and commodity pool operators. 7 U.S.C. § 6p (Supp. 1974), *amending* 7 U.S.C. § 6 (1970), gives the Commission authority to specify standards of training, experience and other qualifications for commission merchants, floor brokers, and persons associated with them.
Registration requirements for futures commission merchants and floor brokers have been expanded to include persons associated with futures commission merchants, commodity pool operators, and commodity trading advisors, in order to protect the investor from trading abuses. *Id.*
87. 7 U.S.C. § 12a(8) (Supp. 1974), *amending* 7 U.S.C. § 12a (1970).
88. 7 U.S.C. § 6n (Supp. 1974), *amending* 7 U.S.C. § 6 (1970).
89. 7 U.S.C. § 6p (Supp. 1974), *amending* 7 U.S.C. § 6 (1970).
90. 7 U.S.C. § 6n (Supp. 1974), *amending* 7 U.S.C. § 7 (1970).
91. 7 U.S.C. § 6j (Supp. 1974), *amending* 7 U.S.C. § 6 (1970).
92. Under the Act, futures trading may be done only on organized contract markets, where trading procedures can be reviewed by the Commission. 7 U.S.C. § 6 (Supp. 1974), *amending* 7 U.S.C. § 6 (1970). One of the requirements for an exchange to be designated a contract market is a showing that it will continue to comply with the requirements of Section 5(a)(8) of the Commodity Exchange Act. Under that provision, the contract market must enforce all of its bylaws, rules, regulations, and resolutions which relate to contract terms and conditions and other trading requirements, which have been approved by the Commission. In support of its application for designation as a contract market, each board of trade must submit a description of its rule enforcement program designed to comply with Section 1.51 of the regulations and showing how compliance will be achieved, as well as the resources devoted to the rule enforcement program. *See* Commodity Futures Trading Comm'n, Guidelines for Contract Market Rule Enforcement Program, Guideline No. 2, May 13, 1975, CCH COMMODITY FUTURES L. REP. § 20,042, at 20,620 (1975).

tions, and bylaws of contract markets relating to contract terms and conditions and other trading requirements, except margin rules,[93] must be submitted to the Commission for approval.[94] The Commission may, after notice and hearing, alter or supplement exchange rules, except those relating to margin requirements, and require the exchanges to adopt these modifications.[95] It may review exchange decisions and disciplinary actions.[96] The Commission can also act quickly in an emergency by ordering the exchanges to adopt necessary procedures to alleviate the disruption of orderly futures trading.[97]

The Commission's comprehensive information program is intended to deter abuses by identifying market manipulation,[98] and

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93. This term is often confused by laymen and legislators alike because it has different meanings in the commodities and securities industries. Margin in the commodities industry serves as a security deposit to insure that both parties to a futures transaction will perform their obligations and responsibilities under the futures contract. In the securities industry on the other hand, margin is the amount of money which a broker may lend to a customer. Such lending to customers by commodity brokers is strictly prohibited by the rules of most commodity exchanges.

94. 7 U.S.C. § 7a(12) (Supp. 1974), *amending* 7 U.S.C. § 7a (1970). Certain operational and administrative rules, and emergency exchange rules may be exempted by the Commission from this requirement.

95. 7 U.S.C. § 12a(7) (Supp. 1974), *amending* 7 U.S.C. § 12a (1970).

96. 7 U.S.C. § 12c(B)(2) (Supp. 1974), *amending* 7 U.S.C. § 12b (1970).

97. 7 U.S.C. § 12a(9) (Supp. 1974), *amending* 7 U.S.C. § 12a (1970). This is one of the most controversial provisions of the Act. The term "emergency" is defined in this section of the Act to mean "[T]hreatened or actual market manipulations and corners, [and] any act of the United States or a foreign government . . . which prevents the market from accurately reflecting the forces of supply and demand for such commodity." The legislative history of this provision makes it clear that the "emergency" itself must, in the Commission's judgment, have a greater adverse impact on the market than the action that the Commission proposes to take. It also emphasizes that nothing in the emergency powers section, the injunctions section, or any other provision of the Act is to be used by the Commission to violate unnecessarily the sanctity of contract. *See* SENATE REPORT, *supra* note 3, at 25; Johnson, *The Commodity Futures Trading Commission: Newest Member of Each Exchange's Management Team*, 34 FED. B.J. 173, 177-79 (1975).

98. 7 U.S.C. § 20 (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970). Neither the Commodity Exchange Act, as amended by the CFTC Act, nor preceding legislation, contains a definition of manipulation. Although discussed in congressional hearings and debates, definition of this term has been deliberately left to the courts. The courts have given a succession of implied definitions. In Volkart Bros., Inc. v. Freeman, 311 F.2d 52, 58 (5th Cir. 1962), the court accepted the following definition:

> 'Manipulation' is any and every operation or transaction or practice . . . calculated to produce a price distortion of any kind in any market either in itself or in 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. . . . Any and every operation, transaction, or device, employed to produce these abnormalities of price relationship in the futures markets, is manipulation.

"The most prevalent form of alleged manipulations prosecuted by the Commodity Exchange Authority [involved]: (a) a dominant or controlling futures position; (b) a dominant or controlling position in deliverable supplies; (c) an artificial price; and (d) manipulative intent. Most cases have also included elements of false information, concealment of records, concealment of positions, and collusion." HIERONYMOUS, *supra* note 30, at 308. For a discussion of past manipulations, *see id.* at 297-312.

encourage investment by giving investors current market information.[99] Clearinghouses, exchanges, futures commission merchants, and brokers are required to maintain daily trading records. Brokers and futures commission merchants must report the amount of trading by individual customers.[100] The Commission has broad investigatory powers to examine these records, as well as other matters ranging from market conditions to customer complaints of alleged violations.[101] Investigatory findings may be reported to the public.[102]

The Commission, unlike the CEA, can go into court to enjoin any contract market or person from violating the Act or restraining trading in any commodity for future delivery.[103] The Commission may also request the Attorney General to bring an action in lieu of bringing the action itself.[104] Penalties have been increased substantially to a maximum of $100,000, and may be imposed in both administrative and criminal proceedings.[105] Additionally,

99. The Commission publishes this data in cooperation with other federal agencies. 7 U.S.C. § 20 (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970).

100. 7 U.S.C. §§ 6g(2), (3) (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970). Pursuant to an interpretation of this provision, the Commission has also requested major grain firms to report each grain sale to a foreign government on the date such agreement is reached, regardless of whether a contract has been formally signed. 40 Fed. Reg. 29,795 (1975). This requirement was prompted by the Russian wheat deal of 1972, in which large purchases of wheat were conducted in secret, and which resulted in spiraling food prices for the consumer.

101. 7 U.S.C. §§ 18, 20 (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970).

102. 7 U.S.C. § 20(a) (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970).

103. 7 U.S.C. § 13a-1 (Supp. 1974), *amending* 7 U.S.C. § 13a (1970). The House version, H.R. 13113, 93d Cong., 2d Sess. (1974), would have authorized the Commission to enjoin any person or contract market "about to" or "in a position" to violate the Act, or if there was a "danger" of a violation occuring. Industry representatives argued against the emergency provision because of the potential for abuse of such broad power. The Senate version modified the provision by eliminating the Commission's authority to enjoin a person merely for being "in a position to" violate the Act, but retained the other subjective language authorizing the Commission to enjoin potential violations.

