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CURTIS FEE - Bio -

File
Commodity Futures
Trading Commission

ROBERT L. MARTIN
603 South Allen Lane, Arlington Heights, Illinois 60005
Phone 312-255-4089

Born October 30, 1914 Vancouver, B. C. (of American parents, US citizen by birth)

Married Two daughters

Education: West High School, Minneapolis, Minn. Graduated January 1932

Military: USAAF S/Sgt Jan 1943-April 1946 Honorable Discharge

Religion: First Presbyterian Church, Arlington Heights, Illinois
Republican

Business History

September 1973-Present Vice President, Cook Grain Co., Inc. Chicago, Ill.

January 1972-August 1973 Vice President, Walston & Co. (succeeded by duPont-Walston), Chicago, Ill.

January 1971-November 1971 Vice President, Harris Upham & Co. New York and Chicago

January 1969-December 1970 Partner, Goodbody & Co. New York City

July 1958-December 1958 Director of Commodities, Goodbody & Co., New York City

May 1952-June 1968 Vice President J & O Grain Co (and successor ADM Grain Co.)
Chicago, Illinois

January 1934-April 1952 Ass't Sec'y, Standard Milling Co. Chicago, Illinois
and Minneapolis, Minn.

Since August 1938 have been intimately engaged in grain trade as clerk, floor manager, pit broker, hedger, speculator and executive with processor, merchandiser and commission house. Have merchandised cash grain as well as handling futures, dealing with all aspects of trade from producer to consumer.

Became a member of the Chicago Board of Trade in 1947. After a series of committees at the Exchange, served as Director 1959-63, Vice-Chairman 1964-65, and Chairman for three terms, 1966-67-68.

Have served on the usual complement of public service and governmental committees. While bulk of experience has been in grain and related commodities, have had exposure to all markets and am familiar with personnel in every one.

Economic Development Administration

Research in Economics

- American Economic Association
- Brookings Institution (National research program in public finance research, education, and information on public policy issues and problems.)

Harvard University

- Research on comparative economic growth
- Research on weapons development and

Acquisition



Commodity Futures Trading Commission

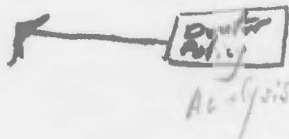
- Executive Positions

- Legislation creating the Commodity Futures Trading Commission gives the Chairman Authority over most personnel matters, the Principal exception being the immediate staff of the individual Commissioners. The General Counsel and the Executive Director positions are created by the legislation and these appointments are made by the entire Commission.

- Since time for implementation of the legislation is short and its initial structure will be reflected for years to come, it is suggested that certain New-career staffing patterns be developed now and recommended to the Chairman as soon as possible.



Chairman



Director of Policy
Planning and Evaluation

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THE INDIVIDUALIZATION OF EXCUSING CONDITIONS _____ *George P. Fletcher*

NOTES

AGE DISCRIMINATION IN EMPLOYMENT: CORRECTING A CONSTITUTIONALLY INFIRM LEGISLATIVE JUDGMENT

THE IMPACT OF DE FACTO DISCRIMINATION BY UNIONS ON THE AVAILABILITY OF NLRB BARGAINING ORDERS

THE MARY CARTER AGREEMENT—SOLVING THE PROBLEMS OF COLLUSIVE SETTLEMENTS IN JOINT TORT ACTIONS

[FEDERAL LEGISLATION FOR COMMODITY OPTION TRADING: A PROPOSAL]

DENIAL OF WORK RELEASE PROGRAMS TO WOMEN: A VIOLATION OF EQUAL PROTECTION

THE GOVERNMENT INSIDER AND RULE 10b-5: A NEW APPLICATION FOR AN EXPANDING DOCTRINE

THE NEED FOR TEACHER CLASSROOM FLEXIBILITY: A PROPOSED REVISION OF CALIFORNIA'S TEACHER REMOVAL STATUTES

DRUG BOUNTY PROGRAMS: A MISGUIDED APPROACH TO THE NARCOTICS PROBLEM

BOOK REVIEWS

BAIN & PARRIS: CONVENTION DECISIONS AND VOTING RECORDS
PARRIS: THE CONVENTION PROBLEM: ISSUES IN REFORM OF
PRESIDENTIAL NOMINATING PROCEDURES

DUNN: FINANCING PRESIDENTIAL CAMPAIGNS

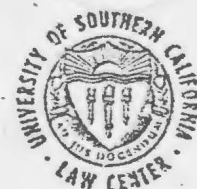
MATTHEWS: PERSPECTIVES ON PRESIDENTIAL

SELECTION _____ *Albert J. Rosenthal*

ARANOW & EINHORN: TENDER OFFERS

FOR CORPORATE CONTROL _____ *J. William Robinson*

BOOKS RECEIVED



Federal Legislation for Commodity Option Trading: A Proposal

Commodity option contracts in unregulated commodities¹ have become widely used investment devices in recent years.² The increased growth of such options has unfortunately been accompanied by abuses in the sales of such instruments and has led to considerable losses by many investors.³ In an effort to curb abuses and protect the public, various governmental entities have attempted to regulate trading in such options.

States have sought to bring commodity options under their control by defining commodity options as "securities" and subjecting them to their "blue sky" regulatory provisions. This Note will argue that commodity options are not "securities" within the general definition of that term because the investor's profit is not significantly dependent on the efforts of others and there is no common plan of enterprise.

The federal government has also sought to bring such options within its control. Attempts on the federal level, however, have been directed toward placing currently unregulated commodity options under the Commodity Exchange Act. An analysis of the proposed fed-

1. Currently the only commodities regulated by the Commodity Exchange Act are:

wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, milk feeds, butter, eggs, onions, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oil (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice.

7 U.S.C. § 2 (1970). The list of non-regulated commodities is almost as large as those regulated, and includes lumber, silver, nickel, cocoa, palladium, molasses, propane, iced broilers, plywood, copper, sugar, platinum, tomato paste, mercury, tin and rubber. Donnelly, *Fraud in the Futures? A Regulatory Crackdown Is Coming in Commodities*, *Barron's*, May 28, 1973, at 11, col. 2.

2. It has been estimated that in California alone sales of commodity options have reached \$200-300 million a year. Loehwing, *California Crackdown—Commodity Options Will Never Be the Same Again*, *Barron's* Mar. 5, 1973, at 5, col. 1 [hereinafter cited as *California Crackdown*].

3. It has been estimated that total losses to speculators, in both actual investment and profits, could exceed \$100 million. *Wall Street Journal*, June 28, 1973, at 38, col. 1.

eral solutions reveals that the enactment of any one of the legislative proposals would result in complete prohibition of commodity option trading. The proposed federal legislation utilizes too broad a brush to achieve its purpose. Commodity options are economically functional trading devices and should be preserved as such. It is the thesis of this Note that federal legislation which would subject commodity option contracts to the control of the Commodity Exchange Act, provide for adequate control over commodity option underwriters, and assure the financial responsibility of the members of the commodity option industry should be enacted.

I. DEVELOPMENT OF COMMODITY TRADING

Commodities have been actively traded in organized commerce for at least fifty centuries.⁴ Modern commodities markets, however, have evolved from medieval European seasonal festivals.⁵ The primary form of "money/goods" transactions entered into at these fairs involved what has come to be known as "spot" sales. The seller displayed his goods to the public; an interested purchaser would enter into individual negotiation of the price; and the exchange of money for merchandise took place "on the spot." Payment and physical transfer were immediate. Farmers' markets still carry on trade in this fashion and can be considered "spot" markets in their purest form.⁶

As the Industrial Revolution shifted the population from the farm to the factory, it became necessary for the remaining farmers to increase their production to provide food for the cities. This necessitated carrying increased quantities of goods on the part of the individual farmer. Supply and demand imbalance and concomitant large price fluctuations in the "spot" markets were major risks assumed by the producer. If the producer of perishable produce over-estimated the demand for his goods, or correctly estimated the demand but arrived at the market after others had filled this demand, he would either have excess inventory on hand at the end of the market period or would be forced to sell his produce at a lower price than he had anticipated.⁷

4. Commodity markets, governed by rules and regulations, existed in China, Egypt, Arabia and India as early as 1200 B.C. S. KROLL & I. SHISKO, *THE COMMODITY FUTURES GUIDE* 3 (1973) [hereinafter cited as KROLL & SHISKO].

5. *Id.*

6. L. BELVEAL, *COMMODITY SPECULATION WITH PROFITS IN MIND* 13 (1967) [hereinafter cited as BELVEAL].

7. See KROLL & SHISKO, *supra* note 4, at 4.

As the quantities being carried by producers and merchants increased and price fluctuations due to spot markets became greater, it became increasingly urgent that some workable means be devised to reduce the economic risks inherent in ownership of large quantities of commodities. To avoid such risks, commodity producers began to offer contracts to deliver a specified quantity of the commodity for a specified price at a designated place within a given number of days. This marked the introduction of "to-arrive" marketing in the commodity trading field and provided the basis for present commodity futures contracts.⁸

Although the introduction of futures trading permitted the shifting of risk of price fluctuation from the producer to the investor, there were those investors who were not willing to fully accept the risks of such price fluctuations. To accommodate these individuals, a trading vehicle was developed which gave the investor a right to sell, or to buy, a commodity futures contract at a fixed price on or before a specified date. For this right or option, the investor was required to pay a non-refundable fee. Such an arrangement permitted the option purchaser to limit the possibility of his loss to the amount of the non-refundable fee since he had entered into no binding agreement to purchase or supply the underlying commodity as was normally done in a straight futures contract. Thus, the commodity option contract evolved in response to the need for another method of risk transfer.

II. CURRENT METHODS OF COMMODITY TRADING

A. COMMODITY FUTURES CONTRACTS

Today there are basically two methods of trading or speculating in commodities. One can either assume a position in a futures contract or obtain an option to purchase or sell such a contract. The most common method of trading is to assume a direct position in a futures contract.⁹ A direct purchase of a commodity futures contract might occur in the following manner. In June, a commodity investor conducts a careful analysis of the wheat market and arrives at the conclusion that wheat prices will rise during the period from June to December. Therefore, he contacts his commodity broker and directs him

8. Such contracts assured the producer of a fixed price for the goods he was about to produce, freeing him from the risk of "spot market" price fluctuation. See generally KROLL & SHISKO, *supra* note 4, at 6-8.

9. The futures contract is the modern equivalent of the "to-arrive contract." See text accompanying note 8 *supra*.

to purchase a futures contract in December wheat¹⁰ at the current market price of \$4.37 a bushel. The broker instructs his floor trader to make the purchase at that price. Assuming a seller is available and willing to sell at \$4.37 per bushel,¹¹ the transaction will be consummated. The end result of the transaction is that the purchaser has made a promise to buy 5000 bushels¹² of wheat at \$4.37 per bushel in December;¹³ conversely, the seller has promised to deliver 5000 bushels of wheat for \$4.37 per bushel in December.¹⁴ If, as anticipated by the purchaser, the price of wheat in December is higher than \$4.37 per bushel, he will have realized a gain on the transaction; conversely, the seller, having incorrectly assessed the market, will have suffered a loss.

The commodity investor has a choice of two methods for fulfilling his contractual obligation. He may actually deliver or accept delivery of the physical commodity. Some people, especially agricultural producers, view this as the only method of satisfying the contract. However, rather than deliver or accept delivery of the physical commodity, the investor may satisfy his obligation by making an offsetting trade before the contract expiration date.¹⁵ For example, the individual who purchased the futures contract for wheat could return to the market and sell a futures contract for December wheat. Having made this second trade in a manner "equal and opposite" to his original trade, the purchaser has "offset" his position and is relieved of further contractual obligations.¹⁶ Currently, over 99 percent of all com-

10. A futures contract creates firm commitments on the part of the buyer and seller to mutually carry out their respective responsibilities; it does not transfer ownership or physical possession of the underlying commodity. See BELVEAL, *supra* note 6, at 33. A purchaser of futures contract has assumed what is referred to as a "long" position and is required to accept delivery of the commodity and, upon delivery, to pay for it in full. *Id.* at 34.

11. The seller anticipates that the market price of wheat will fall during the period from June to December. An individual who sells a futures contract has assumed a "short" position and is required to deliver a fixed amount of a certain grade of a designated commodity within a geographical area on or before a specified date. *Id.* at 34.

12. Each commodity future has a standard contract size called a unit of trading; the futures exchanges establish the standard size of each contract. The standard unit of trading for a futures contract of wheat consists of 5,000 bushels. See KROLL & SHISKO, *supra* note 4, at 11.

13. See note 10 *supra*.

14. See notes 10, 11 *supra*.

15. T. HAMMONDS, *THE COMMODITY FUTURES MARKET FROM AN AGRICULTURAL PRODUCER'S POINT OF VIEW* 11 (1972) [hereinafter cited as HAMMONDS].

16. See *Palmer v. Love*, 18 Tenn. App. 579, 80 S.W.2d 100 (1934) ("set-off," as used on boards of trade, is a method by which a contract to purchase is set off

modity futures contracts are settled by offsetting trades whereas less than one percent are settled by delivery.¹⁷

When the commodity trader either purchases or sells a commodity future he must provide a margin deposit before the order will be accepted.¹⁸ Unlike trading in debt or equity securities, margin on commodity futures is not viewed as a down payment, but rather as a performance bond binding the seller to deliver the specified merchandise and binding the buyer to acceptance of delivery and payment in full.¹⁹

B. COMMODITY OPTION CONTRACTS

1. Investment Characteristics

The second method of speculation in commodities is through an option contract. Trading in commodity options is an indirect method of trading in commodity futures in that it gives the purchaser the option to buy or sell a specific futures contract at a stipulated price for a given time-span. Specifically, the buyer can purchase a "call,"²⁰ a "put,"²¹

against a contract to sell without the formality of an exchange of warehouse receipts or other actual delivery and, in legal effect, is a "delivery").

17. HAMMONDS, *supra* note 15, at 11.

18. Each commodity exchange sets forth minimum margin requirements in its rules and regulations; however, each individual brokerage house is permitted to require greater margin amounts. BELVEAL, *supra* note 6, at 43.

19. Margin is necessitated because payment is not due until the futures contract is completed. Since the futures contract involves a firm price to be paid upon delivery of goods in the future, it is possible that during the term of the contract market prices could rise or fall considerably. If the market price rises, it would be to the financial advantage of the seller to default on his end of the contract and sell the grain to someone else at the currently higher market price. Conversely, if the market price were to decline, it would then be to the financial advantage of the buyer to default on his end of the contract and purchase the grain from someone else at the lower market price. Both buyers and sellers sought some form of protection against default. This protection came in the form of an agreement by the buyer and seller to each deposit a mutually acceptable amount of cash with a disinterested third party. If one party defaulted, the margin deposit was paid over to the other party to reimburse him for any possible loss occasioned by the other party's non-performance. BELVEAL, *supra* note 6, at 19. Margin is now held by the Exchange Clearing House and is no longer set by the parties themselves but rather by the commodity exchanges. The amount of margin to be deposited is based on historic price fluctuations and the current price level of the commodity. KROLL & SHISKO, *supra* note 4, at 217. Since margin acts as a performance bond, both buyer and seller must post margin in a commodity futures transaction.

20. A "call" gives the holder the right to buy a specified quantity of the commodity future at a price specified in the option contract on or before a specified date. KROLL & SHISKO, *supra* note 4, at 259. A purchaser will assume a call position when he believes the price of the underlying commodity futures contract will rise. It is similar in economic effect to a "long" position in a futures contract. See note 10 *supra*.

21. A "put" gives the holder the right to sell a specified quantity of the com-

or a "double option"²² on a given commodity future.

For the privilege of obtaining this option, the option buyer will pay a sum of money called a "premium."²³ The premium the buyer pays for his option is a fee that is kept by the "underwriter";²⁴ therefore, the market price of the commodity must rise or fall more than enough to cover the cost of the premium before he can make a profit.

To illustrate, assume a bullish investor purchases a six-month call on a silver futures contract at a striking price²⁵ of \$29,000 (\$2.90 an ounce for 10,000 ounces). Further assume that for the option he pays a premium of \$1,000. In order for the investor to make a profit, the price of silver must move up by more than 10 cents an ounce, since a 10 cent move in silver is equal to \$1,000 (10,000 ounces x 10 cents). If by the end of the six months, the price has reached \$3.05 an ounce, the investor will exercise his option to buy the contract at the striking price of \$29,000 and then sell the contract for its present worth of \$30,500. His profit, after deducting the \$1,000 cost of the premium is \$500, a 50 per cent profit. If the price rises less than

commodity future at a price specified in the option contract on or before a specified date. KROLL & SHISKO, *supra* note 4, at 259. A purchaser will assume a put position when he believes the price of the underlying commodity futures contract will decline. It is similar in economic effect to a "short" position in a future contract. See note 11 *supra*.

22. A "double option" is a combination put and call on the same commodity which permits the holder to either buy or sell, but not both, a specified quantity of the commodity future at a price specified in the option contract on or before a specified date. KROLL & SHISKO, *supra* note 4, at 259. The double option is used when a price move is anticipated in the futures contract but the purchaser does not know in which direction the price will move. The double option affords him an opportunity to realize a profit if there is sufficient movement in either direction. Since the double option affords a greater degree of flexibility, the premium is correspondingly higher. *Id.* at 267-68.

23. The premium price is determined by a number of independent factors; the most critical factors include the price of the underlying commodity, the historical price volatility of the commodity, and the length of the option term. See KROLL & SHISKO, *supra* note 4, at 259; Biderman, *New Trading Vehicle—Commodity Options Are Growing In Popularity*, *Barron's*, Jan. 8, 1973, at 11, col. 1, 2.

24. The term "underwriter" as used throughout this Note should not be equated with the term "underwriter" as defined in Section 2(11) of the Securities Act of 1933, 15 U.S.C. § 77(b)(11) (1970). As used in the commodity area, an underwriter is the commodity option issuer, *i.e.*, the person who engages in the business of issuing options to acquire or to sell a commodity futures contract.

25. The "striking price" is the price at which the options purchaser has the right to buy and/or sell the commodity at any time prior to the expiration date of the option. The striking price is generally the market price of the commodity futures contract at the time the option is purchased. KROLL & SHISKO, *supra* note 4, at 259. The standard unit of trading for a silver contract is 10,000 troy ounces. KROLL & SHISKO, *supra* note 4, at 11.

10 cents an ounce, the investor may still exercise the option and purchase the contract; however, he will incur a loss. Assuming a 5 cent rise, he loses \$500 or half of his investment.

A "put" option works in the reverse manner. If the investor believes the price of silver will go down, he will purchase an option to sell the silver contract at a striking price of \$29,000. If within the six-month period, the price of silver drops more than 10 cents an ounce, he makes a profit on the transaction after deducting his \$1,000 premium.

There are two principal advantages to be gained by trading in options rather than in futures contracts. First, the investor's risk of loss is limited to the premium paid for the option; second, the option purchaser can maintain his basic position for the life of the option without the risk of margin calls.²⁶

These advantages are of considerable importance to a commodity speculator.²⁷ Investing in a straight commodity future leaves the speculator open to considerable price risks; if he takes a long position in a futures contract and the price of the commodity falls, the investor must assume the total price decline as his loss. However, had the speculator purchased an option to buy the future, his loss would be limited to the premium price irrespective of how far the market declines.²⁸

26. KROLL & SHISKO, *supra* note 4, at 258.

27. Although at times there is aversion to pure speculation, the commodity speculator provides valuable services to the commodity market. The speculator assumes property ownership risks which others seek to avoid; in addition he facilitates the creation of a liquid market for futures contracts and to some extent acts as a stabilizing force on the market. See generally, BELVEAL, *supra* note 6, at 1-9; MATHEMATICA, INC., COMMODITY OPTIONS: ON THEIR CONTRIBUTIONS TO THE ECONOMY 20-21 (1973) [hereinafter cited as MATHEMATICA].

28. If an investor assumes a "long" position in a silver futures contract at a designated price of \$29,000 and the current market price of a silver contract at the time for his performance of the contract is \$27,000, he will incur a \$2,000 loss. The purchaser of the silver contract is contractually bound to accept delivery of the silver at \$29,000; but he is receiving silver which only has a fair market value of \$27,000. However, had he purchased an option on the silver contract at a striking price of \$29,000 for a premium of \$1,000 and in December the price of silver was \$27,000, he could choose not to exercise his option. His loss is thereby limited to the amount of his \$1,000 premium.

Although the option purchaser has limited his loss potential, he has also forfeited some of his gain potential, for in order for him to realize a profit the price must move more than enough to cover the cost of the premium. The straight futures contract purchaser, however, realizes a profit upon any rise in the market price of the commodity.

The speculator who invests in straight futures contracts is also subject to margin calls. As previously explained,²⁹ an investor who takes a position in a commodity future must deposit a margin with the exchange clearing house. The investor is then subjected to a "maintenance margin" requirement, *i.e.*, he must deposit additional funds in the event that the market moves in a direction adverse to his position. The requirement assures that the original margin which is acting, in effect, as a performance bond will remain intact.³⁰

The maintenance margin sets the parameters within which the price of the commodity may fluctuate before additional margin is required. For example, in soybeans the initial margin required is 30 cents per bushel with a maintenance margin of 19 cents per bushel. After a position has been taken, the price on the contract may fluctuate as much as 18 cents per bushel (9 cents per bushel to the disadvantage of the long or short) without requiring either the buyer or seller to post additional margin.³¹ However, should the soybean contract concerned fall 10 cents per bushel, the holder of the long side of the contract would immediately be required to post sufficient additional money to cover the decrease in market value. If he fails to answer the call for the additional margin, the broker may liquidate part or all of the position to keep the holdings within established margin requirements. Since margins are quite small as a percentage of the total price,³² even a minor move in the price of the commodity can require a substantial additional capital outlay; a mere 5 per cent move in the price of some commodities can require another 50 per cent of margin cost just to retain current position. Such an additional margin call places the contract holder in a very unfavorable position because he must either immediately close out his position and suffer the loss or deposit the additional capital in hopes of regaining his initial position.

On the other hand, an option purchaser has no firm commitment to purchase or sell and therefore there is no need to provide security

29. See notes 18, 19 and accompanying text *supra*.

30. The maintenance margin, in effect, guards against the risk of default by one party due to the market moving severely against his position. See note 19 and accompanying text *supra*.

31. Since a commodity margin represents a type of performance guarantee, both the buyer and seller must deposit sufficient margin with the exchange clearing house before a futures contract can be entered into and both are subject to maintenance margin. See note 19 and accompanying text *supra*.

32. Margin on a futures contract can run as low as five percent of the contract price. BELVEAL, *supra* note 6, at 43.

of other states have also at least temporarily stopped all trading in commodity options.³⁸

Throughout the sales promotional periods, Goldstein-Samuelson assured its customers, who were eventually to number 10,000, that it was following a scientific, computerized program to back up their options with purchases of specific futures contracts in the various world commodities.³⁹ Goldstein represented that it came as near to a perfect hedge position as is feasible by matching every dollar of its customer's profit in their option with a dollar in the actual futures market.⁴⁰ Although it did attempt to initially cover the options it issued, Goldstein stopped such practice within six months of the inception of the business.⁴¹

As late as January 26, 1973, Goldstein-Samuelson represented that it maintained a significant commodity account at a certain brokerage firm. Upon subsequent investigation, however, authorities learned that such an account was in essence non-existent.⁴² In fact, there was no evidence of money being received from, or sent to any brokerage house for the entire period of November, 1972, through January, 1973, for the purchase or sale of any commodity futures contracts.⁴³ The only source of funds during this period was from dollars received from new investors.⁴⁴

Initially, Goldstein actually delivered an option contract to the purchaser. However, as business soared and office backlog became insurmountable, the delivery of option contracts was discontinued, and purchases were instead evidenced only by a confirmation.⁴⁵ Of the

38. See generally Administrative Order of Colorado Division of Securities, May 22, 1973, CCH BLUE SKY L. REP. ¶ 9722; Ga. Sec. Comm'r, Rel. 1, Sept. 18, 1973, CCH BLUE SKY L. REP. ¶ 14,612; Letter from Sec. State of Mo., May 29, 1973, CCH BLUE SKY L. REP. ¶ 28651; Amendments to NEV. REV. STAT., CCH BLUE SKY L. REP. ¶ 31,112-1 *et seq.*; Explanatory Notice Utah Sec. Comm'n, March 16, 1973, CCH BLUE SKY L. REP. ¶ 47,655-656.

39. Wall Street Journal, June 28, 1973, at 38, col. 1.

40. See Stipulation, *supra* note 35, at 12.

Although the Goldstein advertisement referred to such a program as a "hedge," the process described is "cover," *i.e.*, adopting in the futures market the same position as that represented by the net collective position of all customers. A "hedge" is the establishment of a position in the futures market opposite to that held by the user of the actual commodity.

41. *Id.* at 6.

42. Pretrial Memo of Fact and Law for Petitioners at 14, S.E.C. v. Goldstein-Samuelson, Inc., No. 73-472 RJK (C.D. Cal., Oct. 11, 1973).

43. *Id.* at 13.

44. *Id.*

45. See Stipulation, *supra* note 35, at 10, 11.

approximately 175,000 options that were purchased, Goldstein attempted to fulfill his obligation to make delivery of the underlying commodity option in only four instances, and purchased a futures contract on behalf of a customer in only one instance.⁴⁶

One of the attractive aspects of investing in commodities is the opportunity for considerable leverage of an initial investment. Leverage in financial terms is the control of a large sum of money with only a small investment or down payment.⁴⁷ The leverage available on a commodity futures contract is much greater than the leverage available when buying stock on margin.⁴⁸ However, Goldstein-Samuelson offered a plan in which leverage could even be increased to a greater extent. Goldstein developed a "Super Leverage" account which would allow any customer who made an initial investment of \$5,000 in double-options to borrow up to 40 percent of his premium costs from the firm. This plan, in effect, allowed customers to double their leverage positions on already highly leveraged commodity futures contracts.⁴⁹

For the commodity investor, very high leverage is a mixed blessing. If the market moves in his favor, then he reaps a huge profit from his relatively small original investment. However, if the market moves adversely, the commodity investor can lose many times his initial investment.⁵⁰ Goldstein's Super Leverage account provided customers an opportunity to place themselves in a very precarious financial position.

The prime factor which led to the bankruptcy of many commodity option firms⁵¹ was their lack of adequate capitalization. Rather than maintaining actual commodity inventories or commodity futures contracts behind their options, the firms sold their options "naked."

46. *Id.* at 11.

47. HAMMONDS, *supra* note 15, at 35.

48. The amount of leverage possible in either the securities or commodities market is a function of the current margin requirements on the relative underlying investment. The lower the margin requirements the greater the available leverage. For example, when an investor places \$5,000 in a margin account with his stockbroker, he controls about \$10,000 worth of stock; if he instead chose to place \$5,000 in commodity futures contracts he could control perhaps \$50,000 worth of commodity futures. See Goldstein-Samuelson, Inc. Advertising Literature, New Market Fact Sheet Number One, The Commodity Option.

49. If an investor placed \$5,000 in a double option from Goldstein-Samuelson and borrowed 40 percent of the premium price, he would control up to \$105,000 worth of commodities. *Id.*

50. *Id.*

51. See note 37 *supra*.

Naked options are options which are sold without either actual commodities or future contracts to back them up. In effect, an individual who profited from his option was being paid either from a fund created because there were more net losers than winners,⁵² or was being paid from premiums paid in by new customers whose options had not matured. All was well until the market reversed and net winners outnumbered the losers and new business slacked; at that point profitable options being exercised were incapable of being fulfilled by the option underwriters. The end result was bankruptcy.

3. Regulatory Problems

The primary reason such firms were able to operate under such conditions is inadequate regulation on both the federal and state level. The Commodity Exchange Act establishes the basic guidelines and procedures which define the federal government's role in regulation of commodity trading.⁵³ Although the Act directly prohibits trading in commodity options,⁵⁴ such prohibition is emasculated by two major jurisdictional limitations.

The Act's jurisdiction extends only to specific products.⁵⁵ Thus each time a "new" commodity is sold, the Act must be amended if its sale is to be regulated. The last commodity to be added to the Act was frozen concentrated orange juice in 1968.⁵⁶ The list of unregulated commodities currently being traded on exchanges is almost as voluminous as those regulated.⁵⁷ Congress has simply failed to include within the Act's coverage many of the newer commodities. Since the Act provides for no jurisdiction over these commodities, the

52. When the market for the underlying commodity moved against the option investor, the option would not be exercised. The premium which the losing option investor has paid could then be utilized to pay other investors who had realized gain on their options and had exercised their options.

53. Commodity Exchange Act, 7 U.S.C. §§ 1-17b (1970).

54. Section 6c states:

It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(B) if such transaction is, is of the character of, or is commonly known to the trade as, a "privilege," "indemnity," "bid," "offer," "put," "call," "advance guaranty," or "decline guaranty," . . .

Commodity Exchange Act, 7 U.S.C. § 6c (1970).

55. See note 1 *supra*.

56. Act of July 23, 1968, Pub. L. No. 90-418, 82 Stat. 413.

57. See note 1 *supra*.

prohibition of options contained in the Act is not applicable to them.

The second major jurisdictional limitation deals with the underwriters of such commodity options. Although the Act regulates "floor brokers"⁵⁸ and "commission merchants,"⁵⁹ no provision is made for commodity option underwriters.⁶⁰ This is wholly consistent, however, since the Act prohibits options on regulated commodities. Since the sale of options on unregulated commodities is not prohibited by the Act, the sellers of such options are virtually unregulated at the federal level.

In addition to the Act not subjecting such options to regulation, the SEC had not, until recently, attempted to regulate the sale of commodity options.⁶¹ The SEC previously maintained the position that commodity trading and its peripheral problems should be subject to the Commodity Exchange Act's authority.⁶²

58. A floor broker is "any person who, in or surrounding any 'pit,' 'ring,' 'post,' or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market." Commodity Exchange Act, 7 U.S.C. § 2 (1970).

59. A futures commission merchant is an individual, association, partnership, corporation, or trust engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in . . . connection with such solicitation or acceptance of orders, accepts any money, securities, or property . . . to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

Commodity Exchange Act, 7 U.S.C. § 2 (1970).

60. Commission merchants and floor brokers are subject to various regulations. Section 6d of the Commodity Exchange Act requires the registration of commission merchants with the Secretary of Agriculture. 7 U.S.C. § 6d (1970). Similarly, Section 6e imposes registration requirements on floor brokers. 7 U.S.C. § 6e (1970). Both sections make it unlawful for such individuals to conduct commodity business without such registration. Section 6d also provides that any funds received by a commission merchant from a commodity customer shall be separately accounted for and shall not be commingled with the funds of the commission merchant; in addition, the section provides that such funds received may not be used to margin or guarantee the contracts of any customers other than the one from whom the money was received. 7 U.S.C. § 6d (1970). Commission merchants and floor brokers are also required to make reports concerning transactions and positions of their customers as may be required by the Secretary of Agriculture; in addition, both are required to keep books and records pertaining to such transactions and positions in accordance with requirements established by the Secretary. Such books and records are also open to inspection by any representative of the U.S. Department of Agriculture or the Department of Justice. 7 U.S.C. § 6g (1970).

61. The SEC's first attempt to define commodity options as "securities" was asserted in *SEC v. Goldstein-Samuelson, Inc.*, No. 73-472 RJK (C.D. Cal., Oct. 11, 1973).

62. *California Crackdown*, *supra* note 2, at 5, col. 2.

in the form of margin. This allows the option purchaser to wait out the option period without fear of having to deposit additional funds.

Thus, the use of commodity options has certain distinct advantages as an alternative to the use of commodity futures contracts. The limitations of loss potential coupled with the freedom from margin calls frees option purchasers from two significant risks inherent in commodity futures trading.

2. *Abuses Surrounding Commodity Options*

Notwithstanding the advantages to be gained by trading in options rather than direct commodity futures, trading in options before 1971 was done on a small scale. It was not until Harold Goldstein developed the technique, approximately two years ago, of promoting the sale of commodity options with heavy advertising and "hard-selling" agents that commodity options began to be traded on a larger scale.³³

In 1971, the year Goldstein-Samuelson, Inc. was formed, the firm recorded \$1,000,000 in option sales. By the end of 1972, with the help of intensive advertising and a network of offices in the U.S. and abroad, the firm gross income had soared to \$45,000,000.³⁴ Option trading was halted in late February, 1973, but, in the 18 selling days in February, \$31,000,000 in commodity options were sold.³⁵ The firm's success spurred other firms to enter the option business, with most starting on a "shoestring." Within a short period of time the commodity option business had become a \$200-300 million a year industry.³⁶

However, as rapidly as sales and apparent success had come to the option industry, so did it depart. In early 1973, Goldstein-Samuelson and two other large option firms in the Los Angeles area were put into involuntary receivership and further sales of such options were forbidden by the California Corporations Commissioner.³⁷ A number

33. *California Crackdown*, *supra* note 2, at 5.

34. *Id.*

35. Stipulation of All Relevant Facts in Lieu of Trial on Preliminary and Permanent Injunction for the Plaintiff at 7, *S.E.C. v. Goldstein-Samuelson, Inc.*, No. 73-472 RJK (C.D. Cal., Oct. 11, 1973) [hereinafter cited as Stipulation].

36. *See California Crackdown*, *supra* note 2, at 5.

37. *In re Goldstein-Samuelson, Inc.*, No. 7303131 (C.D. Cal., filed Mar. 29, 1973); *In re Puts and Calls, Inc.*, No. 7303706 (C.D. Cal., filed Apr. 10, 1973); *In re World Wide Commodity Options*, No. 7302763 (C.D. Cal., filed Mar. 20, 1973). An injunction was granted in *SEC v. Goldstein-Samuelson, Inc.*, No. 73-472 RJK (C.D. Cal., Oct. 29, 1973).

Since the Commodity Exchange Act failed to provide effective control, and the SEC had not attempted to extend its jurisdiction into the commodity field, the door was open for commodity option underwriters to function in an area free from interference by federal agencies. Such freedom from regulation unfortunately resulted in significant abuses exemplified by the Goldstein-Samuelson experience.⁶³

Due to the federal government's failure to provide adequate protection in the area, state governments have attempted to bring the market in hard-sell commodity options under some type of state control. The general thrust has been to define commodity options as "securities" within the framework of their blue sky laws and to effectively put a temporary halt to virtually all commodity option sales.⁶⁴

State courts which have been presented with the problem of whether commodity options are "securities" have been faced with factual patterns wherein the options being sold were not backed by actual commodities or futures contracts, *i.e.*, naked options. These courts have generally held that such option contracts are securities. The bases of the decisions center upon findings that the purchasers of such options relied upon the efforts of others to secure their profit and were investors in a common enterprise.⁶⁵

The courts have not, however, set forth the boundaries of their decisions. It is not clear whether such reasoning is meant to apply only to naked options or is equally applicable to all commodity options.⁶⁶ It is suggested that although the legal analysis may have some justification in respect to naked options, it does not reach commodity options which are adequately backed.

Although commodity options provide a more desirable form of investment for some commodity investors, the abuses surrounding their sales have led to considerable skepticism on the part of many investors

63. See text accompanying notes 39-50 *supra*.

64. Not all action against commodity options has been judicially instituted. Some action has come through pressure from state corporation commissioners by use of administrative opinions concerning their future enforcement of their blue sky laws. Such pressure has resulted in voluntary restraint of sales by option underwriters. See Colorado Division of Securities Administrative Order, May 22, 1973, CCH BLUE SKY L. REP. ¶ 9722.

65. See notes 79, 85, 86 and accompanying text *infra*.

66. See Colorado Division of Securities Administrative Order, May 22, 1973, CCH BLUE SKY L. REP. ¶ 9722, in which the Division specifically mentions the possibility of backed options but does not distinguish them from naked options, choosing instead to treat all commodity options as securities under its blue sky laws.

and spotty regulation on the part of government agencies. Even though many commodity option underwriters operate with sound financial backing,⁶⁷ they have nevertheless discontinued sales of such options due to the uncertainty connected with the legal status of the option. In order to restore use of this valuable investment vehicle, federal legislation should be introduced which will clarify the commodity option's legal status and provide a framework for regulated trading of such options.

III. "SECURITY" STATUS OF COMMODITY OPTIONS

In analyzing the issue of whether an adequately covered commodity option falls within the definition of a "security" as defined by most states, the individual state definitions of a "security" will be presumed for purposes of this Note to be similar to that of § 2(1) of the Securities Act of 1933.⁶⁸ Similarly, federal as well as state interpretations of the term "securities" will be utilized as persuasive authority on the definitional aspects of the term.⁶⁹

Initially, it may be beneficial to analyze commodity options in respect to other options contracts which have been construed as securities. Options are securities when the underlying investment comes within the definition of a "security" as defined in § 2(1) of the Securities Act of 1933.⁷⁰ The underlying investment in a commodity

67. See *California Crackdown*, supra note 2 at 5, col. 3. A number of leading option underwriters and trading houses have formed a group, The Commodity Exchange Member Firm Option Departments Association, which is seeking to prevent total prohibition of option trading. CEMFODA is currently submitting suggestions which may aid in eliminating abuses in commodity option trading. N.Y. Times, Apr. 12, 1973, at 68, col. 6.

68. Section 2(1) of the Securities Act of 1933 states that

(1) the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, *investment contract*, voting-trust certificate, certificates of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (1970) (emphasis added).

69. One commentator feels that state and federal cases are interchangeable in this area "since § 2(1) was modeled on the definitions in some of the state blue sky laws and in turn influenced many of the new state statutes enacted since 1933." 1 L. Loss, *SECURITIES REGULATION* 456 (2d ed. 1961).

70. The S.E.C. has relied upon the phrase within § 2(1), "or right to subscribe to or purchase" any security, in order to bring options within the definitional scope of the term "security." See, e.g., S.E.C. interpretive letter *In re Dean Witter & Co.*, CCH FED. SEC. L. REP. ¶ 78,602 (1971). For a possible argument that "calls" do not

option is the commodity futures contract. Courts have consistently held that commodity futures do not fall within the term "investment contracts" and are not securities⁷¹ because a futures contract involves no common enterprise⁷² nor reliance upon the efforts of others for profit realization.⁷³ Since the underlying futures contract is not a security as defined by § 2(1) of the Securities Act of 1933, an option upon such an investment should likewise not be characterized as a "security."

Nevertheless, those states which have acted against commodity option underwriters have generally taken the position that the commodity options are subject to state security laws because they are "investment contracts."⁷⁴ The Supreme Court has undertaken to define the term "investment contract" by setting forth a two-pronged test. In *SEC v. W. J. Howey Co.*, the Court stated that for the purposes of the Securities Act an "investment contract" is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of [others]."⁷⁵

The "solely from the efforts of others" criterion established in *Howey* has been considerably eroded in recent years. Courts have stated that the word "solely" should not be read as a strict or literal limitation on the definition of an investment contract, but rather that the term should be construed flexibly.⁷⁶ A recent Ninth Circuit case stated the test as whether efforts made by those other than the investor are undeniably *significant* ones, in the sense that they are the essential managerial efforts which affect the failure or success of the enter-

literally fit within the definition, see Gates, *The Developing Option Market: Regulatory Issues and New Investor Interest*, 25 U. FLA. L. REV. 421, 437-38 (1973).

71. *Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359 (S.D.N.Y. 1966) (sugar futures contracts are not "investment contracts" as that term is defined in the Securities Act of 1933).

72. *McCurnin v. Kohlmeyer & Co.*, 340 F. Supp. 1338, 1341 (E.D. La. 1972) (a commodity futures contract is not a "security" within federal securities laws governing broker's liability to his customers).

73. *Schwartz v. Bache & Co.*, 340 F. Supp. 995, 998, 999 (S.D. Iowa 1972) (status as one of the few brokerage houses capable of being a "marketmaker" not a sufficient basis for finding reliance upon the efforts of another).

74. The term investment contract appears in some thirty of the state security statutes. 1 LOSS, SECURITY REGULATION 483 n.77 (2d ed. 1961).

75. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298, 299 (1946) (an offering of units of a citrus grove development coupled with a contract for cultivating, marketing, and remitting the net proceeds to the investor is an offering of an "investment contract" within the meaning of that term as used in § 2(1) of the Securities Act of 1933).

76. See, e.g., *Georgia Mkt. Cents., Inc. v. Fortson*, 225 Ga. 854, 171 S.E.2d 620 (1969); *State v. Hawaii Mkt. Cent., Inc.*, 52 Haw. 642, 485 P.2d 105 (1971).

prise.⁷⁷ The SEC has concurred in these court decisions. In a recent release⁷⁸ the Commission stated that an investment contract may be present in a situation where the investor is not wholly inactive but merely participates to a limited degree in the operation of the business.

Faced with meeting the criteria of *Howey*, the state courts have approached the question of "reliance upon the efforts of others for profit" in a unique manner. The courts seem to have looked beyond the ability of the investor to realize a profit based upon the price movement of the underlying commodity, and have focused instead upon how and from where the funds were to be raised in order to pay the investor the profit he realized.⁷⁹ Since the commodity option underwriters did not own or purchase the underlying commodity futures upon the sale of a commodity option, they could not fulfill the contractual obligation to deliver the futures contract upon exercise of the option. However, since it was necessary to at least pay the option investor any profit earned on the exercise of his option, the underwriter had to earn a profit through independent investing in order to pay the investor his profits. Therefore, the authorities contended that the investor was relying upon the efforts of the underwriter to realize a profit on its investment in order to be paid the profits earned on his original option investment.⁸⁰

Although this reasoning could arguably be the correct result for naked option contracts, it cannot be sustained when applied to a "backed" commodity option contract since the underwriter need not earn a separate profit to pay the option investor his gain. Even in light of the more expansive construction of the "reliance upon the efforts of others" criterion, it would not seem appropriate to say that a

77. SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 (9th Cir. 1973) (self-improvement contracts which primarily offered the buyer the opportunity of earning commissions on the sale of contracts to others were "investment contracts" and thus "securities" within the meaning of the federal securities laws, even though buyers were obliged to contribute their own efforts in finding prospects and bringing them to sales meetings).