The Commission's power to seek an injunction against any contract market or person "about to engage" in a violation will probably be limited by the courts to cases where a real, and not an imagined, injury is about to be inflicted or has been inflicted. An injunction will not usually be granted on the basis of a mere apprehension of injury, or on the basis of a probable future event. The court must be satisfied that the apprehension is well grounded; that there is reasonable probability of real injury; and that there is no adequate remedy at law if the injunction is not granted.

The federal securities laws permit an injunction when a violation is "about to" occur but do not extend that authority to enjoin those who are merely "in a position to" commit a violation or where there is simply a "danger" of violation. Securities Act of 1973 § 20(b), 15 U.S.C. § 77t(b) (1970); Securities Exchange Act of 1934 § 21(e), 15 U.S.C. § 78u(e) (1970). Pursuant to those provisions, no injunctions have been granted absent proof of an actual or threatened violation.

Empowering independent regulatory agencies to seek injunction in the courts directly is not a novel provision. The National Labor Relations Board, for example, is authorized to sue for an injunction in secondary boycott cases, 29 U.S.C. § 160(*l*) (1970), and the SEC may, in its discretion, seek injunctive relief in a proper District Court of the United States.

104. 7 U.S.C. § 13a-1 (Supp. 1974), *amending* 7 U.S.C. § 13a (1970).

105. 7 U.S.C. §§ 8, 9, 13a, 13b, 15 (Supp. 1974), *amending* 7 U.S.C. §§ 8, 9, 13b, 15 (1970).

failure to obey a cease and desist order of the Commission may be punished by imprisonment for up to one year.[106]

The Act's injunctive provision is patterned after a similar provision contained in the Securities and Exchange Act,[107] in that the Commission is limited to seeking civil relief in court.[108] When criminal prosecution is deemed necessary, the Commission may transmit available evidence to the Attorney General who may, in his discretion, institute criminal proceedings under the Act.[109]

The Act gives the Commission far reaching authority over every aspect of futures trading, and the staff resources needed in order to be an active regulator of the commodity markets. It also provides the independence needed for the Commission to establish credibility with the public. The fulfillment of the investigatory and informational role of the Commission will aid the public in understanding an industry which has been long misunderstood. In sum, the Act has created a modern agency to meet the challenge of regulating a complex and rapidly growing industry which is vital to the national economy.

Exclusive Jurisdiction of the CFTC Over Futures Trading

The Act gives the Commission exclusive jurisdiction over all commodity futures transactions executed on domestic boards of trade.[110] The term "commodity" is defined to include "all other goods and articles, except onions, . . . and all services, rights and interests in which contracts for future delivery are presently or in the future dealt in."[111] The Commission also has exclusive jurisdiction over options trading in commodities,[112] and the sale of gold and silver coin and bullion on margin or "leverage" accounts.[113]

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106. 7 U.S.C. §§ 13a, 13b (Supp. 1974), *amending* 7 U.S.C. §§ 8, 9, 13b, 15 (1970).

107. *Compare* 15 U.S.C. § 78u(e) (1970) *with* 7 U.S.C. § 13a (Supp. 1974), *amending* 7 U.S.C. § 13a (1970).

108. *Compare* 15 U.S.C. § 78u(f) (1970) *with* 7 U.S.C. § 13a (Supp. 1974), *amending* 7 U.S.C. § 13a (1970).

109. 7 U.S.C. § 13a (Supp. 1974), *amending* 7 U.S.C. §§ 8, 9, 13b, 15 (1970).

110. 7 U.S.C. § 2 (Supp. 1974), *amending* 7 U.S.C. §§ 2, 4 (1970).

111. 7 U.S.C. § 2 (Supp. 1974). Futures trading in onions is prohibited by federal law, 7 U.S.C. § 13-1 (Supp. 1974). However, this section does not expressly prohibit trading options in onions in the cash market. *See* Address by Howard Schneider, General Counsel, Commodity Futures Trading Commission, before the Federal Bar Association meeting, Atlanta, Georgia, Sept. 10, 1975, at 10-12.

112. 7 U.S.C. § 2 (Supp. 1974), *amending* 7 U.S.C. §§ 2, 4 (1970).

113. 7 U.S.C. § 15a (Supp. 1974), *amending* 7 U.S.C. § 15 (1970). The Commission has adopted an antifraud rule for leverage transaction. *See* 17 C.F.R. § 30.03 (1975). It has also proposed a temporary rule requiring any person offering such transactions to submit a plan of operation to the Commission for its approval before expecting any leverage transactions. *See id.* § 30.04. In this proposed temporary rule, the Commission defined "leverage transactions" as "any transaction for the delivery of silver bullion, gold bullion, or bulk silver coins or bulk gold coins pursuant to a standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract," and a "standardized con-

The Commission also has exclusive jurisdiction over transactions executed on a board of trade involving the sale for future delivery of foreign currency, security warrants and rights, resales of installment loan contracts, repurchase options, government securities or mortgages, and mortgage purchase commitments. In effect, the Commission is entitled to regulate all dealings in commodities covered by the Act unless its jurisdiction is ousted by specific statutory prohibitions.[114]

State jurisdiction superseded

Congress sought to centralize regulatory authority in the Commission and to exclude state regulation in order to avoid the growing diversity of state regulatory provisions affecting futures trading. Congress also wanted to reduce the bureaucratic red tape inherent in requiring a person or an exchange to register with several separate state agencies.[115]

The legislative history clearly indicates that Congress intended to preempt state jurisdiction over the transactions that the Act covers.[116] A sentence in the Commodity Exchange Act which could have been construed as continuing state law in the field was purposefully deleted from the Act[117] to assure preemption of state regulatory authority. The Conference Report on the final bill stated that the Commission "would preempt the field insofar as futures regulation is concerned."[118] Therefore, if any substantive state law regulating futures trading is contrary to or inconsistent with the Act, the Act will govern.[119] In view of the broad grant

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tract" as "any contract effecting a leverage transaction which is or is proposed to be offered on the same or substantially similar terms to ten or more offerees." *Id.* § 30.04(a). For a discussion of leverage contracts *see generally* A. ULROG, JR., REPORT FOR THE COMMODITY FUTURES TRADING COMMISSION: TRADING IN LEVERAGE CONTRACTS FOR GOLD AND SILVER (prepared for the CFTC Program Study Group, Apr. 18, 1975, available at the Commission).

114. SENATE CONFERENCE REPORT, *supra* note 45, at 35-36. The Commission also has jurisdiction over transactions in foreign currency, security warrants and rights, resales of installment loan contracts, repurchase options, government securities or mortgages, and mortgage purchase commitments, if these transactions involve the sale thereof for future delivery on a board of trade. 7 U.S.C. § 15a (Supp. 1974), *amending* 7 U.S.C. § 15 (1970).

115. Address by John B. Rainbolt, II, Vice-chairman, Commodity Futures Trading Commission before the North American Securities Administrators' Conference, Mackinac Island, Michigan, Sept. 9, 1975 [hereinafter cited as Rainbolt].

116. SENATE CONFERENCE REPORT, *supra* note 45, at 35.

117. *Id.*

118. *Id.*

119. *Id.* at 35-36. The Constitutional authority for preemption of state laws regulating activities under the Act is U.S. CONST. art. I, § 8, cl. 3, and U.S. CONST. art. VI, cl. 2. On preemption, *see* Northern States Power Co. v. Minnesota, 447 F.2d 1143, 1146 (8th Cir. 1971).

However, the Act provides that "pending proceedings under existing law shall not be abated by reason of any provision" of the 1974 Act, "but shall be disposed of pursuant to the applicable provisions of the Commodity Exchange Act, as amended, in effect prior to the effective date of this Act." CFTC Act § 412, 88 Stat. 1414 (1974). This section of the Act was recently interpreted by the Texas Court of Civil Appeals as not being applicable of authority to the Commission, the conferees did not contemplate a need for any supplementary regulation by the states.[120]

The Supreme Court of Texas in *Clayton Brokerage Co. v. Mouer*,[121] recently dismissed as moot an action brought under the Securities Act of Texas enforcing an order against a dealer in London commodity options on the grounds that the CFTC Act had preempted state regulation of commodity option transactions. In an earlier decision, *Texas v. Monex International, Ltd.*,[122] the court ruled that the CFTC Act had also preempted state regulation of margin accounts by granting exclusive jurisdiction over all futures trading to the CFTC, commencing April 21, 1975.

Notwithstanding the exclusive jurisdiction provision of the Act, the states may still prosecute fraud under state laws of general application. Additionally, the states may seek to enjoin business conduct which violates the Commodity Exchange Act or regulations issued pursuant thereto, based on the doctrine of *parens patriae*, under which a state may act as protector of its citizens and guardian of their interests. They may also take action against persons who are required to register with the Commission but who have not done so. The Commission has indicated a willingness to cooperate with states to establish a cooperative enforcement effort.[123]

In a recent New York case, *New York v. Monex International, Ltd.*,[124] the CFTC filed a memorandum of law, amicus curiae, in which it took the position that the application of a general state antifraud statute to commodity options trading and leverage transactions would not be precluded by its exclusive grant of jurisdiction over such transactions. In its decision, the New York state court questioned the exclusive jurisdiction of the CFTC over margin accounts in silver and gold coins, which it characterized as securities. The court sidestepped the exclusive jurisdiction issue by concluding that the state had jurisdiction over the subject mat-

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to an appeal by the State of Texas pending at the time the Act became effective. The appeal was from a district court decision holding that the State did not have jurisdiction to regulate margin transactions after April 21, 1975, the effective date of the Act, and not allowing a permanent injunction which would have enjoined future transactions after that date. *See* Texas v. Monex International, Ltd., 527 S.W.2d 804 (Tex. Civ. App. 1975).

120. SENATE CONFERENCE REPORT, *supra* note 45, at 36.

121. 531 S.W.2d 805 (Tex. 1975).

122. 527 S.W.2d 804 (Tex. Civ. App. 1975).

123. The Commission's Office of General Counsel is preparing a memorandum outlining a cooperative enforcement program with the states. *See* Rainbolt, *supra* note 115, at 10. Also, the Commission has recently established an Advisory Committee on State Jurisdiction and Responsibilities to advise it on state-CFTC jurisdictional matters and on enforcement by the states, in coordination with the CFTC, of the provisions of the Commodity Exchange Act, as amended by the CFTC Act of 1974. *See* 41 Fed. Reg. 13,393 (1976).

124. N.Y. Super. Ct. (New York County), *cited in* CCH COMMODITY FUTURES L. REP. ¶ 20,126, Commodity Futures Law Reports No. 16, at 3 (Feb. 3, 1976).

ter because the proceeding before it was pending prior to the effective date of the CFTC Act, and that it had been the congressional intent that regulation of commodity trading should not be interrupted by the creation of the CFTC.[125]

The CFTC is presently examining the statute applied in the *Monex* case to determine whether it is a sufficiently broad statute to be termed *general*, such that it is or could be applied to any fraud case, and not just to one involving commodity options or margin account transactions.[126] If the statute is, in fact, found to have been used by the State of New York to focus specifically on securities and commodities transactions, the CFTC will probably object to its application. On the other hand, it has indicated a willingness to file amicus curiae briefs acknowledging state jurisdiction in cases, brought under statutes of general application, where defendants raise the issue of exclusive CFTC jurisdiction.[127]

SEC jurisdiction

The Commission's jurisdiction over futures trading can not supersede or limit the jurisdiction of the Securities and Exchange Commission or other regulatory authorities under federal or state laws, or restrict them in carrying out their duties and responsibilities in accordance with such laws.[128] However, the dividing line between the jurisdictions of the Commission and the SEC is not entirely clear.

Recently the CFTC and SEC have had strong disagreements over which agency has jurisdiction to regulate trading in government mortgages and securities for future delivery. The Chairman of the SEC has expressed concern that there may be a conflict between the two agencies' jurisdictions to regulate such trading, and has maintained that the SEC has exclusive, or at least concurrent, regulatory jurisdiction in these areas.[129] In a memorandum prepared by its Office of General Counsel, the CFTC acknowledged the concerns expressed by the SEC Chairman but emphasized that the CFTC Act expressly gave it exclusive jurisdiction over trading in futures contracts of government securities and mortgages.[130] The CFTC's memorandum suggested consultation between the two agencies in the future on all financial instruments sought to be traded in futures contract markets. While the

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125. *Id.* The decision by the New York court was opposite to the decision by the Supreme Court of Texas in the *Clayton* and *Monex* cases. *See* notes 121-22 *supra*.
126. CCH COMMODITY FUTURES L. REP., Commodity Futures Law Reports No. 16, at 2 (Feb. 3, 1976).
127. *Id.*
128. 7 U.S.C. § 2 (Supp. 1974), *amending* 7 U.S.C. §§ 2, 4 (1970).
129. CCH COMMODITY FUTURES L. REP., Commodity Futures Law Reports No. 13, at 3 (Dec. 5, 1975).
130. *See CFTC Advisory to the Media*, Dec. 3, 1975; *see also* Securities Regulation and Law Report No. 329 F-1, Nov. 26, 1976.

SEC has not expressly conceded its jurisdictional argument, it appears fairly clear that the CFTC Act was intended to give the CFTC jurisdiction over trading in this area.[131]

Conflict between the CFTC and the SEC may also exist when private parties invoke, as they have in the past, the Securities Act of 1933[132] and the Securities Exchange Act of 1934[133] with respect to commodity transactions, claiming that the method of trading in futures contracts resulted in the creation of a security.[134] The Supreme Court's broad concept of "security" under the federal securities laws appears to support this contention. The Court has stated that "[i]n the Securities Act the term 'security' was defined to include by name or description many documents in which there is common trading for speculation or investment—[T]he reach of the Act does not stop with the obvious and commonplace."[135] In formulating what has become known as the *Howey* test, the Court stated that "[an] 'investment contract' involves investment of money in a 'common enterprise' with 'profit' to come solely from the efforts of others. Form [is to be] disregarded for substance and emphasis [is to be] placed on economic reality."[136] The Court has also held that "[t]he subjection of the investor's money to the risk of an enterprise over which he exercises no managerial control is the basic economic reality of a security transaction."[137] Despite the Supreme Court's language, however, the weight of authority in the lower courts supports the view that the provisions of the securites laws do not extend to transactions involving trading in commodities.[138]

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131. The CFTC Act specifically states:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, *unless such transactions involve the sale thereof for future delivery conducted on a board of trade* . . . .

7 U.S.C. § 2 (Supp. 1974).

132. 15 U.S.C. §§ 77a-77bbbb (1970).

133. 15 U.S.C. §§ 78a-78ii (1970).