78. SEC. ACT REL. NO. 5347 [1972-73 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,163, at 82539.

79. California Corps. Comm'r v. Puts & Calls, Inc., Civil No. 51071 (Sup. Ct. L.A., Aug. 7, 1973). Since the judgment was not accompanied by a full opinion of the presiding judge, arguments are based upon the prevailing party's trial memorandum and memorandum of points and authorities supporting various pre-trial motions; Comm'r of Securities v. First Federated Commodity Trust, (Cir. Ct. Balt. Cty, Md., Feb. 1973), 192 SEC. REG. L. REP. E-1 (1973).

80. Brief for Petitioner at 17-19, California Corps. Comm'r v. Puts & Calls, Inc., Civil No. 51071 (Sup. Ct. L.A., Aug. 7, 1973).

purchaser of a commodity option which is adequately backed expects to derive his profits from the efforts of others. Such an investor expects that a commodity futures contract will be in the inventory of the underwriter or that he will purchase one in order to back the option. An investor's expectation of profit in an option transaction then arises solely from the speculative hope that the market price of the underlying commodity will sufficiently advance or decline so as to enable him to exercise the option, receive possession of the underlying commodity futures contract, sell the contract, and realize his profit from the sale.

Once the non-naked option is purchased, the investor is left to his own devices in realizing a profit; his analysis of the market and its future fluctuations will determine at what point during the term of the option he will exercise his right to purchase or sell the futures contract. Evaluation of the correct point in time at which to exercise becomes crucial. If the option is a call and the market price of the underlying commodity advances rapidly early in the option term, the investor must determine whether to exercise at this point and recognize his profit or await further market action. If he waits and the market advances, he secures additional profit; on the other hand, if he waits and the market declines, he may forego the profit entirely and instead incur a loss. Determination of the point at which to exercise the option is an investment decision completely within the investor's control, and no reliance upon the efforts of the underwriter is needed to reach such a decision.⁸¹ Therefore, since the purchaser of an adequately backed commodity option does not significantly rely on the efforts of others to earn his profits, he does not meet the "reliance" criteria of *Howey*.

81. Activities of the underwriter must be limited to the underwriting and sale of such options for additional activity may bring them within the prohibited areas. If in addition to its underwriting, the underwriter accepts funds from the investor with the understanding that the underwriter will make investment decisions for the investor, such a transaction may be considered a discretionary account. The status of such an account as a "security" is not definite at this point. In two federal district court cases, *Maheu v. Reynolds & Co.*, 282 F. Supp. 423 (S.D.N.Y. 1967) and *Berman v. Orimex Trading, Inc.*, 291 F. Supp. 701 (S.D.N.Y. 1968), the courts held that an agreement whereby a customer placed funds in the hands of a broker to be invested in various commodity futures contracts and was led to anticipate profits from the investments made by such broker was an "investment contract" and a "security" within the federal securities laws. However, in a more recent case, *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972), based upon similar facts, the Court of Appeals held that such an account did not meet the "common enterprise" requirement of *SEC v. Howey* and therefore was not an "investment contract" or "security" as defined by the Securities Act of 1933.

The second criterion set forth by the Court in *Howey* was that the investment be made in a "common enterprise."⁸² Since *Howey*, courts have repeatedly stressed the significance of finding a "common enterprise" in determining whether particular investments are "securities" within the statutory definition.⁸³ One of the criteria utilized in ascertaining whether an investor is investing in a "common enterprise" is the determination of the feasibility of individual economic development of the investment. If the investment cannot be economically developed without the mutual cooperation of other similarly situated investors, courts have found a common enterprise or pooling of interests.⁸⁴

In approaching the "common enterprise" problem, the state courts again looked behind the form of the transaction.⁸⁵ It was argued that since there initially was no backing for the options, in effect, the funds which were being utilized to pay an investor who had earned a profit on the exercise of his option were coming from other investors—either from past investors who had suffered a loss of premium due to lapse of the option or from new investors' premiums.⁸⁶ From this, the courts seem to have reasoned that since all premiums went into a common pool, the investor who profited could not be paid unless there were losers or additional investors from which to derive the funds. Since the investor's monetary realization was dependent on the funds of other investors, he had invested in a common enterprise.

The factual situations presented to the courts have been based solely on the operations of an underwriter who sold naked options.⁸⁷ The courts' legal analysis and conclusion that such conduct resulted in a "common enterprise" may have been arguably correct. However, when the operation of an underwriter who sells adequately backed options is analyzed, a similar result is not justified. Although an underwriter of backed commodity options will engage in a multitude of option transactions all bearing similar characteristics—e.g., terms, conditions, underlying commodities—each option sale is an individual transaction. Each adequately backed commodity option is sus-

82. SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

83. Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 276 (7th Cir. 1972).

84. See Sarmiento v. Arbax Packing Co., 231 Cal. App. 2d 421 (1964) (80-acre plot was susceptible to independent economic development so that a "common enterprise" was lacking).

85. See note 79 *supra*.

86. Memorandum of Points and Authorities in Support of Injunction for Petitioner at 5, California Corps. Comm'r v. Puts & Calls, Inc., Civil No. 51071 (Sup. Ct. L.A., Aug. 7, 1973).

87. See note 79 *supra*.

ceptible of independent economic development; *i.e.*, profit can be realized without the mutual cooperation of other similarly situated investors. The profit anticipated by the option purchaser is wholly independent of the profit or loss sustained by other option purchasers. This is because, for each option sold, an underwriter who sells backed options will either have it in his inventory or will purchase the underlying futures contract, and will deliver such contract to the option purchaser upon eventual exercise of the option. Therefore, eventual realization of the profit is in no way conditioned upon the performance of other purchasers or sellers similarly situated. Since each option contract is susceptible of independent economic development and profit realization, the option purchaser cannot be considered as investing in a "common enterprise."

Since the purchase of an adequately backed commodity option neither entails significant reliance upon the efforts of others to secure a profit from the investment nor involves investment in a common enterprise, the backed commodity option contract is not a "security" under current judicial precedent, and thus should not be subject to the regulatory provisions of the various state blue sky laws.

IV. PROPOSED FEDERAL LEGISLATION AFFECTING COMMODITY OPTIONS

A. PROPOSED ADDITION TO COMMODITY REGULATIONS

Concomitant with state attempts at regulation of commodity options there have been three recent legislative or regulative proposals at the federal level which would affect the status of current, non-regulated commodity options. The most direct proposal has been initiated by the Secretary of Agriculture who has proposed adding a new regulation under the Commodity Exchange Act.⁸⁸ The proposed section states:

No futures commission merchant shall make, underwrite, issue, or otherwise assume any financial responsibility for the fulfillment of, any transaction which is of the character of, or is commonly known to the trade as, a "privilege," "indemnity," "bid," "offer," "put," "call," "advanced guarantee," or "decline guarantee," in any commodity regardless of whether such commodity is included in the term "commodity" as such term is defined in § 1.3(e).⁸⁹

88. The proposal is directed towards adding a new § 1.19 to part 1 of the regulations under the Commodity Exchange Act. See Commodity Exchange Authority, 17 C.F.R. ch. I, pt. I (1973).

89. 38 Fed. Reg. 6190 (1973).

The Commodity Exchange Authority's (CEA)⁹⁰ position is that option trading in unregulated commodities could become a threat to the financial stability of registered futures merchants. If such firms should underwrite, issue, or otherwise assume financial responsibility for the fulfillment of unregulated commodity options and suffer major financial reverse, the possibility of which is inherent in the "naked" option system, the firms' customers trading in regulated commodities could suffer. With a sudden demand for funds to pay option holders, or to secure the futures contracts called for by exercise of the option, a futures commission merchant might become insolvent and be tempted to dip into funds of customers dealing in regulated commodities to meet its obligation to option holders. The CEA additionally claims that a collapse of the option business with substantial losses to option holders would seriously damage public confidence in the entire brokerage industry and the whole system of futures trading which is so essential in the orderly production and marketing of commodities.⁹¹

Although the CEA's purposes for proposing the regulation are certainly valid, its power to institute the regulation can be challenged.⁹² The proposed regulation was issued pursuant to the authority of §§ 5, 6f, and 12a of the Commodities Exchange Act.⁹³

Section 5 of the Act states that:

[T]ransactions in commodity involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest; . . . the transactions and prices of commodity on such boards of trade are susceptible to speculation, manipulation, and control, and sudden or unreasonable fluctuations in prices thereof frequently occur as a result of such speculation, manipulation, or control, which are detrimental to the producer or the consumer and the persons handling commodity and products and byproducts thereof in interstate commerce, and such fluctuations in price are an obstruction to and a burden upon interstate commerce in commodity and the products and byproducts thereof and render regulation imperative for

90. The Commodity Exchange Authority is responsible for administering the Commodity Exchange Act; it functions as an agency of the United States Department of Agriculture. KROLL & SHUSKO, *supra* note 4, at 40.

91. 38 Fed. Reg. 6190 (1973).

92. A more detailed argument against the proposed regulation can be found in Letter from Cadwalader, Wickersham & Taft to Alex C. Caldwell, Administrator of the CEA, May 22, 1973, (Letter on file in offices of the *Southern California Law Review*).

93. 38 Fed. Reg. 6190 (1973), issued pursuant to 7 U.S.C. §§ 5, 6f, 12a (1970).

the protection of such commerce and national public interest therein.⁹⁴

Although the language of § 5 seems broad enough to encompass any form of necessary commodity regulation it must be remembered that the term "commodity" has a limited meaning within the Act and does not extend to all commodities currently being traded. The extent of the section then is limited to regulation of those traded commodities which are listed in § (2) of the Act.⁹⁵ It can be argued that the proposed regulation extends its regulatory effect beyond those commodities specified within the Act and is therefore beyond the jurisdictional limits of the CEA's authority. There would seem to be no mandate to the CEA to attempt to limit activities in non-specified commodities. The CEA's jurisdictional boundaries have been specifically defined by Congressional inclusion of only certain commodities within the definition of "commodity" under the Act.

The CEA also relies upon § 12a of the Act which confers the power "to make and promulgate such rules and regulations, as in the judgment of the Secretary of Agriculture, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this chapter."⁹⁶ Again, however, the purpose of the Act is regulation of the trading of those commodities specifically listed within the Act in order to provide protection for commerce in such commodities. Congress has not given the CEA the power to promulgate rules and regulations which would extend to non-specified commodities.

Section 6f of the Act contains disclosure requirements for registration of commission merchants and also empowers the Secretary of Agriculture to fix minimum financial requirements for such merchants.⁹⁷ The section should be interpreted in light of the purpose of regulation of specified commodities and protection of investors in such commodities. Although the Act does confer on the CEA authority to regulate activities of commission merchants in their dealings in regulated commodities, the Act does not authorize the CEA to forbid such persons from engaging in activities other than as commission merchants dealing in regulated commodities.

Proposed § 1.19 would have the result of so limiting the activities of commission merchants and is accordingly beyond the power of the

94. Commodity Exchange Act, 7 U.S.C. § 5 (1970).

95. See note 1 *supra*.

96. Commodity Exchange Act, 7 U.S.C. § 12a(5) (1970).

97. Commodity Exchange Act, 7 U.S.C. § 6f (1970).

CEA. Such an extension of authority is particularly unwarranted since § 6d(2) of the Act explicitly provides protection for the investor by requiring that money or property received from the purchase or sale of any commodity futures "shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend credit, of any customer or person other than the one for whom the same are held."⁹⁸ Even though the commission merchant might engage in financially unsuccessful non-commodity-related activities, the segregation of commodity funds should provide adequate protection for the investor's interests. The CEA proposal goes beyond the segregation rule. Although perhaps a sound proposal, nothing in the Act would seem to support such efforts. That the commission merchants might be tempted to dip into the funds of customers to satisfy their option holders does not seem sufficient to confer authority on the CEA to take steps beyond those specifically authorized by Congress.

Even assuming authority for such proposed regulations, the regulation does not extend far enough to prevent current abuse. Those firms which have had proceedings brought against them have not been "commission merchants" as that term is defined in § 2 of the Act.⁹⁹ They are instead option issuers, firms which engage in the underwriting and sale of such options. The options issuers are the entities which must be brought under control. The proposed regulation falls short of having jurisdiction over these entities.

B. CONGRESSIONAL PROPOSALS

There are also two proposals currently before Congress which would affect the status of commodity options. The two proposals, H.R. 5406 and S. 2578, both attempt to extend the jurisdictional scope of the term "commodity" by defining the term in a flexible manner so as to allow a commodity to automatically come within the jurisdiction of the Act when certain criteria are met.¹⁰⁰ Because § 6c of the Act

98. *Id.* at § 6d(2).

99. See note 59 and accompanying text *supra*.

100. H.R. 5406, 93d Cong., 1st Sess. (1973) which was introduced by Representative Paul Findley would delete the reference to specific commodities currently within § 2a of the Commodity Exchange Act and insert in lieu thereof the phrase "any agricultural product, forestry product, or natural resource (either in raw or processed form), including divisions, multiples, or derivatives of the aforementioned, that are traded on exchanges in futures contracts."

prohibits trading in options of defined commodities,¹⁰¹ if the definition of "commodity" is extended to encompass all commodities, as would be the case under the congressional proposals, commodity option trading will be totally prohibited.

The definitional approach adopted by the proposed legislation which would automatically incorporate a new commodity into the jurisdiction of the Act is a much needed measure; it will facilitate more efficient control of the commodity trading industry. The result of the provision, however—total prohibition of commodity options—does not seem very practical since commodity options can provide valid economic benefits to both the immediate parties to the option contract and to the consuming public as a whole.

V. BENEFICIAL USES OF COMMODITY OPTIONS

Both federal and state attempts to regulate the sale of commodity options have proceeded in a haphazard manner. Little analysis has been given to the useful role options can play in a commodities market. Commodity options can facilitate overall reduction in prices of manufactured goods, aid in the perpetuation of a representative auction market, and mitigate artificial supply and demand situations created by margin calls. Unfortunately, although options do perform these valuable functions, most regulatory attempts have the effect of their complete prohibition.

A. REDUCTION OF CONSUMER PRICES

The risk of price fluctuations is inherent in the holding of commodities; the commodity option, in effect, derives its functional utility from the presence of such risk. The commodity option provides a means of either transferring the risk or transforming its character. As an example, a manufacturer who has just entered into a sales contract for

S. 2578, 93d Cong., 1st Sess. (1973) which was introduced by Senator George McGovern would allow reference to the specific commodities to remain, but would insert the phrase "and all other goods and articles and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in. . . ."

In addition to the above proposed change in existing law, S. 2578 seeks to replace the existing commodity regulatory scheme with a fully independent five-member Commodity Exchange Commission similar in structure to the SEC. Another bill, S. 2837, 93d Cong., 1st Sess. (1973), introduced by Senator Phillip Hart, is also directed at revamping the regulatory scheme of the Commodity Exchange Act. It does not, however, contain provisions which would extend the jurisdictional definition of the term "commodity."

101. See note 54 and accompanying text *supra*.

goods whose production will begin several months in the future can utilize an option to protect himself from possible fluctuations in the price of raw materials.¹⁰² If he anticipates a rise in raw material prices, a call will afford him the opportunity to purchase the raw materials in the future while at the same time assuring him of present prices. If an investment vehicle can protect the manufacturer from the risk of large price fluctuations, that vehicle performs a valuable economic service for the manufacturer.¹⁰³

The minimization of risk through use of a commodity option will eventually result in cost benefits to all parties. In a competitive market, the assumption of a higher degree of risk is correspondingly associated with a higher expected return on investment. To achieve such a return, the manufacturer must raise the price of his product. Thus, higher risk inevitably means higher cost to the consumer.¹⁰⁴ Since the availability of commodity options permits the manufacturer to reduce his risk, it follows that options enable him to reduce his costs. That, in turn, means that consumers are thereby enabled to purchase the manufactured goods at a lower price. Commodity options, therefore, provide a vehicle for risk minimization which inures directly to the benefit of the consuming public.¹⁰⁵

B. FACILITATION OF A REPRESENTATIVE MARKET PLACE

Appropriate instruments for the transfer of risk, such as commodity options, can be highly beneficial to the economic functioning of the commodity markets. They help to assign risks to those most willing to cope with them. So long as the transactions are voluntarily entered into, and participants are fully informed of the nature of the transaction and its concomitant risks, all immediate parties to the transaction may gain in the process.

The role of a commodity option may be analogized to that of a distributor who separates a homogeneous product into two separate and distinct products for individual distribution, for example, a refiner who produces different grades of oil from his supply of crude petro-

102. Although the same assurance of price stability could be secured by a futures contract, the option avoids the unfavorable "margin call" aspects of the future contracts. See notes 30-32 and accompanying text *supra*.

103. MATHEMATICA, *supra* note 27, at 5, 6.

104. Implicit in the reasoning is that the costs borne by the manufacturer will be passed on to the consumer. To the extent such increased costs are not passed on by the manufacturer, there will be no such increase in price.

105. MATHEMATICA, *supra* note 27, at 16.

leum. By separating the products, he produces nothing that was not previously there. But after separation, the product is more desirable to a greater number of people, *i.e.*, gas for the automobile owner and kerosene for the kerosene user. Just as the refiner produces different products with different demands from crude petroleum of uniform composition, the option permits transformation of risk associated with holding commodities into a variety of different types of investment which differ widely in their risk characteristics and consequent investor demand.¹⁰⁶

Since the commodity option provides a different type of risk than the normal futures contract, it can be expected to attract a number of investors to the commodities markets who are not willing to accept the risks associated with straight futures contracts. These new investors who enter the commodity market, like all speculators, will bring with them various opinions as to the value of the underlying commodities. These opinions add to the free market valuation process inherent in our commodity system. The greater number of individuals contributing to the valuation process, the more representative the price tends to become. To the extent that commodity options increase the number of commodity investors and aid in representative valuation of commodities, they perform a valuable economic function.¹⁰⁷

C. MITIGATION OF ARTIFICIAL SUPPLY AND DEMAND SITUATIONS

Commodity options can also provide a stabilizing effect upon market movements of commodity prices. When a purchaser of a futures contract assumes a position, a margin deposit is paid to the Exchange Clearing House. If the market moves sufficiently against the investor's position, he may be forced to deposit additional funds in order to maintain his position.¹⁰⁸ If he is unable to deposit such funds the broker has the power to enter into a forced sale of the position.¹⁰⁹ However, the investor may have wished to retain his position, in effect, sustaining a "demand" for the commodity. Nevertheless, having been forced into the sale of the contract, due to a failure to meet the margin call, a "supply" for the commodity has been created. Such a situation creates an artificial¹¹⁰ "supply" and "demand" balance for the

106. *Id.* at 11, 12.

107. *Cf.* BELVEAL, *supra* note 6, at 8; P. SAMUELSON, *ECONOMICS* 399-405 (8th ed. 1970).

108. *See* KROLL & SHISKO, *supra* note 4, at 217.

109. *See* BELVEAL, *supra* note 6, at 267.

110. The situation is artificial in that the owner of the commodity future is not

underlying commodity. Since commodity prices are highly volatile and margin calls can be frequent, the situation obviously can aggravate the downward pressure on prices. Such failures to meet margin calls may turn what would otherwise have been a slow decline of prices into a precipitous plunge.¹¹¹

However, if an option position has been assumed as a substitute for the futures position, the aforementioned situation cannot occur. The option is not subject to margin calls and thus there is no triggering mechanism which can force a "demand" position to become an artificial "supply" position.¹¹²

Indeed, the option tends to work in the opposite direction. Rather than forcing immediate sale in response to prices that are already falling, the option may serve to postpone any market response. The fact that the option termination date will typically still be several months away acts as an inducement to sit out the price fall in hope that the economic situation will improve so that the option can still be exercised profitably. Such a "postponement of pressures" may well be precisely what is necessary to permit the market to recover. Thus, the commodity option could have a stabilizing effect upon the commodity market as opposed to the possible destabilizing effect of margin calls required in the investment context of the straight futures contract.

The valid economic uses of commodity options are not proffered to deny that trading in options is not subject to abuse. Any economic activity can be misused by unscrupulous or irresponsible individuals. The answer to possible abuse, however, is adequate regulation, not absolute prohibition.

VI. RECOMMENDATIONS FOR FEDERAL LEGISLATION

The proposed federal legislative measures utilize too broad a brush to achieve their purpose. Rather than correcting the abuses surrounding commodity option trading, they instead result in total prohibition of option trading.¹¹³ A more pragmatic approach seems to have been taken by California, which has attempted to develop a regulatory system which would control the sale and trading of commodity options rather than completely prohibiting them.¹¹⁴ Under the California law,

making a voluntary "supply" decision; the broker, a disinterested third party, is forcing the sale of the contract.