134. *See* Marshall v. Lamson Bros. & Co., 368 F. Supp. 486 (S.D. Iowa 1974); Berman v. Orimex Trading, Inc., 291 F. Supp. 701 (S.D.N.Y. 1968); Maheu v. Reynolds & Co., 282 F. Supp. 423 (S.D.N.Y. 1967).

135. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

136. SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

137. SEC v. Glenn W. Turner Enterprises, Inc., 348 F. Supp. 766 (D. Ore. 1972), *aff'd*, 474 F.2d 476 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973).

138. For example, federal courts have held that discretionary commodity accounts, which are subject to CFTC jurisdiction, are not subject to SEC regulation. *See* Milnarik v. M-S Commodities, Inc., 457 F.2d 274 (7th Cir. 1972); Wasnowic v. Chicago Board of Trade, 352 F. Supp. 1066 (M.D. Pa. 1972), *aff'd*, 491 F.2d 752 (3d Cir. 1973), *cert. denied*, 416 U.S. 994 (1974). *See also* Stuckey v. duPond Glore Forgan, Inc., 59 F.R.D. 129 (N.D. Cal. 1973); Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359 (S.D.N.Y. 1966). Some courts, however, have adopted the contrary view. *See, e.g.*, Marshall v. Lamson Bros. & Co., 368 F. Supp. 486 (S.D. Iowa 1974); *cf.* SEC v. Continental Commodities Corp., 497 F.2d 516 (5th Cir. 1974).

The Act attempts to alleviate confusion between regulatory schemes by giving the Commission exclusive jurisdiction with respect to commodity transactions by trading advisors, pool operators and other professionals, and authorizing it to police them based upon what they or associated persons have done.[139] It applies a broad fiduciary responsibility to these professionals in terms that parallel SEC Rule 10b-5.[140] With regard to sales on margin of gold and silver bullion, bulk silver coins and bulk gold coins, the Act gives exclusive jurisdiction to the Commission and express authority to adopt rules to assure financial solvency of the transaction or to prevent manipulation.[141] However, those transactions not on margin are subject to SEC jurisdiction.[142]

Recognizing that confusion might remain about the extent of the two Commissions' jurisdictions, the House Agriculture Committee Report stated that the two Commissions should consult and cooperate in determining how to exercise their respective jurisdictions in the public interest.[143]

State and federal court jurisdiction.

Although both the House and Senate sought to centralize regulatory jurisdiction over futures trading in the Commission, they did not wish to prevent injured persons from seeking redress in federal and state courts.[144] The inclusion of a provision of the Act which authorized the Commission to hear investor complaints and to award damages or "reparations"[145] did not allay this concern. The Senate, therefore, added the provision that "nothing in [the Act] shall supersede or limit the jurisdiction conferred on courts of the United States or any State."[146] Thus, injured persons may continue to sue in federal or state court.[147] But Congress has not revoked the doctrine of primary regulatory jursdiction. While an injured person may elect initially to bring suit in a court rather than proceed before the Commission, the Act does not preclude the court from referring issues in the case to the Commission for review.[148]

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139. 7 U.S.C. §§ 6*l*-o (Supp. 1974), *amending* 7 U.S.C. § 6 (1970).
140. 17 C.F.R. § 240.10b-5 (Supp. 1975).
141. 7 U.S.C. § 15a (Supp. 1974), *amending* 7 U.S.C. § 15 (1970).
142. 7 U.S.C. § 15a (Supp. 1974).
143. H.R. Rep. No. 93-975, 93d Cong., 2d Sess. 29 (1974) [hereinafter cited as HOUSE REPORT]. For a comparative analysis of the federal regulation of commodity and securities exchanges, *see* Wolff, *supra* note 84.
144. SENATE REPORT, *supra* note 3, at 23.
145. 7 U.S.C. § 18 (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970).
146. 7 U.S.C. § 2 (Supp. 1974), *amending* 7 U.S.C. §§ 2, 4 (1970).
147. *See* Rainbolt, *supra* note 115, at 8. This is similar to the procedure under the Securities Act §§ 77k-*l*, 15 U.S.C. §§ 77k-*l* (1970). *See* J.I. Case Co. v. Borak, 377 U.S. 426 (1964) (proxy violations); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971).
148. *See, e.g.*, Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 (1973); Chicago Mercantile Exchange v. Deaktor, 414 U.S. 113 (1973).

Initial CFTC action to assert jurisdiction

The Commission initially took two steps to assert its exclusive jurisdiction. First, the Commission intervened[149] in a Securities and Exchange Commission case.[150] The complaint alleged that the defendants had offered and sold investment contracts, evidence of indebtedness, and participations in profit sharing agreements in the form of purported options on commodity futures contracts, in violation of the registration[151] and antifraud[152] provisions of the Securities Act of 1933, and the broker dealer registration requirements of the Securities Exchange Act.[153]

In its amicus curiae memorandum, the Commission expressed no opinion as to whether the defendant's alleged activities, which occurred prior to the effective date of the CFTC Act, April 21, 1975, involved the offer and sale of a "security."[154] The Commission stated that the CFTC Act should not be held to affect the jurisdiction of the SEC prior to April 21, 1975,[155] but asserted that the activities alleged in the SEC complaint were now plainly within the jurisdiction of the Commission. The Commission went on to state that the facts alleged would permit a court to conclude that a reasonable probability existed that the defendants, unless enjoined, might violate the antifraud provisions of the Commodity Exchange Act, as amended by the CFTC Act of 1974, and the rules adopted thereunder by the CFTC.[156]

Secondly, the Commission has adopted antifraud rules covering 1) leverage contracts,[157] 2) options trading for newly regulated commodities,[158] and 3) futures contracts traded on other than domestic contract markets.[159] These areas had previously been regulated by the SEC under Rule 10b-5,[160] but had escaped coverage under Section 4b of the CFTC Act because trading did not occur on the contract markets. In asserting jurisdiction, the Commodities Futures Trading Commission recognized that the "willful behavior" test from the regulations applied to these transactions.[161]

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149. *See* CCH COMMODITY FUTURES L. REP., Commodity Futures Law Reports No. 8, at 5 (Aug. 27, 1975).
150. SEC v. American Commodity Exchange, Civil Action No. 15-0436-C (W.D. Okla. 1975).
151. 15 U.S.C. § 77e (1970).
152. *Id.* § 77q(a).
153. *Id.* § 78o(a), *formerly* ch. 404, Title I, § 15, 48 Stat. 881, 895 (1934).
154. SEC v. American Commodity Exchange, Civil Action No. 15-0436-C (W.D. Okla. 1975).
155. CFTC Act, Pub. L. No. 93-463, 88 Stat. 1415 (1974).
156. *See* SENATE REPORT, *supra* note 3, at 22-23, 48.
157. 17 C.F.R. § 30.03 (Supp. 1975).
158. *Id.* § 30.01.
159. *Id.* § 30.02.
160. *See* CFTC PROGRAM STUDY GROUP, REPORT FOR THE COMMODITY FUTURES TRADING COMMISSION: REGULATORY GAP, Project Report #201-h, at 2 (Apr. 1, 1975).
161. 40 Fed. Reg. 26,505 n.2 (1975).

Potential for future conflict

Despite the efforts by Congress to clarify the confusion in the courts regarding the definitions of commodities and securities, and to delineate the jurisdiction of the new Commission vis-a-vis the SEC and state regulatory agencies, the Commission and the SEC already are at odds over jurisdictional matters. Moreover, some of the states may continue to assert jurisdiction over some commodity futures transactions, especially commodity option and leverage contract transactions. Thus, the prospect remains that bureaucratic infighting may continue, and substantial litigation may be necessary to resolve the various jurisdictional conflicts.

The Least Anticompetitive Means Mandate: Antitrust Implications

The CFTC Act directs the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of the Act in issuing any order or adopting any Commission rule or regulation, and in approving the rules, bylaws or regulations of any contract market[162] or registered futures association established pursuant to the Act.[163]

The fact that commodities futures exchanges promulgate rules for the trading of commodities futures contracts presents the possibility that the exchanges may be charged with violations of the federal antitrust laws. Recent class actions against commodities futures exchanges have indeed made such charges. In *United States v. Chicago Board of Trade*,[164] for example, plaintiffs claimed that the fixing of minimum commissions by the exchanges violated the antitrust laws even though the practices antedated those laws and had continued unchallenged for decades with the full knowledge of the government.[165]

Courts have construed even statutory antitrust exemptions very narrowly. The Supreme Court has followed a policy of limiting or ignoring antitrust immunity where Congress has been silent regarding the relation between a regulatory law and the antitrust laws. In *Silver v. New York Stock Exchange*,[166] the Court held

162. 7 U.S.C. § 7a(12) (Supp. 1974), *amending* 7 U.S.C. § 7a (1970). As mentioned earlier, each exchange must submit its bylaws or rules covering contract terms and conditions and other trading requirements to the Commission for approval before those rules can become effective.

163. 7 U.S.C. § 19 (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970). Antitrust review proceedings may be treated as "rulemaking" by the Commission in that such proceedings may involve "approval or prescription for the future" of matters within 5 U.S.C. § 551(4) (1970). The prospect of judicial review was recognized by Congress. *See* SENATE REPORT, *supra* note 3, at 23.

164. No. 71C 2875 (N.D. Ill., June 28, 1974).

165. The Chicago Board of Trade case was settled when the defendant exchanges agreed to phase out minimum commissions. See CCH COMMODITY FUTURES L. REP. ¶ 20,011 (1975).

166. 373 U.S. 341 (1963).

that, in the absence of regulatory supervision over the application of exchange rule, the antitrust laws applied to the stock exchanges.[167] The Court went on to state that:

> [A]ny repealer of the antitrust laws must be discerned as a matter of implication and '[i]t is a cardinal principle of construction that repeals by implication are not favored.' Repeal is to be regarded as implied only if necessary to make the Securities Exchange Act work, and even then only to the minimum extent necessary.[168]

In *Silver*, however, the Court explicitly reserved the question of whether the antitrust laws would apply to the stock exchange if review of exchange self-regulation were provided through another regulatory scheme.[169]

In *United States v. National Association of Securities Dealers, Inc.*,[170] the Supreme Court considered the extent to which the antitrust policies of the Sherman Act were displaced by the regulatory authority conferred upon the Securities and Exchange Commission by provisions of the federal securities laws. The Court in *NASD* held that:

> [I]mplied repeal of the antitrust laws [in this case] is necessary to make the [regulatory scheme] work. *Silver v. New York Stock Exchange* . . . In generally similar situations we have implied immunity in particular and discrete instances to assure that the federal agency entrusted with regulation in the public interest could carry out that responsibility free from the disruption of conflicting judgments that might be voiced by courts exercising jurisdiction under the anti-trust laws . . . . We therefore hold that with respect to . . . [certain of the] activities challenged . . . the Sherman Act has been displaced by the pervasive regulatory scheme . . . .[171]

In finding implied repeal the Court stressed the extensive authority of the SEC over the association and noted that the SEC has closely scrutinized the activities that were in question and had repeatedly indicated that it weighed competitive concerns in the exercise of its continued supervisory responsibility.[172]

The question left open in *Silver* was squarely presented in *Gordon v. New York Stock Exchange, Inc.*[173] *Gordon* involved a class action suit filed in 1971 against the New York Stock Ex-

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167. *See also* United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963); California v. Federal Power Comm'n, 369 U.S. 482 (1962); United States v. Radio Corp. of Am., 358 U.S. 334 (1959); Federal Maritime Board v. Isbrandtsen, 356 U.S. 481, 499-500 (1958).

168. Silver v. New York Stock Exchange, 373 U.S. 341, 357 (1963) (citations omitted).

169. *Id.*

170. 95 S. Ct. 2427 (1975).

171. *Id.* at 2450.

172. *Id.* at 2449.

173. Gordon v. New York Stock Exchange, Inc., 95 S. Ct. 2598 (1975).

change, American Stock Exchange, and two member firms. Plaintiff claimed that the system of fixed commission rates utilized by the exchanges for transactions of less than $500,000 violated the Sherman Antitrust Act.[174] In contrast to the circumstances of *Silver*, the SEC in *Gordon* had direct regulatory powers over exchange rules and practices with respect to fixing reasonable rates of commission, and was also authorized to require alteration or supplementation of those rules and practices. The Court pointed out that all rate changes since 1934 had been brought to the attention of the SEC and that the SEC had taken an active role in reviewing proposed rate changes during the last 15 years. The Court concluded that *Gordon* involved explicit statutory authorization for SEC review of all exchange rules and practices dealing with rates of commission. Therefore, the Court held that the requirements for implied repeal of the antitrust laws in this instance were clearly satisfied because "[t]o permit operation of the antitrust laws with respect to commission rates, as urged by petitioner Gordon and the United States as amicus curiae, would unduly interfere, in our view, with the operation of the Securities Exchange Act."[175]

The Commodities Futures Trading Commission Act provides that the Commission itself must, in the first instance, attempt to resolve the problem of antitrust liability arising from the self-regulation of commodities futures trading exchanges.[176] The legislative history of the Act indicates that the Congress, acting before the Supreme Court's decisions in *NASD* and *Gordon*, determined to give the Commission, rather than the courts, the initial role in applying antitrust policies to the commodities futures exchanges. Congress was strongly urged to make clear its intent with regard to the relationship between the Act's regulatory standards and the antitrust laws.[177] The Senate Report indicates that the Congress intended to allow the public interest represented by the antitrust laws to be vindicated through the regulatory process in the Commission,[178] presumably because the Congress felt that regulatory agencies are better able to guard investors and the public. Granting antitrust immunity to actively supervised exchanges[179]

174. The district court granted the defendant's motion for summary judgment, and dismissed plaintiff's complaint. 366 F. Supp. 1261 (S.D.N.Y. 1973). The court of appeals affirmed, 498 F.2d 1303 (2d Cir. 1974).

175. Gordon v. New York Stock Exchange, Inc., 95 S. Ct. 2598, 2613 (1975).

176. *See* SENATE REPORT, *supra* note 3, at 22-23, 48.

177. *See* HOUSE REPORT, *supra* note 143, at 44-48. *See also* Hale & Hale, *Regulation: A Defense to Anti-Merger Litigation*, 54 KY. L.J. 683, 715 (1966).

178. *See* SENATE REPORT, *supra* note 3, at 23.