111. *MATHEMATICA*, *supra* note 27, at 26-28.

112. See notes 30-32 and accompanying text *supra*.

113. See notes 100, 101 and accompanying text *supra*.

114. California Commodity Law, A.B. 799 (Sept. 25, 1973).

commodity options can be sold and traded as long as the requirements of the California Commodity Law are complied with, and the commodity option is sold pursuant to a permit issued by the California Corporations Commissioner.¹¹⁵ However, although California offers a regulatory scheme which guards against the inherent potential abuses in option trading, it still allows the beneficial economic effects of commodity option trading to develop. Federal legislation to the same effect is necessary. Although options may be bought and or sold in California,¹¹⁶ such trading is at least temporarily halted in some states.¹¹⁷ In addition, although no express prohibition exists in other states,¹¹⁸ the potential for the imposition of such a prohibition undoubtedly exists. Given the clear benefits of option trading, a federal regulatory scheme which expressly *permits* such trading must be devised and adopted.

The most objectionable aspect of commodity option trading, as recently carried on, is the lack of financial stability on the part of the leading option dealers. In particular, the underwriters dealing in "naked options" have been most flagrant in maintaining adequate financial reserves.¹¹⁹ Rather than complete elimination of options, it would seem more appropriate, because of their value in facilitating commodity trading,¹²⁰ to introduce federal legislation which would establish standards of financial responsibility among option underwriters. The legislation should be directed toward establishing minimum financial requirements for underwriters, thus insuring that the purchaser's option was backed by either actual futures contracts or financial reserves sufficient to provide the investor with funds upon profit realization. Such procedures would virtually eliminate the objectionable

115. California Commodity Law § 41 (Sept. 25, 1973). The commissioner may deny an application for or revoke a permit if he finds that the terms of the commodity option contract or the terms of any guaranty thereof are not fair, just, and equitable, or that the manner and method by which such contracts are to be offered and sold does not provide for fair, reasonable, and timely disclosures, or are such as will work a fraud upon prospective purchasers. *Id.* § 41(c)(6). See also CAL. ADMIN. CODE Ch. 2.9, tit. 10, § 350.545 which provides guidelines as to when a commodity option contract will be deemed not fair, just, and equitable. The section also establishes guidelines for the plan of operation of a commodity option issuer and for the method and manner of sale of commodity options which should be followed to secure a permit.

116. Although commodity options are permitted to be sold, there has been no registration or sale of such options since the Act's inception.

117. See note 38 and accompanying text *supra*.

118. New York and Illinois are prime examples.

119. See text accompanying notes 39-50 *supra*.

120. See text accompanying notes 102-112 *supra*.

"naked options" since they would insure some form of backing for the options. Option trading would then be carried on only in adequately backed options; the investor would receive adequate protection while at the same time preserving a valuable commodity trading vehicle.

The first step necessary for effective federal regulation of the commodity option is to bring commodity option underwriters and salesmen within the jurisdiction of appropriate federal legislation.¹²¹ The Commodity Exchange Act establishes the basic guidelines and procedures which define the government's role in the regulation of commodity trading. Its basic purpose is to provide protection for interstate commerce in commodities by establishing procedures for "the policing of contract markets and futures trading to prevent market manipulation and unfair trade practices."¹²² Since commodity option underwriters deal in options which depend upon the commodity market for their functional utility and to some extent influence supply and demand for such commodities,¹²³ it would seem most appropriate to bring them within the purview of the Commodity Exchange Act.¹²⁴

A substantive regulation which would facilitate control over the expanding number of option underwriters would be the mandatory registration of such underwriters with the Commodity Exchange Authority. Registration would require information concerning the business in which the underwriter is, or will be engaged.¹²⁵ Among other

121. The Commodity Exchange Authority has stated that option trading could become a threat to the financial stability of the commodity markets. See note 91 and accompanying text *supra*. However, the commodity option contract itself is not the target of criticism; it is the abuses carried on by individuals who engage in the sale of such options that has presented the commodity industry with problems. See notes 39-50 and accompanying text *supra*. Therefore, in order to correct such abuses, the individuals who deal in such options must be made subject to appropriate federal legislation.

122. KROLL & SHISKO, *supra* note 4, at 40.

123. See text accompanying notes 102-112 *supra*.

124. Commodity option underwriters could be made subject to the Act by addition of a section similar in structure to sections 6d or 6e making it unlawful for futures commission merchants or floor brokers to engage in their respective businesses without first having registered with the CEA. Commodity Exchange Act, 7 U.S.C. § 6e, (1970); 7 U.S.C. § 6d (1970). The section could be directed specifically toward making it unlawful for any commodity option underwriter to offer to sell or engage in the sale of a commodity option unless registered with the Commodity Exchange Authority.

125. The material to be contained in such registration could be patterned after that contained in the registration forms of commodity futures merchants and floor brokers. See generally Commodity Exchange Authority, 17 C.F.R. §§ 1.7-1.15 (1973). Among the information contained in such registration forms, a report of the applicant's financial condition as of a date not more than three months prior to the date on which registration is filed is required. The commission merchant is also subject to continuing

items, information as to the commodity option underwriter's place of business, the type of activity to be conducted or the function to be performed by the underwriter, current financial statements, and the current make-up of management of such underwriter could be secured before business could be commenced. Such information would afford the CEA an opportunity to more closely monitor the status of firms entering the option field.¹²⁶

In addition, as an on-going requirement, Congress could mandate the submission of various reports; the authority to determine which reports might be deemed appropriate could be vested in the CEA. Providing the CEA with flexible rulemaking power in this area would allow the Authority to require industry wide reports when such reports would help in focusing on possible areas of industry abuse of market position or financial status of individual firms. Balance sheets, profit and loss statements, and various net capital calculations submitted at regular intervals could significantly aid the CEA in overseeing the financial responsibilities of the commodity option issuers.¹²⁷

requirement to file a report of his financial condition as of each June 30 and each December 31. Both futures merchants and floor brokers must also prepare a written computation of their net worth at least once each month. Whenever such computation shows that the registrant's net worth has declined 20 percent or more from his net worth as shown in the report of his financial condition which he most recently filed with the CEA, he must immediately notify the CEA thereof. Commodity Exchange Authority, 17 C.F.R. § 1.10 (1973).

Similar information is required of commodity option issuers by the California registration statements. See CAL. ADMIN. CODE, Subch. 29, tit. 10 § 350.515.3 (1973).

126. If the Secretary of Agriculture, at any time, has reason to believe that an issuer has willfully made any false or misleading statement of a material fact in any registration application or willfully omitted to state any material fact which is required to be stated therein, he has the power to prohibit contract markets from trading with the issuer until a hearing on the suspension of the issuer is conducted. Commodity Exchange Act, 7 U.S.C. § 9 (1970).

127. The Commodity Exchange Act currently allows the Secretary of Agriculture to require futures commission merchants and floor brokers to make such reports regarding their commodity transactions as the Secretary deems necessary. Commodity Exchange Act, 7 U.S.C. § 6g (1970). Congress could enact legislation which would include commodity option underwriters within the scope of the above section. In addition, the Commodity Exchange Authority could then subject such underwriters to the reporting requirements of Part 15 of their regulations. See Commodity Exchange Authority, 17 C.F.R. Ch. 1, pt. 15 (1973). The issuer would be subject to suspension from trading or revocation of his registration for false or misleading reports filed with the Secretary. Commodity Exchange Act, 7 U.S.C. § 9 (1970) and see note 126 and accompanying text *supra*.

Under the authority of Section 29 of the California Commodity Law, the California Corporate Commissioner has promulgated regulations which provide that a commodity option issuer must give prompt notification to the Commissioner if his adjusted working capital falls below 120 percent of the minimum adjusted working capital he is required

Although reports need not necessarily be required in all areas, records of various transactions should be required to be kept by option issuers and should be open to investigation by the CEA. At minimum, every commodity option issuer should be required to maintain records indicating commodity transactions as to each customer, a complete record of all commodity transactions entered into for the account of the commodity option issuer, and a record of all commodity options currently outstanding showing as to each, the position taken, the total premium received, and the total obligation thereon.¹²⁸

Although administrative monitoring can be quite beneficial, regulation directed toward the use and management of the invested funds is probably the most critical factor in effective regulation of the commodity option industry. The objective is to eliminate commodity options which are not "covered" by requiring adequate capital to be available upon exercise of the option. Controls can be instituted which will sufficiently protect the investor while still allowing the option underwriter to carry on his business in an effective and profitable manner.

The first steps which should be taken are to require all commodity option underwriters to be members of a regulated exchange or contracts market and to require all trades or sales of commodity options to be effected through such organizations.¹²⁹ Since each major futures

to maintain. CAL. ADMIN. CODE, Subch. 2.9, tit. 10 § 350.535.1(b) (1973). He is also required to forward to the Commissioner a weekly copy of daily reconciliations of segregated customer accounts, showing total premiums received on outstanding options and the total obligations thereon. CAL. ADMIN. CODE, Subch. 2.9, tit. 10 § 350.535.1(c) (1973).

128. Similar to the reporting requirements, Congress could subject commodity option underwriters to record keeping requirements by including them within section 6g of the Commodity Exchange Act which already establishes such record keeping requirements for commission merchants and floor brokers. Records required to be kept by the CEA's regulations include daily computation of the amount of money, securities and property which must be in segregated accounts, a monthly statement for the customer and a record of the customer's position in each future, a complete record of cash commodity and futures transactions, and records of the customer's name, address, and principal occupation. Commodity Exchange Authority, 17 C.F.R. §§ 1.31, 1.32, 1.33, 1.35, 1.37 (1973).

Section 29 of the California Commodity Law authorizes the Commissioner to require reports; in accordance with such power, the Commissioner has instituted regulations requiring reports similar to those established by the Commodity Exchange Authority. See California Commodity Law § 29 (Sept. 25, 1973); CAL. ADMIN. CODE Subch. 2.9, tit. 10 § 350.535 (1973).

129. If commodity options underwriters are brought within the jurisdiction of the Commodity Exchange Act, they will automatically be subjected to section 6h which makes it unlawful for any person to conduct a business for the purpose of soliciting

exchange operates in conjunction with a clearing house,¹³⁰ which simplifies clearing and settlement of transactions and ensures contract compliance, all trades by the option underwriter would go through a clearinghouse, which would match up the trades and clear them.

As the option underwriter issues a commodity option contract, he should be required to forward the premium to the Exchange or its clearing house to be deposited in a separate segregated account maintained by the exchange.¹³¹ The premium would not be disbursed to the underwriter of the option until such time as the option is either liquidated, expired, or exercised. Since the premium price of a commodity option contract approximates the margin quotation of the actual futures contract,¹³² the segregation of the premium into an independent account, will in effect, provide "cover" or "backing" for the option.

However, in order to more adequately protect the option investor, an additional control should be instituted through which the investor will be assured that should the market move sufficiently in his favor that the segregated premium would not cover his realized profit there would be additional funds available to do so. A simple clearing house procedure can be used to effectuate such a result.

As an option underwriter enters into a sales transaction through

or accepting any order for the purchase or sale of any commodity for future delivery unless such orders, contracts, or dealings are executed or consummated by or through a member of a contract market. Commodity Exchange Act, 7 U.S.C. § 6h (1970). To include option underwriters it may be necessary to add language which would make it unlawful to conduct business for the purpose of soliciting or accepting any order for the purchase or sale, or option to purchase or sell, any commodity for future delivery except through a member of a contract market.

130. Senate Bill 2837 would define "clearinghouse" as a "central agency, which may be a separate entity or part of an exchange, through which transactions for the purchase and sale of futures contracts are settled by matching purchases with sales." See note 100 *supra*.

131. Futures commission merchants are currently required to separately account for customer's funds and are prohibited from commingling such segregated funds with their own funds. Commodity Exchange Act, 7 U.S.C. § 6d (1970). The Commodity Exchange Authority has also established regulations which set out the exact manner in which such segregated accounts must be held. In addition, they clearly delineate the rights of the commission merchant in relation to use of the money, securities, or property of the customer, and the interest which may be earned thereon. Commodity Exchange Authority, 17 C.F.R. §§ 1.20-1.30 (1973). Subjecting commodity option issuers to the same type of obligations would adequately insure the preservation of the commodity option purchaser's investment.

California has instituted similar controls which are applicable to commodity option issuers. See California Commodity Law § 30 (Sept. 25, 1973); CAL. ADMIN. CODE Subch. 2.9, tit. 10, § 350.537.2 (1973).

132. See note 19 and accompanying text *supra*.

the exchange, the clearinghouse will record the transaction terms—premium, striking price, option term, *etc.* If the account of each option firm is kept separate, the current outstanding position of the option firm can be determined at any given point by a summarization of his total individual transactions. The outstanding position of the option firm can then be measured against the current market price of the underlying futures contracts and a net profit or loss position can be determined.¹³³ If the net loss position of the option underwriter exceeds the amount of funds in his segregated premium account, the underwriter should be required to submit a check for the amount of excess of loss over premium segregation to the clearing house before the opening of the market the following day. These funds would also be deposited and credited to the segregated premium account of the option issuer. Such a procedure on a daily basis would assure the option investor that at all times during the term of his option there was sufficient capital to meet any profit he might realize.

As a corollary measure, Congress could provide that the exchange would guarantee to promptly meet the obligations arising under any outstanding commodity option in the event of a default by the underwriter. The guarantee could provide for payment in full of all amounts due, or delivery of the commodity futures contract at the election of the option holder. In turn, the exchange could fund such a guarantee by requiring that each member of the exchange deposit, and keep deposited with the exchange an indemnity bond in some predetermined amount.

The final step in assuring financial responsibility is a minimum capital requirement for each underwriter. Although minimum capital requirements designated by other federal legislation are generally quite low,¹³⁴ such requirements would seem to provide somewhat of a buffer between total insolvency of the option dealer and the investor. It can also provide an indicator that business operations should be more closely monitored when the capital of the firms begins to approach the minimum capital requirement. A requirement that a commodity option underwriter shall have, and maintain a net working cap-

133. The net profit or loss position is not a recognized profit or loss at this point since the options are still outstanding; it is merely a measure of current paper profit or loss.

134. The SEC places various net capital requirements upon its brokers and dealers ranging from \$2,500-\$25,000 depending upon when the broker or dealer registered and how he conducts his business. See SEC Reg., 17 C.F.R., § 240.15c3-1 (1973).

ital of at least \$50,000 might provide a reasonable measure of safety while at the same time causing minimal capital tie-up to the underwriter.¹³⁵

Subjecting commodity option underwriters to the aforementioned regulatory measures should sufficiently curtail the abuses which have been connected with the sale of naked commodity options. In addition, the CEA, conscious of the current abuses, can initially monitor such underwriters more closely than it would its other "regulatees." A combination of the two approaches should be sufficient to adequately protect commodity option investors while maintaining the economic benefits to be gained from commodity option trading.¹³⁶

135. Futures commission merchants must currently comply with minimum financial requirements established by the CEA. No commission merchant may be registered unless he has adjusted working capital equal to or in excess of the greater of (1) \$10,000 or (2) the sum of specified safety factors plus five percent of the commission merchant's aggregate indebtedness. Commodity Exchange Authority, 17 C.F.R. § 1.17 (b) (1973). In the case of open futures contracts held in customers' accounts carried by the commission merchant, the safety factor is one-half of 1 percent of the market value of the greater of either the total long or total short futures contracts in each commodity. *Id.* § 1.17(e). In the case of open futures contracts held in proprietary accounts carried by the commission merchant the safety factor shall be 10 percent of the market value of the greater of either the total long or total short futures contracts in each commodity. The term "proprietary account" includes any account directly or indirectly owned or controlled by the commission merchant or anyone affiliated with such merchant. *Id.* § 1.17(f).

California imposes similar requirements upon commodity option issuers except that the adjusted working capital minimum is \$100,000 or the sum of the safety factors plus 10 percent of the issuer's aggregate indebtedness, whichever is greater. CAL. ADMIN. CODE, Subch. 2.9, tit. 10, § 350.537.4 (1973). See also *id.* §§ 350.537(c) and (d).

136. If Congress were to reasonably find that the sale of commodity option contracts is susceptible to speculation, manipulation and control, affecting market prices of future contracts in such a way as to cause a direct burden on and interference with interstate commerce, it could legislate regulations for the protection of such commerce. See *Board of Trade v. Olsen*, 262 U.S. 1 (1922) holding that Congress had the power to provide for placing grain boards of trade under federal supervision as "contract markets." Congress has the constitutional responsibility for control of interstate commerce; consequently, state courts would not be permitted to decide whether Congress' authorization for and regulation of commodity option contracts was appropriate. Cf. *Albers v. Lamson*, 380 Ill. 35 (1942); *Goffe & Carkener, Inc. v. Henneberger*, 132 Kan. 211 (1931). However, even if Congress did enact legislation regulating the sale of commodity options, it would not so occupy and preempt the field as to deprive the state of authority to regulate trading in commodity options, except to the extent that the state regulations conflicted with the federal regulations. See *Rice v. Board of Trade*, 331 U.S. 247 (1947) (state regulations, promulgated but unadopted, cannot be deemed to conflict with federal regulations and any claim of supersedure is premature). Therefore, unless the California Commodity Law directly conflicted with the provisions of the federal legislation, the state's regulation of commodity option sales could coexist with that of the federal system.

VII. CONCLUSION

Commodity option contracts are a beneficial means of transferring the risk involved in commodity ownership to those most willing to cope with such risks. Commodity options should be permitted to be utilized because they are valid investment devices. However, it is imperative that a viable means of control over the sale of such options be instituted. State attempts at regulation of commodity options by deeming such options to be "securities" seem to be inappropriate inasmuch as they do not necessarily involve undue reliance upon the efforts of others to realize a profit nor an investment in a common enterprise. Current proposed federal legislation tends to either fall short of providing the control needed, or extends to a total prohibition of all commodity option trading. A more realistic approach would be to permit the use and trading of commodity options, to subject the sale of such options to the regulatory provisions of the Commodity Exchange Act, and to provide additional legislation which would assure the financial responsibility of the members of the commodity option industry.

Richard A. Knezevich



United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

September 27, 1974

Memorandum

To: Norman E. Ross, Jr.
Domestic Council Staff
The White House

From: Jack W. Carlson *JWC*
Assistant Secretary - Energy and Minerals

Subject: Membership - Commodity Commission

I recommend the following individuals for consideration to be members of the Commodity Commission:

Industry

E. D. Leisenring, Jr.
President, Westmoreland
Coal Company
2500 Fidelity Building
Philadelphia, Pennsylvania 19109

Ian MacGregor
Chairman, AMAX, Inc.
1270 Avenue of the Americas
New York, New York 10020

George H. Weyerhaeuser
President, Weyerhaeuser Company
Tacoma, Washington 98401

Environmentalist

Michael McCloskey
Executive Director
Sierra Club
1015 Mills Tower
San Francisco, California 94104

Academic

Paul MacAvoy
Massachusetts Institute of
Technology
Cambridge, Massachusetts 02139

Edward Mitchell
University of Michigan
Ann Arbor, Michigan 48104

Research Institute

Dr. Marion Clawson
President, Resources for
the Future, Inc.
1755 Massachusetts Avenue, N. W.
Washington, D. C. 20036



Re: The Commission on Raw Materials Shortages

Bureau of Mines suggestions:

As Executive Secretary -

Dr. Walter R. Hibbard, Vice President

Owens-Corning Fiberglass, Toledo, Ohio
(formerly Director Bureau of Mines)

Dr. Earl P. Hayes, Consultant (formerly Chief

Scientist BuMines) Washington, D.C.

Dr. Joseph W. Berg, Jr., Executive Secretary, Div. Earth Sciences

National Academy of Sciences, Washington, D.C.

As Members of the Commission -

Mr. Charles D. Michaelson, President, Metal Mining Div.

Kennecott Copper Company, New York, New York

Mr. Charles F. Barber, Chairman (or Simon D. Strauss, Executive Vice President)

American Smelting & Refining Co., New York, New York

Mr. Ian MacGregor, Chairman

AMAX, Inc., New York, New York

Mr. Eric A. Walker, Vice President

Alcoa, Pittsburgh, Pennsylvania

Mr. E. B. Leisenring, Jr., President

Westmoreland Coal Co., Philadelphia, Pennsylvania

Mr. Frederick G. Jaicks, Chairman

Inland Steel Company, Chicago, Illinois

Mr. John P. Weir, President

Paul Weir Company, Chicago, Illinois

Mr. George E. Kruger, Vice President

Chase Manhattan Bank, New York, New York

Mr. Gordon Haworth, Vice President

Continental Illinois National Bank, Chicago, Illinois

Dr. Elburt F. Osborn

Carnegie Institution, Washington, D.C.
(also Chairman of Panel on Mineral Resources,
National Academy of Sciences)

Dr. James E. Boyd (formerly Executive Director of

National Commission on Materials Policy) Washington, D.C.

Mr. Jerome L. Klaff, President

H. Klaff and Company, Baltimore, Maryland
(formerly Chairman, National Commission on Materials Policy)



Dr. Fredrick C. Kruger, Head, Dept. of Earth Sciences,
Stanford University, Stanford, California

Dr. Earl H. Beistline, Executive Officer
University of Alaska, Fairbanks, Anchorage

Dr. Stefan Boshkov, Chairman, School of Mines
Columbia University, New York, New York

Dr. William B. Drescher, Dean, College of Mines
University of Arizona, Tuscon, Arizona

Mr. Joseph P. Brennan
National Coal Association, Washington, D.C.
(formerly Director Research, United Mine Workers)

Mr. Thomas N. Bethell, Research Director
United Mine Workers of America, Washington, D.C.

Mr. Marion Clawson, President
Resources for the Future Inc., Washington, D.C.

Hon. Wayne Aspinall (formerly Congressman from Colorado)
Senator

Hon. Alan Bible/from Nevada (retiring)

Hon. Gordon C. Allott (formerly Senator from Colorado)

Hon. Julia Butler Hansen, Congresswoman from Washington (retiring)



COMMODITY FUTURES TRADING COMMISSION ACT
OF 1974

SEPTEMBER 30, 1974.—Ordered to be printed

Mr. TALMADGE, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 13113]^{SEN}

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 13113) to amend the Commodity Exchange Act to strengthen the regulation of futures trading, to bring all agricultural and other commodities traded on exchanges under regulation, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

That this Act may be cited as the "Commodity Futures Trading Commission Act of 1974".

TITLE I—COMMODITY FUTURES TRADING
COMMISSION

SEC. 101. (a) Section 2(a) of the Commodity Exchange Act, as amended (7 U.S.C. 2, 4), is amended—

(1) By inserting "(1)" after the subsection designation.

(2) By striking the last sentence of section 2(a) and inserting in lieu thereof the following new sentence: "The words 'the Commission' shall mean the Commodity Futures Trading Commission established under paragraph (2) of this subsection."

(3) By adding at the end thereof the following new paragraphs:

"(2) There is hereby established, as an independent agency of the United States Government, a Commodity Futures Trading Commis-

(1)

sion. The Commission shall be composed of a Chairman and four other Commissioners, who shall be appointed by the President, by and with the advice and consent of the Senate. In nominating persons for appointment, the President shall seek to establish and maintain a balanced Commission, including, but not limited to, persons of demonstrated knowledge in futures trading or its regulation and persons of demonstrated knowledge in the production, merchandising, processing or distribution of one or more of the commodities or other goods and articles, services, rights and interests covered by this Act. Not more than three of the members of the Commission shall be members of the same political party. Each Commissioner shall hold office for a term of five years and until his successor is appointed and has qualified, except that he shall not so continue to serve beyond the expiration of the next session of Congress subsequent to the expiration of said fixed term of office, and except (A) any Commissioner appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed for the remainder of such term, and (B) the terms of office of the Commissioners first taking office after the enactment of this paragraph shall expire as designated by the President at the time of nomination, one at the end of one year, one at the end of two years, one at the end of three years, one at the end of four years, and one at the end of five years.

"(3) A vacancy in the Commission shall not impair the right of the remaining Commissioners to exercise all the powers of the Commission.

"(4) The Commission shall have a General Counsel, who shall be appointed by the Commission and serve at the pleasure of the Commission. The General Counsel shall report directly to the Commission and serve as its legal advisor. The Commission shall appoint such other attorneys as may be necessary, in the opinion of the Commission, to assist the General Counsel, represent the Commission in all disciplinary proceedings pending before it, represent the Commission in courts of law whenever appropriate, assist the Department of Justice in handling litigation concerning the Commission in courts of law, and perform such other legal duties and functions as the Commission may direct.

"(5) The Commission shall have an Executive Director, who shall be appointed by the Commission, by and with the advice and consent of the Senate, and serve at the pleasure of the Commission. The Executive Director shall report directly to the Commission and perform such functions and duties as the Commission may prescribe.

"(6) (A) Except as otherwise provided in this paragraph and in paragraphs (4) and (5) of this subsection, the executive and administrative functions of the Commission, including functions of the Commission with respect to the appointment and supervision of personnel employed under the Commission, the distribution of business among such personnel and among administrative units of the Commission, and the use and expenditure of funds, shall be exercised solely by the Chairman.

"(B) In carrying out any of his functions under the provisions of this paragraph, the Chairman shall be governed by general policies



of the Commission and by such regulatory decisions, findings, and determinations as the Commission may by law be authorized to make.

"(C) The appointment by the Chairman of the heads of major administrative units under the Commission shall be subject to the approval of the Commission.

"(D) Personnel employed regularly and full time in the immediate offices of Commissioners other than the Chairman shall not be affected by the provisions of this paragraph.

"(E) There are hereby reserved to the Commission its functions with respect to revising budget estimates and with respect to determining the distribution of appropriated funds according to major programs and purposes.

"(F) The Chairman may from time to time make such provisions as he shall deem appropriate authorizing the performance by any officer, employee, or administrative unit under his jurisdiction of any functions of the Chairman under this paragraph.

"(7) No Commissioner or employee of the Commission shall accept employment or compensation from any person, exchange, or clearing-house subject to regulation by the Commission under this Act during his term of office, nor shall he participate, directly or indirectly, in any contract market operations or transactions of a character subject to regulation by the Commission.

"(8) The Commission shall, in cooperation with the Secretary of Agriculture, establish a separate office within the Department of Agriculture to be staffed with employees of the Commission for the purpose of maintaining a liaison between the Commission and the Department of Agriculture. The Secretary shall take such steps as may be necessary to enable the Commission to obtain information and utilize such services and facilities of the Department of Agriculture as may be necessary in order to maintain effectively such liaison. In addition, the Secretary shall appoint a liaison officer, who shall be an employee of the Office of the Secretary, for the purpose of maintaining a liaison between the Department of Agriculture and the Commission. The Commission shall furnish such liaison officer appropriate office space within the offices of the Commission and shall allow such liaison officer to attend and observe all deliberations and proceedings of the Commission.

"(9) (A) Whenever the Commission submits any budget estimate or request to the President or the Office of Management and Budget, it shall concurrently transmit copies of that estimate or request to the House and Senate Appropriations Committees and the House Committee on Agriculture and the Senate Committee on Agriculture and Forestry.

"(B) Whenever the Commission transmits any legislative recommendations, or testimony, or comments on legislation to the President or the Office of Management and Budget, it shall concurrently transmit copies thereof to the House Committee on Agriculture and the Senate Committee on Agriculture and Forestry. No officer or agency of the United States shall have any authority to require the Commission to



submit its legislative recommendations, or testimony, or comments on legislation to any officer or agency of the United States for approval, comments, or review, prior to the submission of such recommendations, testimony, or comments to the Congress. In instances in which the Commission voluntarily seeks to obtain the comments or review of any officer or agency of the United States, the Commission shall include a description of such actions in its legislative recommendations, testimony, or comments on legislation which it transmits to the Congress.

"(10) The Commission shall have an official seal, which shall be judicially noticed.

"(11) The Commission is authorized to promulgate such rules and regulations as it deems necessary to govern the operating procedures and conduct of the business of the Commission."

(b) Section 12 of the Commodity Exchange Act, as amended (7 U.S.C. 16), is amended by striking such section and inserting in lieu thereof the following:

"SEC 12. (a) The Commission may cooperate with any Department or agency of the Government, any State, territory, district, or possession, or department, agency, or political subdivision thereof, or any person.

"(b) The Commission shall have the authority to employ such investigators, special experts, Administrative Law Judges, clerks, and other employees as it may from time to time find necessary for the proper performance of its duties and as may be from time to time appropriated for by Congress. The Commission may employ experts and consultants in accordance with section 3109 of title 5 of the United States Code, and compensate such persons at rates not in excess of the maximum daily rate prescribed for GS-18 under section 5332 of title 5 of the United States Code. The Commission shall also have authority to make and enter into contracts with respect to all matters which in the judgment of the Commission are necessary and appropriate to effectuate the purposes and provisions of this Act, including, but not limited to, the rental of necessary space at the seat of Government and elsewhere.

"(c) All of the expenses of the Commissioners, including all necessary expenses for transportation incurred by them while on official business of the Commission, shall be allowed and paid on the presentation of itemized vouchers therefor approved by the Commission.

"(d) There are hereby authorized to be appropriated to carry out the provisions of this Act such sums as may be required for the fiscal year ending June 30, 1975, for the fiscal year ending June 30, 1976, for the fiscal year ending June 30, 1977, and for the fiscal year ending June 30, 1978."

SEC. 102. (a) Section 5314 of title 5 of the United States Code is amended by adding at the end thereof the following new paragraph:

"(60) Chairman, Commodity Futures Trading Commission."

(b) Section 5315 of title 5 of the United States Code is amended by adding at the end thereof the following new paragraph:

"(100) Members, Commodity Futures Trading Commission."

(c) Section 5316 of title 5 of the United States Code is amended by adding at the end thereof the following new paragraphs:

"(135) General Counsel, Commodity Futures Trading Commission.



"(136) Executive Director, Commodity Futures Trading Commission."

Sec. 103. The Commodity Exchange Act, as amended, is amended—

(a) By striking the word "Secretary" and the words "Secretary of Agriculture" wherever such words appear therein (except where the words "Secretary of Agriculture" first appear in section 5(a) (7 U.S.C. 7) or where said words would be stricken by subsection (b), (c), or (d) of this section) and by inserting in lieu thereof the word "Commission".

(b) By striking the words "the Secretary of Agriculture or" wherever they appear in the phrase "the Secretary of Agriculture or the Commission".

(c) By striking the words "the Secretary of Agriculture, who shall thereupon notify the other members of" from section 6(a) thereof (7 U.S.C. 8).

(d) By striking "the Secretary of Agriculture (or any person designated by him)," from section 6(b) thereof (7 U.S.C. 15).

(e) By striking the word "he", "his", or "He" wherever such word is used therein to refer to the Secretary of Agriculture, and by inserting in lieu thereof the word "it", "its", or "It", respectively.

(f) By striking the words "United States Department of Agriculture" and "Department of Agriculture" wherever they appear therein and by inserting in lieu thereof the word "Commission".

(g) By inserting in section 5(a) (7 U.S.C. 7) after the words "Secretary of Agriculture" where the same first appear therein the words "or the Commission".

Sec. 104. All of the personnel of the Commodity Exchange Authority, property, records, and unexpended balance of appropriations, allocations, and other funds employed, used, held, available, or to be made available in connection with administration of the Commodity Exchange Act shall be transferred to the Commodity Futures Trading Commission upon the effective date of this Act.

Sec. 105. Section 8 of the Commodity Exchange Act, as amended (7 U.S.C. 12, 12-1), is amended by adding at the end thereof the following new paragraphs:

"The Commission shall submit to the Congress a written report within one hundred and twenty days after the end of each fiscal year detailing the operations of the Commission during such fiscal year. The Commission shall include in such report such information, data, and recommendations for further legislation as it may deem advisable with respect to the administration of this Act and its powers and functions under this Act.

"The Comptroller General of the United States shall conduct reviews and audits of the Commission and make reports thereon. For the purpose of conducting such reviews and audits the Comptroller General shall be furnished such information regarding the powers, duties, organizations, transactions, operations, and activities of the Commission as he may require and he and his duly authorized representatives shall, for the purpose of securing such information, have access to and the right to examine any books, documents, papers, or records of the Commission except that in his reports the Comptroller General shall not include data and information which would separately disclose the business transactions of any person and trade secrets



or names of customers, although such data shall be provided upon request by any committee of either House of Congress acting within the scope of its jurisdiction."

SEC. 106. The Commodity Exchange Act, as amended, is amended by adding at the end thereof the following new section:

"SEC. 14. (a) Any person complaining of any violation of any provision of this Act or any rule, regulation, or order thereunder by any person registered under section 4d, 4e, 4k, or 4m of this Act may, at any time within two years after the cause of action accrues, apply to the Commission by petition, which shall briefly state the facts, whereupon, if, in the opinion of the Commission, the facts therein contained warrant such action, a copy of the complaint thus made shall be forwarded by the Commission to the respondent, who shall be called upon to satisfy the complaint, or to answer it in writing, within a reasonable time to be prescribed by the Commission.

"(b) If there appear to be, in the opinion of the Commission, any reasonable grounds for investigating any complaint made under this section, the Commission shall investigate such complaint and may, if in its opinion the facts warrant such action, have said complaint served by registered mail or by certified mail or otherwise on the respondent and afford such person an opportunity for a hearing thereon before an Administrative Law Judge designated by the Commission in any place in which the said person is engaged in business: Provided, That in complaints wherein the amount claimed as damages does not exceed the sum of \$2,500, a hearing need not be held and proof in support of the complaint and in support of the respondent's answer may be supplied in the form of depositions or verified statements of fact.

"(c) After opportunity for hearing on complaints where the damages claimed exceed the sum of \$2,500 has been provided or waived and on complaints where damages claimed do not exceed the sum of \$2,500 not requiring hearing as provided herein, the Commission shall determine whether or not the respondent has violated any provision of this Act or any rule, regulation, or order thereunder.

"(d) In case a complaint is made by a nonresident of the United States, the complainant shall be required, before any formal action is taken on his complaint, to furnish a bond in double the amount of the claim conditioned upon the payment of costs, including a reasonable attorney's fee for the respondent if the respondent shall prevail, and any reparation award that may be issued by the Commission against the complainant on any counterclaim by respondent: Provided, That the Commission shall have authority to waive the furnishing of a bond by a complainant who is a resident of a country which permits the filing of a complaint by a resident of the United States without the furnishing of a bond.

"(e) If after a hearing on a complaint made by any person under subsection (a) of this section, or without hearing as provided in subsections (b) and (c) of this section, or upon failure of the party complained against to answer a complaint duly served within the time prescribed, or to appear at a hearing after being duly notified, the Commission determines that the respondent has violated any provision of this Act, or any rule, regulation, or order thereunder, the Commission shall, unless the offender has already made reparation to the person complaining, determine the amount of damage, if any,



to which such person is entitled as a result of such violation and shall make an order directing the offender to pay to such person complaining such amount on or before the date fixed in the order. If, after the respondent has filed his answer to the complaint, it appears therein that the respondent has admitted liability for a portion of the amount claimed in the complaint as damages, the Commission under such rules and regulations as it shall prescribe, unless the respondent has already made reparation to the person complaining, may issue an order directing the respondent to pay to the complainant the undisputed amount on or before the date fixed in the order, leaving the respondent's liability for the disputed amount for subsequent determination. The remaining disputed amount shall be determined in the same manner and under the same procedure as it would have been determined if no order had been issued by the Commission with respect to the undisputed sum.

"(f) If any person against whom an award has been made does not pay the reparation award within the time specified in the Commission's order, the complainant, or any person for whose benefit such order was made, within three years of the date of the order, may file a certified copy of the order of the Commission, in the district court of the United States for the district in which he resides or in which is located the principal place of business of the respondent, for enforcement of such reparation award by appropriate orders. The orders, writs, and processes of such district court may in such case run, be served, and be returnable anywhere in the United States. The petitioner shall not be liable for costs in the district court, nor for costs at any subsequent state of the proceedings, unless they accrue upon his appeal. If the petitioner finally prevails, he shall be allowed a reasonable attorney's fee, to be taxed and collected as a part of the costs of the suit. Subject to the right of appeal under subsection (g) of this section, an order of the Commission awarding reparations shall be final and conclusive.

"(g) Any order of the Commission entered hereunder shall be reviewable on petition of any party aggrieved thereby, by the United States Court of Appeals for any circuit in which a hearing was held, or if no hearing was held, any circuit in which the appellee is located, under the procedure provided in paragraph (b) of section 6 of this Act. Such appeal shall not be effective unless within 30 days from and after the date of the reparation order the appellant also files with the clerk of the court a bond in double the amount of the reparation awarded against the appellant conditioned upon the payment of the judgment entered by the court, plus interest and costs, including a reasonable attorney's fee for the appellee, if the appellee shall prevail. Such bond shall be in the form of cash, negotiable securities having a market value at least equivalent to the amount of bond prescribed, or the undertaking of a surety company on the approved list of sureties issued by the Treasury Department of the United States. The appellee shall not be liable for costs in said court. If the appellee prevails, he shall be allowed a reasonable attorney's fee to be taxed and collected as a part of his costs.

"(h) Unless the registrant against whom a reparation order has been issued shows to the satisfaction of the Commission within fifteen days from the expiration of the period allowed for compliance with such order that he has either taken an appeal as herein authorized or has



made payment in full as required by such order, he shall be prohibited from trading on all contract markets and his registration shall be suspended automatically at the expiration of such fifteen-day period until he shows to the satisfaction of the Commission that he has paid the amount therein specified with interest thereon to date of payment: *Provided*, That if on appeal the appellee prevails or if the appeal is dismissed the automatic prohibition against trading and suspension of registration shall become effective at the expiration of thirty days from the date of judgment on the appeal, but if the judgment is stayed by a court of competent jurisdiction the suspension shall become effective ten days after the expiration of such stay, unless prior thereto the judgment of the court has been satisfied.

"(i) The provisions of this section shall not become effective until one year after the date of its enactment: *Provided*, That claims which arise within nine months immediately prior to the effective date of this section may be heard by the Commission after such one year period."

SEC. 107. The Commodity Exchange Act, as amended, is amended by adding at the end thereof the following new section:

"SEC. 15. The Commission shall 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 this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation, or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of this Act."

TITLE II—REGULATION OF TRADING AND EXCHANGE ACTIVITIES

SEC. 201. Section 2(a) of the Commodity Exchange Act, as amended (7 U.S.C. 2, 4), is amended—

(a) By striking after the word "eggs," the word "onions,".

(b) By striking the period at the end of the third sentence of the section and substituting therefor the following: ", and all other goods and articles, except onions as provided in Public Law 85-839, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in: *Provided*, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty'), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 5 of this Act or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 217 of the Commodity Futures Trading Commission Act of 1974: And provided further. That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws. Nothing in this sec-



tion shall supersede or limit the jurisdiction conferred on courts of the United States or any State. Nothing in this Act 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."

SEC. 202. Section 2(a) of the Commodity Exchange Act, as amended (7 U.S.C. 2, 4), is amended by adding at the end of paragraph (1) the following new sentences: "The term 'commodity trading advisor' shall mean any person who, for compensation or profit, engages in the business of advising others, either directly or through publications or writings, as to the value of commodities or as to the advisability of trading in any commodity for future delivery on or subject to the rules of any contract market, or who for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning commodities; but does not include (i) any bank or trust company, (ii) any newspaper reporter, newspaper columnist, newspaper editor, lawyer, accountant, or teacher, (iii) any floor broker or futures commission merchant, (iv) the publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation including their employees, (v) any contract market, and (vi) such other persons not within the intent of this definition as the Commission may specify by rule, regulation, or order: Provided, That the furnishing of such services by the foregoing persons is solely incidental to the conduct of their business or profession. The term 'commodity pool operator' shall mean any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order."

SEC. 203. The Commodity Exchange Act, as amended, is amended by inserting after section 4i (7 U.S.C. 6i), the following new section:

"SEC. 4j. (1) The Commission shall within six months after the effective date of the Commodity Futures Trading Commission Act of 1974, and subsequently when it determines that changes are required, make a determination, after notice and opportunity for hearing, whether or not a floor broker may trade for his own account or any account in which such broker has trading discretion, and also execute a customer's order for future delivery and, if the Commission determines that such trades and such executions shall be permitted, the Commission shall further determine the terms, conditions, and circumstances under which such trades and such executions shall be conducted: Provided, That any such determination shall, at a minimum, take into account the effect upon the liquidity of trading of each market: And provided further, That nothing herein shall be construed to prohibit the Commission from making separate deter-



minations for different contract markets when such are warranted in the judgment of the Commission, or to prohibit contract markets from setting terms and conditions more restrictive than those set by the Commission.

"(2) The Commission shall within six months after the effective date of the Commodity Futures Trading Commission Act of 1974, and subsequently when it determines that changes are required, make a determination, after notice and opportunity for hearing, whether or not a futures commission merchant may trade for its own account or any proprietary account, as defined by the Commission, and if the Commission determines that such trades shall be permitted, the Commission shall further determine the terms, conditions, and circumstances under which such trades shall be conducted: Provided, That any such determination, at a minimum, shall take into account the effect upon the liquidity of trading of each market: And provided further, That nothing herein shall be construed to prohibit the Commission from making separate determinations for different contract markets when such are warranted in the judgment of the Commission, or to prohibit contract markets from setting terms and conditions more restrictive than those set by the Commission."