179. This is to be distinguished from a "pervasive" regulatory scheme. The SEC action to control the minimum commission rules, pursuant to express statutory authorization, served to take this practice out of the antitrust field. A broad antitrust immunity regarding all phases of exchange activity was not at issue. Gordon v. New York Stock Exchange, 95 S. Ct. 2598 (1975).

appeared to prevent the dilemma of agency rules conflicting with court decisions.[180] The House Report recognized the "[c]onfusion in court decisions, . . .with regard to the antitrust consequences of self-regulating activities of exchanges"[181] and the "[g]rowing difficulties facing exchanges engaged in self-regulatory actions as a result of private plaintiffs seeking damages against self-regulating activities of the markets,"[182] and decided to include the "least anticompetitive means test" in the Act.[183]

The *Gordon* and *NASD* decisions appear to support Congress' determination to subordinate the antitrust laws to independent regulatory schemes. However, the legislative history of the Act indicates that Congress did not favor granting an automatic antitrust exemption to Commission rules or to exchange bylaws subject to Commission approval.[184] Inclusion of the least anticompetitive means provision in the Act clearly reflects the congressional intent that antitrust inquiry should occur before the rules in question become effective, and while they are still under review by the Commission, rather than later in court after reliance on their validity.[185] The fact that the Commission is given initial jurisdiction, nonetheless, does not mean that Commission orders are immune from court review.[186]

The scope of judicial review of Commission orders with respect to antitrust policies remains unclear. In two recent decisions[187] the Supreme Court deferred the question of antitrust review by invoking the doctrine of primary jurisdiction and deferring to the Commodity Exchange Authority on decisions where the agency has expertise to deal with "intricate and technical facts of the commodity industry."[188] The Court made clear, however, that it is not bound by an agency decision, and pointed out that an

180. HOUSE REPORT, *supra* note 143, at 48.
181. *Id.*
182. *Id.*
183. *See* SENATE REPORT, *supra* note 3, at 8, 22-23. In order to avoid imposing a procedural burden on the Commission, it made clear its intention that the Commission was not required to consider antitrust and anticompetitive matters in separate proceedings.
184. The Justice Department had objected to the original language of H.R. 11955 containing explicit exemption language and argued that existing case law, and particularly the test formulated by the Supreme Court in Silver v. New York Stock Exchange, 373 U.S. 341 (1963), "provides an adequate antitrust exemption for those activities of contract markets necessary to achieve valid objectives of the Commodity Exchange Act." HOUSE REPORT, *supra* note 143, at 23-24, 27. The Committee accepted the arguments of the Justice Department, relying on the Department's assurances that antitrust exemption would exist for any exchange activity which was necessary to achieve the purpose or objectives of the regulatory statute.
185. *See* HOUSE REPORT, *supra* note 143, at 27-28.
186. *See* City of Lafayette v. SEC, 454 F.2d 941 (D.C. Cir. 1971), *aff'd sub nom.* Gulf States Util. v. Federal Power Commission, 411 U.S. 747 (1973); Independent Broker-Dealers' Trade Ass'n v. SEC, 442 F.2d 132 (D.C. Cir. 1971).
187. Chicago Mercantile Exchange v. Deaktor, 414 U.S. 113 (1973); Ricci v. Chicago Mercantile Exchange, 409 U.S. 289 (1973).
188. Chicago Mercantile Exchange v. Deaktor, 414 U.S. 113 (1973).

adjudication by the agency did not necessarily settle the question of immunity from liability under the antitrust laws.[189]

CFTC Authority Over Cash Markets

The CFTC is charged by the Commodity Exchange Act with responsibility for preventing and prosecuting manipulation of the cash, as well as the futures, markets. The Act, however, is ambiguous as to the extent of the CFTC's authority to do so. For example, the term "manipulation" is not even defined in the Act.[190] Although discussed in congressional hearings and debates, definition of this term has been deliberately left to the courts. Court decisions in past manipulation cases[191] are not very helpful in arriving at a definition because they related to centralized futures markets, rather than cash markets which are fairly decentralized and informal. Also, they are not fully consistent on what constitutes manipulation.[192] While various provisions of the Act prohibit the manipulation of the market "price of any commodity, in interstate commerce,"[193] to corner any such commodity,[194] to knowingly communicate false, misleading or inaccurate crop or market information,[195] or to fail to maintain proper records of cash transactions,[196] the Act does not specifically require the CFTC to affirmatively regulate the cash markets.

While the great majority of cash transactions are made in informal, decentralized markets all over the country, there are some boards of trade which have separate cash and futures markets facilities under the same roof. The Act is unclear as to the CFTC's jurisdiction over these cash markets, which operate alongside an organized futures market.[197]

This ambiguity is especially evident in the two provisions of the Act, sections 7a(12) and 12a(7), which were added by the CFTC Act. Section 7a(12) requires a contract market to submit for

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189. *Id.*
190. *See* text accompanying note 96 *supra* for a discussion of manipulation.
191. Great W. Food Distrib. v. Brannan, 201 F.2d 476, 478 (7th Cir. 1953), *cert. denied*, 345 U.S. 997 (1953); *see also* Moore v. Brannan, 191 F.2d 775 (D.C. Cir. 1951), *cert. denied*, 342 U.S. 860 (1951); Gamco, Inc. v. Providence Fruit & Produce Bldg., 194 F.2d 484 (1st Cir. 1952), *cert. denied*, 344 U.S. 817 (1952).
192. *See* Campbell, *Trading in Futures under the Commodity Exchange Act*, 26 GEO. WASH. L. REV. 215, 233-44 (1958); *see also* Memorandum on Manipulation from Anthony M. McDonald, Jr., Executive Director of CFTC to Terry L. Claasen, Counsel to CFTC Cash Commodity Markets Subcommittee, Dec. 10, 1975 (available at the CFTC); *and* Kauffman, *Recent Developments in Futures Trading under the Commodity Exchange Act*, U.S. Dep't of Agriculture Information Bulletin No. 155, at 7 (1956).
193. Commodity Exchange Act, 7 U.S.C. §§ 6(b), 6(c), 9 (1970).
194. *Id.* § 9(b).
195. *Id.*
196. *Id.* § 6(i).
197. Two examples of cash markets operating alongside futures contract markets under the auspices of the some board of trade are the Minneapolis Grain Exchange and the Board of Trade of Kansas City, Missouri, Inc.

CFTC approval "all bylaws, rules, regulations, and resolutions . . . which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements, except those relating to the setting of levels of margin."[198]

In other provisions of the Act, a distinction is made when those provisions are intended to apply to both cash and futures transactions. Section 7a(12) does not contain such a distinction and makes no specific reference to cash or futures transactions. This would indicate that it is applicable only to contract market rules relating to futures contract and futures transactions, which are clearly the primary subject of regulation under the Act. Moreover, section 7a(12) applies only to "contract markets," and the public interest test of Section 7(g), which was added by the CFTC amendments and must be satisfied by a board of trade seeking "contract market" designation, indicates that "contract market" designation is only granted for futures trading. This language in the Act, and the legislative history of section 7a(12), which specifically refers to futures contracts and makes no mention of cash contracts,[199] appear to support a conclusion that this provision of the Act is not applicable to cash market rules.

Section 12a(7) authorizes the CFTC to

> alter or supplement the rules of a contract market insofar as necessary or appropriate by rule or regulation or by order, if after making the appropriate request in writing to a contract market that such contract market effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such contract market has not made the changes so required, and that such changes are necessary or appropriate for the protection of persons producing, handling, processing, or consuming any commodity traded for future delivery on such contract market, or the product or byproduct thereof, or for the protection of traders or to insure fair dealing in commodities traded for future delivery on such contract market. . . .[200]

While containing different language than section 7a(12), section 12a(7) also does not appear to be applicable to cash market rules. The stated objective of section 12a(7) is to protect "persons producing, handling, processing or consuming *any commodity* [or byproduct of any commodity] *traded for future delivery*, . . . and to protect traders or to insure fair dealing in *commodities traded for future delivery* . . . ."[201] This language would indicate that sec-

198. 7 U.S.C. § 7a(12) (Supp. 1974), *amending* 7 U.S.C. § 7a (1970).
199. *See* SENATE CONFERENCE REPORT, *supra* note 45, at 37; SENATE REPORT, *supra* note 3, at 7; HOUSE REPORT, *supra* note 143, at 3.
200. 7 U.S.C. § 12a(7) (Supp. 1974), *amending* 7 U.S.C. § 12a (1970).
201. 7 U.S.C. § 12a(7) (Supp. 1974) (emphasis added).

tion 12a(7) applies only to contract market rules relating to futures contracts and transactions and does not apply to cash transactions or to contract market rules relating to such transactions. A recent article written by two CFTC attorneys argues that "the fact that identical terms are not used in 7a(12) and 12a(7) should not be construed to indicate that a narrow construction of one section as opposed to another was intended, but rather that those sections are to be read in *pari materia* in their application to contract market rules."[202] This argument is also consistent with the legislative history of section 12a(7) which states that the Commission is authorized "to alter or supplement rules previously-approved."[203] Since the Commission is authorized to approve such rules only under section 7a(12), it would appear that section 12a(7) is limited by the scope of section 7a(12). Thus, it may be concluded that, if section 12a(7) is no broader than section 7a(12) and section 7a(12) is not applicable to cash market rules, section 12a(7) is not applicable to cash market rules. The CFTC has not yet made a final determination with regard to the applicability of sections 7a(12) and 12a(7) to the rules of a cash market which operates alongside a futures contract market, although it has taken a no action position with regard to section 7a(12), pending a final determination.[204]

Because of the vague authority granted to the CFTC by the Act over cash markets, the large and uncertain dimensions of the "cash market," the CFTC's limited resources, and its primary mandate to regulate the futures market, the CFTC may decide to focus its efforts on preventing price manipulation in the areas where there is the most potential for such manipulation. Such efforts could include enforcement action to prosecute manipulations reported to or complained of the CFTC, and undertaking a monitoring or surveillance program of the cash market in a manner that would be most effective to prevent price manipulation.[205]

Dispute Resolution

The CFTC Act added new provisions to the Commodity Exchange Act establishing two procedures by which disputes could be promptly and equitably resolved. First, it required the Commission to establish by January 23, 1976, a reparation procedure for handling complaints against any person registered under the Act.[206] Secondly, it requires the contract markets to provide a

202. Markham & Schoebel, *Commodity Exchange Rule Approval: Procedural Mishmash or Antitrust Umbrella?*, Securities Regulation and Law Report No. 335 (Jan. 14, 1976) (special supplement).
203. *See* SENATE CONFERENCE REPORT, *supra* note 45, at 37.
204. *See* CCH COMMODITY FUTURES L. REP. ¶ 20,133, Commodity Futures Law Reports No. 17 (Feb. 25, 1976).
205. This conclusion concurs with the Draft Recommendations of The Cash Commodity Market Subcommittee of the CFTC, Advisory Committee on Market Instruments (Mar. 1976).
206. 7 U.S.C. § 18 (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970).

fair and equitable procedure, through arbitration or otherwise, for the settlement of customers' claims (but not claims of futures commission merchants or floor brokers) against any of its members or employees.[207]

Reparation procedure

The reparations procedure established by the Act is similar to those provided for in the Perishable Agricultural Commodities Act (PACA).[208] However, unlike the PACA reparations scheme, a party dissatisfied with the results of a hearing may not apply to the district court for a trial de novo.[209]

The Commission will consider complants against any registrant based on any violation of the Commodity Exchange Act or rules and regulations promulgated thereunder.[210] If the facts alleged warrant it, the Commission may send a copy of the complaint to the respondent, and conduct an investigation.[211] If further proceedings are in order, the respondent will be afforded an opportunity to be heard before an administrative law judge.[212]

Upon finding a violation, the Commission will determine the damages and order the respondent to pay the complainant.[213] The Commission's order is reviewable by the court of appeals,[214] but findings of fact are conclusive if supported by the weight of evidence.[215] If the respondent refuses to pay and does not appeal, he will be prohibited from trading on contract markets and his registration will be automatically suspended.[216]

The Commission has promulgated rules, which became effective in Janaury 23, 1976, to implement the requirements of the Act with regard to reparation proceedings.[217] The rules establish procedures for persons with complaints against certain persons registered under the Act as floor brokers, futures commission merchants, commodity trading advisors, commodity pool operators,

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207. 7 U.S.C. § 7a(11) (Supp. 1974), *amending* 7 U.S.C. § 7a (1970).
208. 7 U.S.C. §§ 499(e)-(g) (1970).
209. 7 U.S.C. § 18g (Supp. 1974), *amending* 7 U.S.C. §§ 1-17a (1970).
210. *Id.* § 18a. The Commission will consider a complaint against persons registered as futures commission merchants, floor brokers, persons associated with futures commission merchants or with agents thereof, commodity trading advisors, or commodity pool operators. A complaint based on any violation of the Commodity Exchange Act or rules, regulations, or orders promulgated thereunder can be filed by any person up to two years after accrual of the cause of action alleged therein.
211. *Id.* § 18b.
212. *Id.* Proof in support of the complaint and of respondent's answer may be supplied by deposition or verified statements of fact, if the complaint claims damages not exceeding $2,500.
213. *Id.* §§ 18e-f. If the reparation award is not paid, the complainant has three years to enforce the award in the appropriate United States District Court.
214. *Id.* § 18g.
215. 7 U.S.C. § 9 (Supp. 1974), *amending* 7 U.S.C. § 9 (1970).
216. *Id.* § 18h.
217. 41 Fed. Reg. 3994 (1976).

and persons associated with a futures commission merchant or agents thereof, to get a just, speedy and inexpensive adjudication of their claims. The rules are designed to fully protect the rights of all interested parties, and the Commission has endeavored to eliminate all unnecessary formalities in the process of reaching settlement of the claims. It has determined that no party to a reparation proceeding should be prejudiced by a technical and inadvertent violation of these rules which does not prejudice the interest of any other party.

These reparation rules provide the procedures by which a claimant may pursue one of the remedies the law will permit for the recovery of claims. The other available remedies are arbitration and the filing of a lawsuit in an appropriate state or federal court.

The Commission has determined that the utilization of either an arbitration proceeding or civil court litigation is a waiver of the remedies available under the reparation procedures if the arbitration proceeding or court litigation is pursued to a final decision on the merits. In order to prevent the utilization of the reparation procedures while an arbitration proceeding or civil court litigation is pending, the Commission requires the complainant to set forth in the complaint any pending arbitration proceeding or court litigation based on the facts set forth and against the same party or parties named in the complaint. If such an arbitration proceeding or court litigation is pending at the time the reparation complaint is filed with the Commission, the Commission will ordinarily stay the reparation proceeding pending a decision by the arbitration panel or court.