SEC. 204. (a) The Commodity Exchange Act, as amended, is amended by adding the following new section:

"SEC. 4k. (1) It shall be unlawful for any person to be associated with any futures commission merchant or with any agent of a futures commission merchant as a partner, officer, or employee (or any person occupying a similar status or performing similar functions), in any capacity which involves (i) the solicitation or acceptance of customers' orders (other than in a clerical capacity) or (ii) the supervision of any person or persons so engaged, unless such person shall have registered, under this Act, with the Commission and such registration shall not have expired nor been suspended (and the period of suspension has not expired) or revoked, and it shall be unlawful for any futures commission merchant or any agent of a futures commission merchant to permit such a person to become or remain associated with him in any such capacity if such futures commission merchant or agent knew or should have known that such person was not so registered or that such registration had expired, been suspended (and the period of suspension has not expired) or revoked: Provided, That any individual who is registered as a floor broker or futures commission merchant (and such registration is not suspended or revoked) need not also register under these provisions.

"(2) Any such person desiring to be registered shall make application to the Commission in the form and manner prescribed by the Commission, giving such information and facts as the Commission may deem necessary concerning the applicant. Such person, when registered hereunder, shall likewise continue to report and furnish to the Commission such information as the Commission may require. Such registration shall expire two years after the effective date thereof, and shall be renewed upon application therefor unless the registration has been suspended (and the period of such suspension has not expired) or revoked after notice and hearing as prescribed in section 6(b) of this Act: Provided, That upon initial registration, the effective period of such registration shall be set by the Commission, not to



exceed two years from the effective date thereof and not to be less than one year from the effective date thereof."

(b) Section 6(b) of the *Commodity Exchange Act*, as amended (7 U.S.C. 9), is amended by inserting after the words "futures commission merchant" each time those words appear, the following: "or any person associated therewith as described in section 4k of this Act,".

(c) Section 8a(1) of the *Commodity Exchange Act*, as amended (7 U.S.C. 12a(1)), is amended by inserting after the words "futures commission merchants" the following: "and persons associated therewith as described in section 4k of this Act,".

Sec. 205. (a) The *Commodity Exchange Act*, as amended, is amended by adding the following new sections:

"Sec. 4l. It is hereby found that the activities of commodity trading advisors and commodity pool operators are affected with a national public interest in that, among other things—

"(1) their advice, counsel, publications, writings, analyses, and reports are furnished and distributed, and their contracts, solicitations, subscriptions, agreements, and other arrangements with clients take place and are negotiated and performed by the use of the mails and other means and instrumentalities of interstate commerce;

"(2) their advice, counsel, publications, writings, analyses, and reports customarily relate to and their operations are directed toward and cause the purchase and sale of commodities for future delivery on or subject to the rules of contract markets; and

"(3) the foregoing transactions occur in such volume as to affect substantially transactions on contract markets.

"Sec. 4m. It shall be unlawful for any commodity trading advisor or commodity pool operator, unless registered under this Act, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor or commodity pool operator: Provided, That the provisions of this section shall not apply to any commodity trading advisor who, during the course of the preceding twelve months, has not furnished commodity trading advice to more than fifteen persons and who does not hold himself out generally to the public as a commodity trading advisor.

"Sec. 4n. (1) Any commodity trading advisor or commodity pool operator, or any person who contemplates becoming a commodity trading advisor or commodity pool operator, may register under this Act by filing an application with the Commission. Such application shall contain such information, in such form and detail, as the Commission may, by rules and regulations, prescribe as necessary or appropriate in the public interest, including the following:

"(A) the name and form of organization, including capital structure, under which the applicant engages or intends to engage in business; the name of the State under the laws of which he is organized; the location of his principal business office and branch offices, if any; the names and addresses of all partners, officers, directors, and persons performing similar functions or, if the applicant be an individual, of such individual; and the number of employees;



"(B) the education, the business affiliations for the past ten years, and the present business affiliations of the applicant and of his partners, officers, directors, and persons performing similar functions and of any controlling person thereof;

"(C) the nature of the business of the applicant, including the manner of giving advice and rendering of analyses or reports;

"(D) the nature and scope of the authority of the applicant with respect to clients' funds and accounts;

"(E) the basis upon which the applicant is or will be compensated; and

"(F) such other information as the Commission may require to determine whether the applicant is qualified for registration.

"(2) Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission, or within such shorter period of time as the Commission may determine.

"(3) All registrations under this section shall expire on the 30th day of June of each year, and shall be renewed upon application therefor subject to the same requirements as in the case of an original application.

"(4) (A) Every commodity trading advisor and commodity pool operator registered under this Act shall maintain books and records and file such reports in such form and manner as may be prescribed by the Commission. All such books and records shall be kept for a period of at least three years, or longer if the Commission so directs, and shall be open to inspection by any representative of the Commission or the Department of Justice. Upon the request of the Commission, a registered commodity trading advisor or commodity pool operator shall furnish the name and address of each client, subscriber, or participant, and submit samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients, subscribers, or participants, or prospective clients, subscribers, or participants.

"(B) Unless otherwise authorized by the Commission by rule or regulation, all commodity trading advisors and commodity pool operators shall make a full and complete disclosure to their subscribers, clients, or participants of all futures market positions taken or held by the individual principals of their organization.

"(5) Every commodity pool operator shall regularly furnish statements of account to each participant in his operations. Such statements shall be in such form and manner as may be prescribed by the Commission and shall include complete information as to the current status of all trading accounts in which such participant has an interest.

"(6) The Commission is authorized, without hearing, to deny registration to any person as a commodity trading advisor or commodity pool operator if such person is subject to an outstanding order under this Act denying to such person trading privileges on any contract market, or suspending or revoking the registration of such person as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or suspending or expelling such person from membership on any contract market.

"(7) The Commission after hearing may by order deny registration, revoke or suspend the registration of any commodity trading advisor



or commodity pool operator if the Commission finds that such denial, revocation, or suspension is in the public interest and that—

"(A) the operations of such person disrupt or tend to disrupt orderly marketing conditions, or cause or tend to cause sudden or unreasonable fluctuations or unwarranted changes in the prices of commodities;

"(B) such commodity trading advisor or commodity pool operator, or any partner, officer, director, person performing similar function or controlling person thereof—

"(i) has within ten years of the issuance of such order been convicted of any felony or misdemeanor involving the purchase or sale of any commodity or security, or arising out of any conduct or practice of such commodity trading advisor or commodity pool operator or affiliated person as a commodity trading advisor or commodity pool operator; or

"(ii) at the time of the issuance of such order, is permanently or temporarily enjoined by order, judgment or decree of any court of competent jurisdiction from acting as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or as an affiliated person or employee of any of the foregoing, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of commodities or securities; or

"(C) any partner, officer, or director of such commodity trading advisor or commodity pool operator, or any person performing a similar function or any controlling person thereof is subject to an outstanding order of the Commission denying trading privileges on any contract market to such person, or suspending or revoking the registration of such person as a commodity trading advisor, commodity pool operator, futures commission merchant, or floor broker, or suspending or expelling such person from membership on any contract market.

SEC. 40. (1) It shall be unlawful for any commodity trading advisor or commodity pool operator registered under this Act, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

"(A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or

"(B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

"(2) It shall be unlawful for any commodity trading advisor or commodity pool operator registered under this Act to represent or imply in any manner whatsoever that he has been sponsored, recommended, or approved, or that his abilities or qualifications have in any respect been passed upon, by the United States or any agency or officer thereof: Provided, That this section shall not be construed to prohibit a statement that a person is registered under this Act as a commodity trading advisor or commodity pool operator, if such statement is true in fact and if the effect of such registration is not misrepresented."

(b) Section 6(b) of the Commodity Exchange Act, as amended (7 U.S.C. 9), is amended by inserting immediately before the words



"or as floor broker" each time those words appear, the following: "commodity trading advisor, commodity pool operator,".

"(c) Section 8a(1) of the Commodity Exchange Act, as amended (7 U.S.C. 12a(1)), is amended by inserting immediately before the words "and floor brokers" the following: "commodity trading advisors, commodity pool operators,".

SEC. 206. The Commodity Exchange Act, as amended, is amended by adding the following new section:

"SEC. 4p. The Commission may specify by rules and regulations appropriate standards with respect to training, experience, and such other qualifications as the Commission finds necessary or desirable to insure the fitness of futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers. In connection therewith, the Commission may prescribe by rules and regulations the adoption of written proficiency examinations to be given to applicants for registration as futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers, and the establishment of reasonable fees to be charged to such applicants to cover the administration of such examinations. The Commission may further prescribe by rules and regulations that, in lieu of examinations administered by the Commission, futures associations registered under section 17 of this Act or contract markets may adopt written proficiency examinations to be given to applicants for registration as futures commission merchants, floor brokers, and those persons associated with futures commission merchants or floor brokers, and charge reasonable fees to such applicants to cover the administration of such examinations. Notwithstanding any other provision of this section, the Commission may specify by rules and regulations such terms and conditions as it deems appropriate to protect the public interest wherein exception to any written proficiency examination shall be made with respect to individuals who have demonstrated, through training and experience, the degree of proficiency and skill necessary to protect the interests of the customers of futures commission merchants and floor brokers."

SEC. 207. Section 5 of the Commodity Exchange Act, as amended (7 U.S.C. 7), is amended by adding after subsection (f) thereof the following new subsection:

"(g) When such board of trade demonstrates that transactions for future delivery in the commodity for which designation as a contract market is sought will not be contrary to the public interest."

SEC. 208. Section 5a of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended—

(a) By inserting after the word "purposes" in subsection (7) the following: ": And provided further, That this subsection shall apply only to futures contracts for those commodities which may be delivered from a warehouse subject to the United States Warehouse Act".

(b) By striking out "and" at the end of subsection (8).

(c) By striking out the period at the end of subsection (9) and inserting in lieu thereof a semicolon.

(d) By adding at the end of subsection (9) thereof the following new subsection:

"(10) permit the delivery of any commodity, on contracts of sale thereof for future delivery, of such grade or grades, at such point or points and at such quality and locational price differen-



tials as will tend to prevent or diminish price manipulation, market congestion, or the abnormal movement of such commodity in interstate commerce. If the Commission after investigation finds that the rules and regulations adopted by a contract market permitting delivery of any commodity on contracts of sale thereof for future delivery, do not accomplish the objectives of this subsection, then the Commission shall notify the contract market of its finding and afford the contract market an opportunity to make appropriate changes in such rules and regulations. If the contract market within seventy-five days of such notification fails to make the changes which in the opinion of the Commission are necessary to accomplish the objectives of this subsection, then the Commission after granting the contract market an opportunity to be heard, may change or supplement such rules and regulations of the contract market to achieve the above objectives: Provided, That any order issued under this paragraph shall not apply to contracts of sale for future delivery in any months in which contracts are currently outstanding and open: And provided further, That no requirement for an additional delivery point or points shall be promulgated following hearings until the contract market affected has had notice and opportunity to file exceptions to the proposed order determining the location and number of such delivery point or points."

SEC. 209. Section 5a of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended by adding a new subsection (11) as follows:

"(11) provide a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof: Provided, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of \$15,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term 'customer' as used in this subsection shall not include a futures commission merchant or a floor broker; and".

SEC. 210. Section 5a of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended by inserting the following new subsection (12) as follows:

"(12) except as otherwise provided in this subsection, submit to the Commission for its approval all bylaws, rules, regulations, and resolutions made or issued by such contract market, or by the governing board thereof or any committee thereof 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. The Commission shall approve, within thirty days of their receipt unless the Commission notifies the contract market of its inability to make such determination within such period of time, such bylaws, rules, regulations, and resolutions upon a determination that such bylaws, rules, regulations, and resolutions are not in violation of the provisions of this Act or the regulations of the Commission and thereafter the Commission shall disapprove, after appropriate notice and opportunity for hearing, any bylaw, rule, regulation, or resolution which the



Commission finds at any time is in violation of the provisions of this Act or the regulations of the Commission. The Commission shall specify the terms and conditions under which a contract market may, in an emergency, as defined by the Commission, adopt a temporary rule dealing with trading requirements without prior Commission approval. In the event of such an emergency, as defined by the Commission, requiring immediate action, the contract market by a two-thirds vote of its governing board may place into immediate effect without prior Commission approval a temporary rule dealing with such emergency if it notifies the Commission of such action with a complete explanation of the emergency involved. The Commission may adopt a regulation exempting enumerated types of contract market operational and administrative rules from the requirement that they be submitted to the Commission for its approval."

Sec. 211. The Commodity Exchange Act, as amended, is amended by inserting the following new section immediately after section 6b (7 U.S.C. 13a):

"Sec. 6c. Whenever it shall appear to the Commission that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act or any rule, regulation, or order thereunder, or is restraining trading in any commodity for future delivery, the Commission may bring an action in the proper district court of the United States or the proper United States court of any territory or other place subject to the jurisdiction of the United States, to enjoin such act or practice, or to enforce compliance with this Act, or any rule, regulation or order thereunder, and said courts shall have jurisdiction to entertain such actions: Provided, That no restraining order or injunction for violation of the provisions of this Act shall be issued ex parte by said court. Upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond. Upon application of the Commission, the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall also have jurisdiction to issue writs of mandamus, or orders affording like relief, commanding any person to comply with the provisions of this Act or any rule, regulation, or order of the Commission thereunder, including the requirement that such person take such action as is necessary to remove the danger of violation of this Act or any such rule, regulation, or order: Provided, That no such writ of mandamus, or order affording like relief, shall be issued ex parte. Any action under this section may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the act or practice occurred, is occurring, or is about to occur, and process in such cases may be served in any district in which the defendant is an inhabitant or wherever the defendant may be found. In lieu of bringing actions itself pursuant to this section, the Commission may request the Attorney General to bring the action. Where the Commission elects to bring the action, it shall inform the Attorney General of such suit and advise him of subsequent developments."

Sec. 212. (a) Section 6 of the Commodity Exchange Act, as amended (7 U.S.C. 8, 9, 13b, 15), is amended—



(1) By substituting a comma for the period at the end of the fourth sentence in paragraph (b) and adding thereafter the following: "and may assess such person a civil penalty of not more than \$100,000 for each such violation."

(2) By adding in the sixth sentence in paragraph (b), a comma after the word "petition" and inserting thereafter and before the word "praying" the following phrase: "within fifteen days after the notice of such order is given to the offending person,".

(3) By adding after paragraph (c) thereof the following new paragraph:

"(d) In determining the amount of the money penalty assessed under paragraph (b) of this section, the Commission shall consider, in the case of a person whose primary business involves the use of the commodity futures market—the appropriateness of such penalty to the size of the business of the person charged, the extent of such person's ability to continue in business, and the gravity of the violation; and in the case of a person whose primary business does not involve the use of the commodity futures market—the appropriateness of such penalty to the net worth of the person charged, and the gravity of the violation. If the offending person upon whom such penalty is imposed, after the lapse of the period allowed for appeal or after the affirmance of such penalty, shall fail to pay such penalty the Commission shall refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court."

(b) Section 6b of the Commodity Exchange Act, as amended (7 U.S.C. 13a), is amended to read as follows:

"Sec. 6b. If any contract market is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this Act, or if any contract market, or any director, officer, agent, or employee of any contract market otherwise is violating or has violated any of the provisions of this Act or any of the rules, regulations, or orders of the Commission thereunder, the Commission may, upon notice and hearing and subject to appeal as in other cases provided for in paragraph (a) of section 6 of this Act, make and enter an order directing that such contract market, director, officer, agent, or employee shall cease and desist from such violation, and assess a civil penalty of not more than \$100,000 for each such violation. If such contract market, director, officer, agent, or employee, after the entry of such a cease and desist order and the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall fail or refuse to obey or comply with such order, such contract market, director, officer, agent, or employee shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$100,000 or imprisoned for not less than six months nor more than one year, or both. Each day during which such failure or refusal to obey such cease and desist order continues shall be deemed a separate offense. If the offending contract market or other person upon whom such penalty is imposed, after the lapse of the period allowed for appeal or after the affirmance of such penalty, shall fail to pay such penalty, the Commission shall refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court. In determining the amount of the money penalty



assessed under this section, the Commission shall consider the appropriateness of such penalty to the net worth of the offending person and the gravity of the offense, and in the case of a contract market shall further consider whether the amount of the penalty will materially impair the contract market's ability to carry on its operations and duties."

(c) Section 6(c) of the Commodity Exchange Act, as amended (7 U.S.C. 13b), is amended by deleting the words "not less than \$500 nor more than \$10,000" and substituting therefor the words "not more than \$100,000".

(d) Section 9 of the Commodity Exchange Act, as amended (7 U.S.C. 13), is amended as follows:

(1) Subsection (a) is amended by striking "\$10,000" and substituting therefor "\$100,000".

(2) Subsection (b) is amended by striking "\$10,000" and substituting therefor "\$100,000".

(3) Subsection (c) is amended by striking "\$10,000" and substituting therefor "\$100,000".

SEC. 213. Section 8a of the Commodity Exchange Act, as amended (7 U.S.C. 12a), is amended by striking subsection (7) and inserting in lieu thereof the following new subsection:

"(7) 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. Such rules, regulations, or orders may specify changes with respect to such matters as:

"(A) terms or conditions in contracts of sale to be executed on or subject to the rules of such contract market;

"(B) the form or manner of execution of purchases and sales for future delivery;

"(C) other trading requirements, excepting the setting of levels of margin;

"(D) safeguards with respect to the financial responsibility of members;

"(E) the manner, method, and place of soliciting business, including the content of such solicitations; and

"(F) the form and manner of handling, recording, and accounting for customers' orders, transactions, and accounts; and".

SEC. 214. Section 8a of the Commodity Exchange Act, as amended (7 U.S.C. 12a), is amended by adding the following new subsection (8):

"(8) to make and promulgate such rules and regulations with respect to those persons registered under this Act, who are not



members of a contract market, as in the judgment of the Commission are reasonably necessary to protect the public interest and promote just and equitable principles of trade, including but not limited to the manner, method, and place of soliciting business, including the content of such solicitation; and".

SEC. 215. Section 8a of the Commodity Exchange Act, as amended (7 U.S.C. 12a), is amended by adding the following new subsection (9):

"(9) to direct the contract market whenever it has reason to believe that an emergency exists, to take such action as, in the Commission's judgment, is necessary to maintain or restore orderly trading in, or liquidation of, any futures contract. The term 'emergency' as used herein shall mean, in addition to threatened or actual market manipulations and corners, any act of the United States or a foreign government affecting a commodity or any other major market disturbance which prevents the market from accurately reflecting the forces of supply and demand for such commodity: Provided, That nothing herein shall be deemed to limit the meaning or interpretation given by a contract market to the terms 'market emergency', 'emergency', or equivalent language in its own bylaws, rules, regulations, or resolutions."

SEC. 216. The Commodity Exchange Act, as amended, is amended by inserting the following new section immediately after section 8b (7 U.S.C. 12b):

"SEC. 8c. (1) (A) Any exchange or the Commission if the exchange fails to act, may suspend, expel, or otherwise discipline any person who is a member of that exchange, or deny any person access to the exchange. Any such action shall be taken solely in accordance with the rules of that exchange.

"(B) Any suspension, expulsion, disciplinary, or access denial procedure established by an exchange rule shall provide for written notice to the Commission and to the person who is suspended, expelled, or disciplined, or denied access, within thirty days, which includes the reasons for the exchange action in the form and manner the Commission prescribes. Otherwise the notice and reasons shall be kept confidential.

"(2) The Commission may, in its discretion and in accordance with such standards and procedures as it deems appropriate, review any decision by an exchange whereby a person is suspended, expelled, otherwise disciplined, or denied access to the exchange. In addition, the Commission may, in its discretion and upon application of any person who is adversely affected by any other exchange action, review such action.

"(3) The Commission may affirm, modify, set aside, or remand any exchange decision it reviews pursuant to subsection (2), after a determination on the record whether the action of the exchange was in accordance with the policies of this Act. Subject to judicial review, any order of the Commission entered pursuant to subsection (2) shall govern the exchange in its further treatment of the matter.

"(4) The Commission, in its discretion, may order a stay of any action taken pursuant to subsection (1) pending review thereof.

SEC. 217 (a). No person shall offer to enter into, enter into, or confirm the execution of 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 contrary to any rule, regulation, or order of the Commodity Futures Trading Commission designed to insure the financial solvency of the transaction or prevent manipulation or fraud: Provided, That such rule, regulation, or order may be made only after notice and opportunity for hearing. If the Commission determines that any such transaction is a contract for future delivery within the meaning of the Commodity Exchange Act, as amended, such transaction shall be regulated in accordance with the provisions of such Act.

(b) The provisions of section 9(c) of the Commodity Exchange Act, as amended, shall be applicable with respect to persons who violate the provisions of this section.

TITLE III—ENABLING AUTHORITY FOR CREATION OF NATIONAL FUTURES ASSOCIATIONS

SEC. 301. The Commodity Exchange Act, as amended, is amended by adding the following new section:

"SEC. 17. (a) Any association of persons may be registered with the Commission as a registered futures association pursuant to subsection (b) of this section, under the terms and conditions hereinafter provided in this section, by filing with the Commission for review and approval a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

"(1) Data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest; and

"(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this section collectively referred to as the 'rules of the association'.

"(b) An applicant association shall not be registered as a futures association unless the Commission finds, under standards established by the Commission, that—

"(1) such association is in the public interest and that it will be able to comply with the provisions of this section and the rules and regulations thereunder and to carry out the purposes of this section;

"(2) the rules of the association provide that any person registered under this Act, contract market, or any other person designated pursuant to the rules of the Commission as eligible for membership may become a member of such association, except such as are excluded pursuant to paragraph (3) or (4) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or



appropriate in the public interest and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to, or refuse to continue in such association any person if (i) such person, whether prior or subsequent to becoming registered as such, or (ii) any person associated with in the meaning of 'associated person' as set forth in section 4k of this Act, whether prior or subsequent to becoming so associated, has been and is suspended or expelled from a contract market or has been and is barred or suspended from being associated with all members of such contract market, for violation of any rule of such contract market;

"(3) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall be admitted to or continued in membership in such association, if such person—

"(A) has been and is suspended or expelled from a registered futures association or from a contract market or has been and is barred or suspended from being associated with all members of such association or from being associated with all members of such contract market, for violation of any rule of such association or contract market which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade; or

"(B) is subject to an order of the Commission denying, suspending, or revoking his registration pursuant to section 6(b) of this Act (7 U.S.C. 9), or expelling or suspending him from membership in a registered futures association or a contract market, or barring or suspending him from being associated with a futures commission merchant; or

"(C) whether prior or subsequent to becoming a member, by his conduct while associated with a member, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such member, and in entering such a suspension, expulsion, or order, the Commission or any such contract market or association shall have jurisdiction to determine whether or not any person was a cause thereof; or

"(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who would be ineligible for admission to or continuance in membership under clause (A), (B), or (C) of this paragraph.

"(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated



with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such a member. For the purpose of defining such standards and the application thereof, such rules may—

“(A) appropriately classify prospective members (taking into account relevant matters, including type or nature of business done) and persons proposed to be associated with members.

“(B) specify that all or any portion of such standard shall be applicable to any such class.

“(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

“(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members) of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

“(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association shall adopt procedures for verification of qualifications of the applicant.

“(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (b) of section 6 of the Act, be deemed an application required to be filed under this section).

“(5) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

“(6) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

“(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, in general, to protect the public interest, and to remove impediments to and perfect the mechanism of free and open futures trading.

“(8) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

“(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and per-



sons associated with members and the denial of membership to any person seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include—

“(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted.

“(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

“(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

“(D) a statement setting forth the penalty imposed.

“In any proceeding to determine whether a person shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based.

“(10) the rules of the association provide for a fair and equitable procedure through arbitration or otherwise for the settlement of a customer's claims and grievances against any member or employee thereof: Provided, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of \$5,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term ‘customer’ as used in this subsection shall not include a futures commission merchant or a floor broker.

“(c) The Commission may, after notice and opportunity for hearing, suspend the registration of any futures association if it finds that the rules thereof do not conform to the requirements of the Commission, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

“(d) In addition to the fees and charges authorized by section 8a (4) of this Act, each person registered under this Act, who is not a member of a futures association registered pursuant to this section, shall pay to the Commission such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed by the Commission because such person is not a member of a registered futures association. The Commission shall establish such additional fees and charges by rules and regulations.

“(e) Any person registered under this Act, who is not a member of

a futures association registered pursuant to this section, in addition to the other requirements and obligations of this Act and the regulations thereunder shall be subject to such other rules and regulations as the Commission may find necessary to protect the public interest and promote just and equitable principles of trade.

"(f) Upon filing of an application for registration pursuant to subsection (a), the Commission may by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration.

"(g) A registered futures association may, upon such reasonable notice as the Commission may deem necessary in the public interest, withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe.

"(h) If any registered futures association takes any disciplinary action against any member thereof or any person associated with such a member or denies admission to any person seeking membership therein, or bars any person from being associated with a member, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (k) of this section unless the Commission otherwise orders, after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).

"(i) (1) In a proceeding to review disciplinary action taken by a registered futures association against a member thereof or a person associated with a member, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant—

"(A) finds that such member or person has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and

"(B) determines that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association, the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission determines that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.



"(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

"(3) In any proceeding to review the denial of membership in a registered futures association or the barring of any person from being associated with a member, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which such denial or bar is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant to membership therein, or to permit such person to be associated with a member.

"(j) Every registered futures association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a) of this section. Any change in or addition to the rules of a registered futures association shall be submitted to the Commission for approval and shall take effect upon the thirtieth day after such approval by the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of this section and the provisions of this Act.

"(k) (1) The Commission is authorized by order to abrogate any rule of a registered futures association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or effectuate the purposes of this title.

"(2) The Commission may in writing request any registered futures association to adopt any specified alteration or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested, or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or to effectuate the purposes of this section, with respect to—

"(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with members, or the qualifications required for members or natural persons associated with members or any class thereof;



"(B) the method for adoption of any change in or addition to the rules of the association;

"(C) the method of choosing officers and directors.

"(l) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or to carry out the purposes of this section—

"(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered futures association, if the Commission finds that such association has violated any provisions of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this Act;

"(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered futures association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person—

"(A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder; or

"(B) has willfully violated any provision of the Commodity Exchange Act, as amended, or of any rule, regulation, or order thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule, regulation, or order.

"(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered futures association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

"(m) The Commission shall include in its annual reports to Congress information concerning any futures associations registered pursuant to this section and the effectiveness of such associations in regulating the practices of the members."

TITLE IV—MISCELLANEOUS PROVISIONS

SEC. 401. Section 9 of the Commodity Exchange Act, as amended (7 U.S.C. 13), is amended by adding the following new subsections:

"(d) It shall be a felony punishable by a fine of not more than \$10,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any Commissioner of the Commission or any employee or agent thereof, to participate, directly or indirectly, in any transaction in commodity futures or any transaction of the character of or which is commonly known to the trade as an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty', or for any such person to participate, directly or indirectly, in any investment transaction in an actual commodity: Provided, That such prohibition against any investment



transaction in an actual commodity shall not apply to a transaction in which such person buys an agricultural commodity or livestock for use in his own farming or ranching operations or sells an agricultural commodity which he has produced in connection with his own farming or ranching operations nor to any transaction in which he sells livestock which he has owned at least three months. With respect to such excepted transactions, the Commission shall require any Commissioner of the Commission or any employee or agent thereof who participates in any such transaction to notify the Commission thereof in accordance with such regulations as the Commission shall prescribe and the Commission shall make such information available to the public.

"(e) It shall be a felony punishable by a fine of not more than \$10,000 or imprisonment for not more than five years, or both, together with the costs of prosecution—(1) for any Commissioner of the Commission or any employee or agent thereof who, by virtue of his employment or position, acquires information which may affect or tend to affect the price of any commodity futures or commodity and which information has not been made public to impart such information with intent to assist another person, directly or indirectly, to participate in any transaction in commodity futures, any transaction in an actual commodity, or in any transaction of the character of or which is commonly known to the trade as an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty'; and (2) for any person to acquire such information from any Commissioner of the Commission or any employee or agent thereof and to use such information in any transaction in commodity futures, any transaction in an actual commodity, or in any transaction of the character of or which is commonly known to the trade as an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty'."

SEC. 402. Section 4c of the Commodity Exchange Act, as amended (7 U.S.C. 6c), is amended—

(a) by inserting "(a)" after "SEC. 4c."

(b) By striking paragraph (B) in its entirety and inserting in lieu thereof the following:

"(B) if such transaction involves any commodity specifically set forth in section 2(a) of this Act, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, and if such transaction is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty', or"

(c) By adding at the end thereof the following new subsection:

"(b) No person shall offer to enter into, enter into, or confirm the execution of, any transaction subject to the provisions of subsection (a) of this section involving any commodity regulated under this Act, but not specifically set forth in section 2(a) of this Act, prior to the enactment of the Commodity Futures Trading Commission Act of 1974, which is of the character of, or is commonly known to the trade as, an 'option', 'privilege', 'indemnity', 'bid', 'offer', 'put', 'call', 'advance guaranty', or 'decline guaranty', 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 shall prescribe within one year after the effective date of the



Commodity Futures Trading Commission Act of 1974 unless the Commission determines and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture that it is unable to prescribe such terms and conditions within such period of time: Provided, That any such order, rule, or regulation may be made only after notice and opportunity for hearing: And provided further, That the Commission may set different terms and conditions for different markets."

(d) *By striking the last sentence of subsection (a) as designated by this section.*

SEC. 403. Section 4a(1) of the Commodity Exchange Act, as amended (7 U.S.C. 6a), is amended by inserting, following the word "straddles" in the last sentence of such paragraph the words "or 'arbitrage'" and by adding the following new sentences at the end of such paragraph: "The word 'arbitrage' in domestic markets shall be defined to mean the same as a 'spread' or 'straddle'. The Commission is authorized to define the term 'international arbitrage'."

SEC. 404. Section 4a(3) of the Commodity Exchange Act, as amended (7 U.S.C. 6a), is amended by deleting the period at the end of the first sentence and adding "as such terms shall be defined by the Commission within ninety days after the effective date of the Commodity Futures Trading Commission Act of 1974 by order consistent with the purposes of this Act."; and by deleting, effective immediately on enactment of this Act, the remainder of paragraph (3): Provided, That notwithstanding any other provision of law, the Secretary of Agriculture, immediately upon the enactment of the Commodity Futures Trading Commission Act of 1974, is authorized and directed to promulgate regulations defining bona fide hedging transactions and positions: And provided further, That until the Secretary issues such regulations defining bona fide hedging transactions and positions and such regulations are in full force and effect, such terms shall continue to be defined as set forth in the Commodity Exchange Act prior to its amendment by the Commodity Futures Trading Commission Act of 1974.

SEC. 405. Section 4b of the Commodity Exchange Act, as amended (7 U.S.C. 6b), is amended—

(a) *By deleting the word "cotton" where it appears in the last full paragraph of such section, and inserting in lieu thereof the words "a commodity".*

(b) *By striking the period at the end of such section and adding the following: ": And provided further, That such transactions shall be made in accordance with such rules and regulations as the Commission may promulgate regarding the manner of the execution of such transactions."*

SEC. 406. Section 5a(6) of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended by deleting the semicolon at the end of said subsection and inserting in lieu thereof the following: "and adopted by the Commission;".

SEC. 407. Section 5a(8) of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended—

(a) *By deleting the words "not been disapproved by the Secretary of Agriculture pursuant to paragraph (7) of section 8a" and inserting in lieu thereof the words "been approved by the Commission pursuant to paragraph (12) of section 5a".*



(b) By deleting the word "so", and inserting the words "by the Commission" immediately before the semicolon at the end of such subsection.

SEC. 408. Section 6(b) of the Commodity Exchange Act, as amended (7 U.S.C. 9), is amended—

(a) By striking in the second sentence "a referee" and inserting in lieu thereof "an Administrative Law Judge".

(b) By striking the word "referee" each other place it appears and inserting in lieu thereof "Administrative Law Judge".

SEC. 409. Section 9(c) of the Commodity Exchange Act, as amended (7 U.S.C. 13), is amended by inserting after "section 4i" the following: "section 4k, section 4m, section 4o,".

SEC. 410. Section 5108(c) of title 5 of the United States Code is amended by adding after paragraph (11) thereof the following new paragraph:

"(12) The Commodity Futures Trading Commission, subject to the standards and procedures prescribed by this chapter, may place an additional twenty positions in GS-16, GS-17, and GS-18 for purposes of carrying out its functions."

SEC. 411. All operations of the Commodity Exchange Commission and of the Secretary of Agriculture under the Commodity Exchange Act, including all pending administrative proceedings, shall be transferred to the Commodity Futures Trading Commission as of the effective date of this Act and continue to completion. All rules, regulations, and orders heretofore issued by the Commodity Exchange Commission and by the Secretary of Agriculture under the Commodity Exchange Act to the extent not inconsistent with the provisions of this Act shall continue in full force and effect unless and until terminated, modified, or suspended by the Commodity Futures Trading Commission.

SEC. 412. Pending proceedings under existing law shall not be abated by reason of any provision of this 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.

SEC. 413. If any provision of this Act or the application thereof to any person or circumstance is held invalid, the validity of the remainder of the Act and the application of such provision to other persons or circumstances shall not be affected thereby.

SEC. 414. The Commodity Exchange Act, as amended, is amended by adding the following new section at the end thereof:

"SEC. 16. (a) The Commission may conduct regular investigations of the markets for goods, articles, services, rights, and interests which are the subject of futures contracts, and furnish reports of the findings of these investigations to the public on a regular basis. These market reports shall, where appropriate, include information on the supply, demand, prices, and other conditions in the United States and other countries with respect to such goods, articles, services, rights, interests, and information respecting the futures markets.

"(b) The Commission shall cooperate with the Department of Agriculture and any other Department or Federal agency which makes market investigations to avoid unnecessary duplication of information-gathering activities.

"(c) The Department of Agriculture and any other Department or Federal agency which has market information sought by the Commis-



sion shall furnish it to the Commission upon the request of any authorized employee of the Commission. The Commission shall abide by any rules of confidentiality applying to such information.

"(d) The Commission shall not disclose in such reports data and information which would separately disclose the business transactions of any person and trade secrets or names of customers except as provided in section 8 of this Act."

SEC. 415. Section 4g of the Commodity Exchange Act, as amended, is amended by inserting "(1)" after the section designation and by adding the following new subsections:

"(2) Every clearinghouse and contract market shall maintain daily trading records. The daily trading records shall include such information as the Commission shall prescribe by rule.

"(3) Brokers and futures commission merchants shall maintain daily trading records for each customer in such manner and form as to be identifiable with the trades referred to in subsection (2).

"(4) Daily trading records shall be maintained in a form suitable to the Commission for such period as may be required by the Commission. Reports shall be made from the records maintained at such times and at such places and in such form as the Commission may prescribe by rule, order, or regulation in order to protect the public interest and the interest of persons trading in commodity futures.

"(5) Before the beginning of trading each day, the exchange shall, insofar as is practicable and under terms and conditions specified by the Commission, make public the volume of trading on each type of contract for the previous day and such other information as the Commission deems necessary in the public interest and prescribes by rule, order, or regulation.

"(6) Nothing contained in this section shall be construed to prohibit the Commission from making separate determinations for different clearinghouses, contract markets, and exchanges when such determinations are warranted in the judgment of the Commission."

SEC. 416. The Commodity Exchange Act, as amended, is amended by adding at the end thereof the following new section:

"SEC. 18. (a) The Commission shall establish and maintain, as part of its ongoing operations, research and information programs to (1) determine the feasibility of trading by computer, and the expanded use of modern information system technology, electronic data processing, and modern communication systems by commodity exchanges, boards of trade, and by the Commission itself for purposes of improving, strengthening, facilitating, or regulating futures trading operations; (2) assist in the development of educational and other informational materials regarding futures trading for dissemination and use among producers, market users, and the general public; and (3) carry out the general purposes of this Act.

"(b) The Commission shall include in its annual reports to Congress plans and findings with respect to implementing this section."

SEC. 417. The Commodity Futures Trading Commission shall submit to the Congress, not later than June 30, 1976, a report respecting the need for legislation insuring owners of commodity futures accounts and persons handling or clearing trades in such accounts against loss by reason of the insolvency or financial failure of a futures commis-



sion merchant carrying such accounts. The report shall contain the recommendations of the Commission concerning the form and nature of any such legislation.

Sec. 418. (a) Except as otherwise provided specifically in this Act, the effective date of this Act shall be the 180th day after enactment. The Commission referred to in section 101 is hereby established effective immediately on enactment of this Act. Sections 102 and 410 shall be effective immediately on enactment of this Act. Activities necessary to implement the changes effected by this Act may be carried out after the date of enactment and before as well as after the 180th day thereafter. Activities to be carried out after the date of enactment and before the 180th day thereafter may include, but are not limited to the following: designation of boards of trade as contract markets, registration of futures commission merchants, floor brokers, and other persons required to be registered under the Act, approval or modification of bylaws, rules, regulations, and resolutions of contract markets, and issuance of regulations, effective on or after the 180th day after enactment; appointment and compensation of the members of the Commission; hiring and compensation of staff; and conducting of investigations and hearings. Nothing in this Act shall limit the authority of the Secretary of Agriculture or the Commodity Exchange Commission under the Commodity Exchange Act, as amended, prior to the 180th day after enactment of this Act.

(b) Funds appropriated for the administration of the Commodity Exchange Act, as amended, may be used to implement this Act immediately after the date of enactment of this Act.

And the Senate agree to the same.

HERMAN E. TALMADGE,
GEORGE MCGOVERN,
HUBERT H. HUMPHREY,
DICK CLARK,
CARL T. CURTIS,
ROBERT DOLE,
HENRY BELLMON,
Managers on the Part of the Senate.

W. R. POAGE,
FRANK A. STUBBLEFIELD,
THOMAS S. FOLEY,
BOB BERGLAND,
WILLIAM C. WAMPLER,
ROBERT PRICE,
CHARLES THONE,
Managers on the Part of the House.



JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H.R. 13113) to amend the Commodity Exchange Act to strengthen the regulation of futures trading, to bring all agricultural and other commodities traded on exchanges under regulation, and for other purposes, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report. The differences between the House bill and the Senate amendment and the substitute agreed to in conference are noted in the following outline, except for conforming, clarifying, and technical changes:

(1) *Nature of Commission.*

The *House* bill creates a five-man regulatory Commission with certain ties to the Department of Agriculture. The Commission would consist of four public members and the Secretary of Agriculture or his designee. The four public members of the Commission would be appointed by the President from the general public and confirmed by the Senate. Any of the five members of the Commission could be separately nominated by the President as Chairman of the Commission, although such nomination would be subject to separate Senate approval. The four public members would serve on a part-time basis. They would be compensated at Executive Level IV on a per diem basis for the time they spend in the performance of their official activities. The Commission would be allowed to utilize the facilities and services of the Department of Agriculture, at cost, including adequate office space if available. The Commission would be required to meet as often as necessary, but not less than one regular meeting per month. Additional meetings could be called by the Chairman or any two members of the Commission. The Commission would have a General Counsel, an Executive Director, and a Secretary.

The *Senate* amendment creates a five-man independent regulatory Commission consisting of a Chairman and four other Commissioners. In nominating persons for appointment, the President is to seek to establish and maintain a balanced Commission that will include—but not be limited to—persons of demonstrated knowledge in futures trading or its regulation and persons of demonstrated knowledge in the production, merchandising, processing, or distribution of the goods, articles, services, rights, and interests covered by the Act. The Chairman would be the chief administrative officer and compensated at Executive Level III. The other Commissioners would be compensated at Executive Level IV. The Commission would have a General Counsel and an Executive Director, but no Secretary. Both the General Counsel and the Executive Director would be subject to Senate confirmation. They would be compensated at Executive Level V.



The *Conference* substitute adopts the *Senate* provision with an amendment. Under the *Conference* substitute, the Secretary of Agriculture will appoint a liaison officer, who shall be an employee of the Department of Agriculture, for the purpose of maintaining liaison between the Commission and the Department. The Commission shall furnish the liaison officer with appropriate office space and clerical help, and he shall have the right to attend and observe all deliberations and proceedings of the Commission. Likewise, the Commission shall establish a separate office within the Department of Agriculture to be staffed with employees of the Commission for the purpose of maintaining liaison between the Department and the Commission. The Secretary shall take such steps as may be necessary to enable the Commission to obtain information and utilize such services and facilities of the Department as may be necessary in order to maintain effectively such liaison.

Under the *Conference* substitute, the Commission would appoint the General Counsel and the Executive Director. Only the Executive Director would be subject to Senate confirmation. Both would serve at the pleasure of the Commission.

The *Conference* substitute includes the *House* provision that a vacancy in the Commission would not impair the right of the remaining Commissioners to exercise the powers of the Commission. Thus, during the period of transition between the date of enactment and the effective date of the bill, it will be possible for the Commission to function when three of the Commissioners have been appointed and have qualified.

The *Conference* substitute also provides that whenever the Commission submits any budget estimate or request to the President or the Office of Management and Budget, it shall concurrently transmit copies of that estimate or request to the House and Senate Agriculture Committees and the House and Senate Appropriations Committees. Likewise, whenever the Commission submits any legislative recommendation, or testimony, or comments on legislation to the President or the Office of Management and Budget, it shall concurrently transmit copies thereof to the House and Senate Agriculture Committees.

(2) *Reparations procedure.*

Under the *Senate* amendment, a person would have three years instead of nine months, as provided in the *House* bill, to make a complaint to the Commission.

Judicial review of the Commission's findings and order would under the *House* bill be de novo, except that the findings of fact and orders of the Commission would be prima facie evidence of the facts therein stated. Under the *Senate* amendment, the findings would be reviewable only for purposes of determining if they are supported by substantial evidence.

Under the *House* bill, the period of time for a person to comply with or appeal a reparations order entered against him is five days. Under the *Senate* amendment, the period of time is extended to 15 days.