Since aggrieved parties may appeal only to the court of appeals,[218] the Commission hearings probably must satisfy the requirements of due process. As a result, the reparation procedures will require a great deal of the Commission's energies and resources. In fact, one member of the Commission has already expressed concern that the reparations procedure "could make [the Commission] a huge small claims court for the Commodity industry."[219]

Nonetheless, since the interests of the parties involved are significant, the requirement of due process seems justified. A time consuming and burdensome reparation procedure could, however, divert the Commission's limited resources from its regulatory function. This would cast doubt on the ability of the Commission to discharge its regulatory responsibilities effectively, thus threatening its reputation from the very beginning.

218. 7 U.S.C. § 18g (Supp. 1974).

219. *See* Address by Commissioner Gary L. Seevers before the Regulatory Reform Conference, Washington, D.C., Sept. 11, 1975, at 4 (available at the Commission).

Arbitration

Arbitration is an effective and quick method for resolving disputes, saving time and costs for both parties to a dispute. This makes it especially suitable for an industry where time is of the essence.

The Act now requires contract markets to provide a fair and equitable procedure through arbitration or otherwise for settlement of customer claims and grievances against any member or employee thereof.[220] The use of such procedure by a customer is required to be voluntary.

While some exchanges had informal arbitration procedures before the Act, they were not uniform and did not provide all the necessary safeguards the Commission now requires. Each exchange must now establish procedures for claims under $15,000.[221] A contract market may also establish separate procedures for claims over $15,000,[222] but such mechanisms must not interfere with or delay the adjudication of claims for the smaller amounts.[223] No contract market-related appeal is allowed from the award of the arbitrators.[224]

The Commission has proposed rules to establish requirements necessary for a fair and equitable settlement procedure.[225] The proposed rules prohibit prior agreements to submit claims to settlement procedures.[226] This prohibition will cause confusion regarding existing agreements and ongoing arbitration. In order to avoid this, the Commission should permit existing arbitration agreements to continue in force for their duration, or for a convenient period of time before requiring renegotiation in accordance with the new rules. At recent hearings,[227] the Commission expressed concern that existing arbitration agreements, if allowed to remain in force, would greatly limit the use of the CFTC's reparation procedure. The Commission is also concerned that customers are not made aware by future commission merchants that, in addition to contract market arbitration, the reparations procedure is now available for settling disputes. Although these are proper concerns, the voiding of existing arbitration agreements between

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220. 7 U.S.C. § 7a(11) (Supp. 1974), *amending* 7 U.S.C. § 7a (1970).
221. *Id.*
222. 40 Fed. Reg. 54, 434-35 (1975). Also, counterclaims under $15,000 are permitted pursuant to Proposed Reg. § 180.4 if the customer agrees to their submission after the counterclaim has arisen.
223. *Id.* Also, a contract market may establish, pursuant to Proposed Reg. § 180.6 a procedure for settlement of claims and grievances involving only its members.
224. *Id.*
225. *Id.*, Proposed Reg. § 180.2. The rules have been published for comment but have not yet been adopted by the Commission. The final rules may vary somewhat from the proposed version.
226. *Id.*
227. *See* 41 Fed. Reg. 6120 (1976), announcing the public hearing to be held in March, 1976.

customers and commission merchants in order to provide an alternative forum through the reparations procedure would seem to be an unwise step. The proposed rules are expected to be modified as a result of information obtained at the CFTC public hearings held in March, 1976, and should be made effective in the near future.

Issues Delegated By Congress to CFTC

Congress left several critical issues for the Commission to resolve during the first year of its life.[228] Among these are the following: 1) define "bona fide hedging transaction or positions" to allow legitimate hedging for example, by users of byproducts of traded commodities and seed companies of the contract bushel equivalent of anticipated seed production;[229] 2) adopt regulations governing trading in commodity options within one year after the effective date of the Act;[230] 3) determine within six months of the effective date of the Act whether, or on what terms, persons executing orders for customers should be allowed to trade also for their own controlled accounts;[231] 4) determine the type of trading records and the types and frequency of trading reports to be required of clearinghouses; 5) develop research and information programs to investigate the feasibility of trading by computer and the expanded use of modern information system technology;[232] and 6) investigate and report to Congress not later than June 30, 1976 on the need for legislation providing insurance against losses caused by the financial failure of futures commission merchants.[233]

The Commission has assigned the responsibility for making appropriate recommendations for resolving these issues to four advisory committees it has established. These advisory committees will have a membership drawn from various segments of the industry, academia, labor, agriculture and the public. The committees will study and make recommendations to the Commission in four broad areas: 1) economic performance of contract markets; 2) definition and regulation of market instruments; 3) regulation of futures trading professionals; and 4) regulation of con-

228. The deadlines established by the Act for Commission resolution of several of these issues were extended by Pub. L. No. 94-16, 89 Stat. 78 (1975).

229. 7 U.S.C. § 6(a)(3) (Supp. 1974) allows the Commission to define the term consistent with the purpose of the Act.

230. *Id.* § 6 continues the ban on trading in options (privileges, indemnities, bids, offers, puts, calls, advanced guaranties, and decline guaranties) in the commodities previously regulated under the Commodity Exchange Act, but permits trading in options in all other commodities if not done contrary to any rule, regulation or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission may prescribe.

231. *Id.* § 6j.

232. *Id.* § 22.

233. CFTCA, Pub. L. No. 93-463, § 417, 88 Stat. 1415 (1974).

tract markets and national futures associations.[234] The committees began their initial meetings in October and November, 1975, and will complete deliberations and submit their recommendation to the CFTC by mid-1976.[235]

The Commission has held a number of public hearings and conducted several studies to obtain information on these issues. Before taking final action on these issues, it will consider the recommendations of its advisory committees, although it has already taken interim steps to deal with several of them. The Commission has promulgated interim rules to regulate dual trading,[236] options trading,[237] and bona fide hedging.[238] Because of the complexity of these issues, the Commission may request an extension of the congressionally imposed deadlines to undertake additional study before making all of its final determinations.[239]

Conclusion

The recent spectacular increases in the volume of futures trading now exceeds the trading volume of securities on the various stock exchanges. This statistic is only one indicator of the importance of futures trading to the general public, the nation and the actual users of the futures markets. The shift in government policy to foster a market-oriented economy since the beginning of this decade has caused greater reliance on futures markets by producers, processors and others to avoid losses due to price fluctuations in the marketing of agricultural and other commodities. The continuation of this policy is bound to make the futures markets increasingly vital to the nation's economy.

In order that futures trading continue to serve this vital economic function, Congress saw the need for modernizing the regulation of these markets. The Commodity Exchange Act, originally passed in 1936, needed a substantial overhaul, and a strong independent enforcement agency to meet the challenges of the tremendous growth in futures trading in recent years and the accompanying potential for illegal and unethical trading practices which cause damage to the users of the market, the consumer and producer, and the futures markets themselves. The Commodity Futures Trading Commission Act of 1974 has now provided the necessary regulatory authority to meet those challenges and to assure that futures trading will be conducted properly. The Act truly is landmark legislation whose time has come.

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234. *See* 40 Fed. Reg. 32,866 (1975).
235. *Id.*
236. *See* 40 Fed. Reg. 58,660 (1975).
237. *See* 41 Fed. Reg. 7774 (1976).
238. *See* 40 Fed. Reg. 48,688 (1975).
239. The deadlines established by the CFTC Act for Commission resolution of several of these issues were initially extended by P.L. No. 94-16, 89 Stat. 77 (1975). The CFTC must have congressional approval for additional extension of these deadlines.