Under the *Conference* substitute, a person would have two years to make a complaint to the Commission. In lieu of the *House* and *Senate* provisions, judicial review of the Commission's findings and order would on appeal be in the Court of Appeals pursuant to the procedure provided in section 6(b) of the Commodity Exchange Act.

Under section 6(b) of the Act, the findings of the Commission, as to the facts, would, if supported by the weight of the evidence, be conclusive. The *Conference* substitute retains the *Senate* provision that the period of time for a person to comply with or appeal a reparations order entered against him is 15 days.

(3) *Antitrust laws.*

Under the *House* bill, the Commission—in issuing any order, rule, or regulation or in requiring or approving any bylaw, rule, or regulation of a contract market—is to take into consideration the public interest to be protected by the antitrust laws.

The *Senate* amendment retains this provision, and, in addition, requires the Commission to endeavor to take the least anticompetitive means of achieving the objectives of the Commodity Exchange Act.

The *Conference* substitute adopts the *Senate* amendment with only a technical change. However, the requirement that the Commission endeavor to take the least anticompetitive means of achieving the objectives of the Commodity Exchange Act is not intended to constitute any procedural roadblock to the Commission in regulating the futures trading industry, and separate proceedings to consider antitrust and anticompetitive matters are not required by the Commission in issuing any order, adopting any Commission rule or regulation, or in requiring or approving any bylaw, rule, or regulation of a contract market.

(4) *Jurisdiction of the Commission.*

The *House* bill provides for exclusive jurisdiction of the Commission over all futures transactions. However, it is provided that such exclusive jurisdiction would not supersede or limit the jurisdiction of the Securities and Exchange Commission or other regulatory authorities.

The *Senate* amendment retains the provision of the *House* bill but adds three clarifying amendments. The clarifying amendments make clear that (a) the Commission's jurisdiction over futures contract markets or other exchanges is exclusive and includes the regulation of commodity accounts, commodity trading agreements, and commodity options; (b) the Commission's jurisdiction, where applicable, supersedes State as well as Federal agencies; and (c) Federal and State courts retain their respective jurisdictions.

In addition, the *Senate* amendment provides that interbank trading of foreign currencies and specified financial instruments is not subject to Commission regulation.

Also, the *Senate* amendment provides that the Commission's authority in section 217 of the bill to regulate transactions for the delivery of silver bullion, gold bullion, or bulk silver coins or bulk gold coins pursuant to standardized margin or leverage contracts is exclusive.

The *Conference* substitute adopts the *Senate* amendment, including the provision in section 402(d) of the bill which strikes the last sentence of section 4c of the Commodity Exchange Act. The language being struck provides that "Nothing in this section [section 4c] or section 4b shall be construed to impair any State law applicable to any transaction enumerated or described in such sections."

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned. Therefore, if any substantive State law regu-



lating futures trading was contrary to or inconsistent with Federal law, the Federal law would govern. In view of the broad grant of authority to the Commission to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States.

(5) *Fitness requirements for floor brokers, futures commission merchants, and persons associated with them.*

The *Senate* amendment provides in section 206 that the Commission may exempt floor brokers, futures commission merchants, and persons associated with them, from any written proficiency examinations, if they have previously demonstrated the required proficiency and skill necessary to protect the interests of customers.

The *Senate* amendment strikes a similar provision in section 204 of the *House* bill which would be applicable only with respect to persons associated with futures commission merchants.

The *Conference* substitute adopts the *Senate* provision.

(6) *Contract market designation (economic justification).*

The *House* bill requires a board of trade, before designation as a contract market, to demonstrate (a) that the prices involved in transactions for future delivery in the commodity for which such designation is sought, are, or reasonably can be expected to be, generally quoted and disseminated as a basis for determining prices to producers, merchants, or consumers of such commodity or the products or byproducts thereof or (b) that such transactions are, or reasonably can be expected to be, utilized by producers, merchants, or consumers engaged in handling such commodity or the products or byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price.

The *Senate* amendment strikes the *House* provision and substitutes therefor the requirement that the board of trade demonstrate that transactions for future delivery in the commodity for which designation as a contract market is sought will not be contrary to the public interest.

The *Conference* substitute adopts the *Senate* provision. The Conferees note that the broader language of the *Senate* provision would include the concept of the "economic purpose" test provided in the *House* bill subject to the final test of the "public interest".

(7) *Delivery points.*

The *Senate* amendment would give contract markets 75 days, instead of 60 days as specified in the *House* bill, to make changes in delivery points as deemed necessary by the Commission.

In addition, the *Senate* amendment eliminates any requirement that warehouse receipts issued under the United States Warehouse Act be accepted in satisfaction of futures contracts where such a requirement is totally inappropriate.

The *Conference* substitute adopts the *Senate* provision.

(8) *Voluntary arbitration of customers' claims.*

Under the *House* bill, a contract market's voluntary arbitration procedure is limited to claims not in excess of \$5,000.

The *Senate* amendment increases this amount to \$15,000.

The *Conference* substitute adopts the *Senate* provision.

(9) *Commission approval of exchange bylaws, rules, regulations, and resolutions.*

The *Senate* amendment retains the provision of the *House* bill that a contract market submit for Commission approval bylaws, rules, regulations, and resolutions which relate to the terms and conditions of futures contracts or other trading requirements.

The *Senate* amendment provides that the Commission is to approve or disapprove such bylaws, rules, regulations, and resolutions within 30 days unless the Commission determines that a longer period of time is necessary for such determination and so notifies the contract market. In addition, the *Senate* amendment (a) authorizes contract markets to adopt rules in an emergency without prior approval by the Commission, and (b) permits the Commission to exempt contract market operational and administrative rules from the requirement that they be submitted to the Commission for approval.

The *Conference* substitute retains the *Senate* provision with an amendment providing that the Commission shall specify the terms and conditions under which a contract market may, in an emergency, adopt a temporary rule dealing with trading requirements without prior Commission approval.

Under section 213 of the bill, the Commission retains its authority and flexibility to alter or supplement previously-approved exchange bylaws, rules, regulations, and resolutions.

(10) *Restraining orders, injunctions, and writs of mandamus.*

The *House* bill provides that whenever it shall appear to the Commission that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of the Act or any rule, regulation, or order thereunder, or is in a position to effectuate a squeeze or corner or otherwise restrain trading in any commodity for future delivery, the Commission is permitted to notify the Attorney General, and the Attorney General is permitted to bring a court action to enjoin such act or practice, or to enjoin the continued maintenance of such a position, or to enforce compliance with the Act, or any rule, regulation, or order thereunder.

The *Senate* amendment authorizes the Commission to go directly into court itself—without going through the Attorney General—to enjoin any contract market or other person from violating the Act or restraining trading in any commodity for future delivery. The *Senate* amendment retains the authority for the Commission to seek injunctions with respect to persons “about to engage” in violations of the Act, but deletes the authority to seek injunctions with respect to persons “in a position to” effectuate a squeeze or corner. Under both the *Senate* amendment and the *House* bill, no restraining order, injunction, or writ of mandamus will be issued ex parte.

The *Conference* substitute adopts the *Senate* provision with an amendment providing that, in lieu of bringing actions itself, the Commission may request the Attorney General to bring the action. Where the Commission elects to bring the action, it shall inform the Attorney General and advise him of subsequent developments.

(11) *Emergency powers.*

The *House* bill authorizes the Commission to direct any contract market, “whenever [the Commission] has reason to believe that the



amount of deliverable supplies, the number of open contracts, the relative size of individual traders' positions, the amount and direction of price movements in cash and futures markets, the impact of government edicts and regulations, the existence of a market emergency, or any other such market factor creates a condition which threatens orderly trading in, or liquidation of, any futures contract, to take such action as in the Commission's judgment is necessary to maintain or restore orderly trading in, or liquidation of, any futures contract." The *House* bill specifies examples of actions that the Commission may take.

Under the *Senate* amendment, the Commission will have authority to act only in "emergency" situations and direct a contract market to take such action as is necessary to maintain or restore orderly trading. The term "emergency" is defined as meaning—in addition to threatened or actual market manipulations and corners—any act of government affecting a commodity or any other major market disturbance which prevents the market from accurately reflecting the forces of supply and demand. In addition, the "emergency" itself must—in the Commission's judgment—have a greater adverse impact on the market than the action the Commission proposes to take.

The *Conference* substitute adopts the *Senate* provision with an amendment deleting the language that the "emergency" must, in the Commission's judgment, have a greater adverse impact on the market than the action the Commission proposes to take. At the outset of an emergency, it might not be practicable for the Commission to reach such a judgment.

However, the Conferees do not intend that the emergency powers section be used to prescribe a remedy more severe than the malady sought to be cured. The effective use of the emergency powers requires the careful exercise of expert and impartial judgment by the Commission.

Under the *Conference* substitute, the Commission may take, but is not limited to, all of the emergency actions specified in the *House* bill.

(12) *Disciplinary procedures.*

The *Senate* amendment (a) authorizes the Commission to discipline exchange members if the exchange fails to act and (b) permits a member who is disciplined by an exchange to appeal to the Commission. The provision does not require any person to submit to the appeal procedure of the Commission and it does not deny any person the right to seek relief in the courts. Nor does it limit the liability of any person in any suit by a State or Federal agency.

The *House* bill contains no comparable provision.

The *Conference* substitute adopts the *Senate* provision with an amendment under which review by the Commission of exchange disciplinary action would be discretionary and, if allowed, in accordance with such standards and procedures as the Commission deems appropriate. The *Conference* substitute deletes the *Senate* provision stating that nothing therein (a) requires any person to submit to the appeal procedure of the Commission, (b) prohibits any person from seeking relief in the courts, or (c) limits the liability of any person in any suit by a State or Federal agency. The appeal procedure, under the *Conference* substitute, is discretionary. While as a matter of primary ad-

ministrative jurisdiction, courts may defer to any review afforded by the Commission, the availability of such review procedure will not affect rights that are otherwise available to persons adversely affected by exchange action.

(13) *Leverage contract regulation.*

The *Senate* amendment requires the Commission to regulate leverage transactions for the delivery of silver bullion, gold bullion, or bulk silver coins or bulk gold coins. Under the *Senate* amendment, if the Commission determines at any time that such transactions are futures contracts within the meaning of the Act, they would be regulated accordingly.

The *House* bill contains no comparable provision.

The *Conference* substitute adopts the *Senate* provision. If the Commission determines that any leverage transaction is a contract for future delivery within the meaning of the Commodity Exchange Act, all of the requirements in the Act would be applicable to trading in such transaction.

(14) *Futures associations.*

Title III of the *House* bill provides enabling authority at the discretion of the Commission for persons registered under the Commodity Exchange Act and in the commodity trading business to establish voluntary associations for regulating the practices of the members.

The *Senate* amendment strikes title III of the *House* bill and requires the Commission to investigate the need for legislation providing for the registration of futures associations. The Commission is to report its findings to Congress within two years.

The *Conference* substitute adopts the *House* provision with an amendment providing that the Commission's annual reports to the Congress are to include information concerning the futures associations registered pursuant to title III and the effectiveness of such associations in regulating the practices of the members. Thus, Congress will be in a position to make a continuing review of the effectiveness of any futures associations registered by the Commission.

(15) *Insider trading.*

The *Senate* amendment makes technical changes in the *House* section on insider trading. In addition, it modifies the *House* prohibition against insider trading in *actual commodities*. The *Senate* amendment prohibits trading in actual commodities only if the insider is using "information acquired by virtue of his employment or position" to do such trading.

The *Senate* amendment would also make it a felony for any person to *acquire* information from an insider and *use* such information for futures trading, options trading, and trading in actual commodities.

The *House* bill does not impose any sanctions against persons *acquiring* information from insiders.

The *Conference* substitute deletes the *Senate* provision requiring that, for a crime to be committed under the new section 9(d), a Commissioner of the Commission or employee or agent thereof engaging in a transaction in an actual commodity must be proven to have used "information acquired by virtue of his employment or position". The

Conferees wished to make it clear that the deletion of this requirement should not be construed to mean that a Commissioner or other employee or agent of the Commission would be prohibited from engaging in *any* transaction in an actual commodity (e.g., the purchase of butter or other commodities for his own use). The *Conference* substitute, therefore, adds the word "investment" to define the type of actual transaction sought to be prohibited. This makes clear that the purchase of commodities for one's own use and consumption is not prohibited. In addition, the Conferees added language refining the "excepted transactions" language to permit "purchase" as well as sale of actual commodities and livestock in connection with farming and ranching operations of a Commissioner, employee or agent.

The *Conference* substitute retains the *Senate* provision making it a felony for any person to acquire and use insider information.

(16) *Options trading.*

The *House* bill continues the ban now contained in section 4c of the Act on trading in options (privileges, indemnities, bids, offers, puts, calls, advance guaranties, and decline guaranties) in the now-regulated commodities, 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. The Commission could promulgate such an order, rule, or regulation only after notice and opportunity for hearing. The Commission may set different terms and conditions for different markets.

The *Senate* amendment retains the *House* provision, but provides that the Commission is to prescribe the regulations governing such options trading within one year after the effective date of the bill.

The *Conference* substitute adopts the *Senate* provision with an amendment providing that the period for issuing regulations governing such options trading may be extended if the Commission determines, and notifies the Senate Committee on Agriculture and Forestry and the House Committee on Agriculture, that it will be unable to promulgate such regulations within the one-year period.

(17) *Arbitrage.*

The *House* bill authorizes the Commission, in fixing trading and position limits, to exempt "arbitrage" transactions, and defines the word "arbitrage" as meaning the same as a "spread" or "straddle".

The *Senate* amendment retains such exemption but limits the definition to arbitrage in domestic markets and authorizes the Commission to define "international arbitrage".

The *Conference* substitute adopts the *Senate* provision.

(18) *Hedging.*

The *House* bill deletes the definition of "bona fide hedging transactions or positions" now contained in the Act and allows the Commission to define that term "by order consistent with the purposes of this Act." However, until the Commission issues regulations defining what constitutes bona fide hedging transactions and positions under the Act and such regulations are in full force and effect, such terms will continue to be defined as set forth in the Act prior to its amendment by the bill.



The *Senate* amendment allows the Commission to define hedging, as would the *House* bill, but requires that the Commission allow the hedging of "contract" bushels of seed and extend anticipatory hedging privileges to persons such as bakers who use products (for example, flour) of traded commodities rather than the commodity itself. Under the *Senate* amendment, the new definitions must be issued by the Commission within 90 days after the effective date of the bill.

The *Conference* substitute adopts the *House* provision, with an amendment. The Conferees recognize that the language of the *House* bill accommodates the *Senate* provision requiring the Commission to allow hedging by users of products of traded commodities as well as hedging by seed companies of the contract bushel equivalent of anticipated seed production. The Conferees intend that such hedging be allowed by the Commission. Further, with respect to this change in existing law which allows bakers to be deemed legitimate hedgers for purpose of exceeding the speculative limits provided under the Act, the Conferees intend that the right of such hedging on products of traded commodities be extended to all persons similarly situated—i.e., to all legitimate businessmen seeking to offset an existing cash risk in a product of a traded commodity—unless otherwise provided by the Commission. Therefore, the Commission retains control over potential abuse, if any, of this provision through its general authority to refine the mandate intended by the Conferees by order consistent with the purposes of the Act.

Immediately upon the enactment of the bill, the Secretary of Agriculture is to issue regulations defining bona fide hedging transactions to allow hedging by the persons described above. Such regulations would, of course, only be applicable with respect to the now-regulated commodities. The new Commission would issue hedging definitions for the other commodities within 90 days after the effective date of the bill.

(19) *Separability.*

Both the *House* bill and the *Senate* amendment preserve the validity of the remainder of the bill if any portion is held invalid.

The *Senate* amendment strikes that part of the *House* bill which would preserve any section of the Commodity Exchange Act in its applicability to any person or circumstance if such section is amended by any provision of the bill which is held invalid.

The *Conference* substitute adopts the *Senate* provision.

(20) *Market reports.*

The *Senate* amendment authorizes the Commission to investigate markets for goods, articles, services, rights, and interests which are the subject of futures contracts, and publish regular market reports. The Commission would be required to cooperate with other Federal agencies to avoid unnecessary duplication of information-gathering activities. Other agencies would be required to furnish market information to the Commission, which would in turn be subject to any rules of confidentiality applying to the information. The Commission could not disclose the names of individual companies.

The *House* bill contains no comparable provision.



The *Conference* substitute adopts the *Senate* provision with an amendment providing that, except as provided in section 8 of the Act, the Commission shall not disclose in the market reports data and information which would separately disclose the business transactions of any person and trade secrets or names of customers.

(21) *Daily trading reports.*

The *Senate* amendment requires every clearinghouse to deliver a daily report to the Commission, specifying for each trade made on the exchange that day, the time, the subject, the number of contracts, the price, the delivery month, and the identification of the traders. The Commission would be authorized to require additional information in such reports, and to prescribe the form and manner of such reports. The Commission would be permitted to disclose such reports or information from them if it determines that disclosure furthers the regulation of futures trading. Exchanges would be required to publish daily reports of the volume of trading on each type of contract. The Commission would be authorized to require exchanges to include additional information in such daily reports.

The *House* bill contains no comparable provision.

The *Conference* substitute adopts the *Senate* provision with an amendment authorizing the Commission to determine the type of trading records and the type and frequency of trading reports to be required of clearinghouses and contract markets. In carrying out the *Conference* substitute, the Commission may obtain whatever information is needed for the effective enforcement of the Commodity Exchange Act, including—but not limited to—the items specified in the *Senate* amendment. If, for example, the Commission determines that it needs the time of each trade made on the exchanges and the identification of the traders involved in each trade, it can require that a record be kept of this information and that it be reported to the Commission by the clearinghouse and contract market. In lieu of the daily reporting requirement in the *Senate* amendment, if the Commission requires that reports be made, the frequency of such reports is to be determined by the Commission. However, reports shall be submitted on a daily basis if, in the Commission's judgment, this is necessary. Whatever records are required by the Commission shall be maintained by the clearinghouses and contract markets in order to avoid the necessity of the Commission going to the individual clearing members to obtain such information. Under the *Conference* substitute, the Commission's authority to make the reports available to the public would be governed by the provisions of section 8 of the Commodity Exchange Act.

(22) *Investor protection.*

The *Senate* amendment makes it unlawful for a futures commission merchant to accept a futures contract order from any person, or for a commodity trading advisor to advise any person to buy or sell a futures contract, without first obtaining a statement from such person that he understands the risks involved.

The *House* bill contains no comparable provision.

The *Conference* substitute deletes the *Senate* provision.



(23) *Research and information programs.*

The *Senate* amendment requires the Commission to establish and maintain research and information programs to investigate new technology and the feasibility of its use for improving, strengthening, facilitating or regulating futures trading; to assist in developing materials for educating producers, market users, and the general public about futures trading; and to carry out the general purposes of the Act. Annual reports of such programs would be required.

The *House* bill contains no comparable provision.

The *Conference* substitute adopts the *Senate* provision.

(24) *Forward contracting insurance program.*

The *Senate* amendment requires the Commission to encourage and assist private insurers to establish a pool to provide insurance to protect the parties to any forward contract from financial loss resulting from failure of the other party to comply with the terms of the contract for future delivery.

The *House* bill contains no comparable provision.

The *Conference* substitute deletes the *Senate* provision.

(25) *Commodity futures account insurance.*

The *Senate* amendment requires the Commission to 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.

The *House* bill contains no comparable provision.

The *Conference* substitute adopts the *Senate* provision.

(26) *Effective date.*

Both the *House* bill and the *Senate* amendment provide that the bill is effective 180 days after enactment. Activities necessary to implement the changes made by the bill may, however, be carried out after the date of enactment and before the effective date.

The *Senate* amendment provides, in addition to the items specified in the *House* bill, that activities to be carried out after the date of enactment and before the effective date shall include the necessary steps to regulate futures trading in silver immediately on the effective date of the bill.

The *Conference* substitute adopts new language relating to the effective date of the new Act for that contained in section 414 of the *House* bill and section 321 of the *Senate* amendment. This language is intended to clarify the interim authority between the date of enactment and 180 days after enactment, the date on which the new law will become fully operational.

In order that it may be prepared to begin full operation on the effective date of the Act, the Commission may, prior to the effective date, make such studies, conduct such hearings, and require such reports as are authorized to carry out the purposes of the Act and may issue and publish in the Federal Register such proposed regulations and notices as it deems appropriate. The fact that the detailed activities specified in this provision remain permissive as provided in the *House* bill is not intended to deter their implementation. The Conferees fully expect that implementing activities under this Act shall begin as



soon as practicable in order that the Commission is fully operational at the end of 180 days.

In addition, the Conferees intend that the new Commission take the necessary steps to regulate effectively futures trading in all commodities, including silver, immediately on the effective date of the Act. The Conferees believe that current conditions on the silver futures market particularly require the most effective and informed regulation as soon as feasible but are persuaded that the earliest feasible time is the effective date.

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ROBERT PRICE,
CHARLES THONE,

Managers on the Part of the House.

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