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Leida Slater

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NOTES AND COMMENTS

THE COMMODITIES GAME HAS A NEW REFEREE*

Since at least 1200 B.C. commodities markets in some form have existed. These early markets were cash or "spot" markets where producers brought their goods to sell to purchasers and the negotiations for and the sale and transfer of the goods took place "on the spot". The commodities markets which we know today bear little resemblance to this early version but have come to be seen as a "forum for investors", with commodities futures contracts and commodities option contracts as investment devices.

This widespread use of commodities futures and option contracts has been a relatively recent development and, not surprisingly, the vast growth has resulted in abuse, fraud, mismanagement and ignorance of the risks involved in the business. Efforts have been made by both federal and state agencies, legislatures, and courts as well as by the commodities exchanges to

* The assistance provided by George J. Sotos of the law firm of Moses, Gibbons, Abramson and Fox of Chicago, Illinois in the development of this article is acknowledged with gratitude.
2. The exception to this is what is known as a farmer's market in this country, where farmers actually bring their produce to a central market location for sale on the spot to consumers. See generally L. BELVEAL, COMMODITY SPECULATION WITH PROFITS IN MIND 13 (1967) [hereinafter cited as BELVEAL].
3. The congressional reports relating to the CFTCA use the term "investor" when discussing hedgers and speculators who trade on the commodity exchange. It is not an accurate term to use in this context. The term investment has developed an accepted meaning in the business world. In its simplest terms it contemplates an investor who lends his money to others for their use. He anticipates a return of the principle loaned and a profit earned as a result of their efforts. Such transactions occur most often in corporate stocks, bonds and securities. In commodities transactions any profit earned is a direct result of the fundamental principles of supply and demand which determine the basic market value of the commodity underlying the contract which the commodity trader buys or sells. Interview with George J. Sotos of the firm of Moses, Gibbons, Abramson and Fox, Chicago, Illinois, Nov. 12, 1975.
4. "Futures contracts" or "futures" are contracts for the purchase and sale of commodities for delivery at a time in the future on an organized exchange and subject to the terms and conditions of the particular exchange.
prevent such abuses. For many reasons these efforts have not been entirely successful.

After intensive hearings, debates, discussion and compromise, a new and comprehensive effort to attack these past abuses and to prevent new ones has been launched in the form of the Commodity Futures Trading Commission Act of 1974. The Act promises to have a massive impact on the commodities industry, the heart of which is at the Chicago Board of Trade. It is clear that the Act vests regulation of futures trading, futures markets, commodity futures accounts and agreements (including options) and leverage contracts for gold and silver bullion and coins in the newly created Commodity Futures Trading Commission, thereby vastly expanding the scope of regulation which previously existed under the Commodity Exchange Act. Certain aspects of the Commodity Futures Trading Commission Act give rise to new concerns. There may be some jurisdictional conflict between the Commodity Futures Trading Commission and the Securities and Exchange Commission. The provisions in the Act for new remedies which are to be available to injured commodities traders pose a potentially confusing forum problem for litigants. The failure of the Act to provide a specific private damages action in the federal courts for violations of its provisions compounds both of these problems.

This article will outline the history of the development of the commodities markets, the attempts to regulate the transactions which occur on the markets and the functions of the market in the business world. The new Act will be reviewed and the problems which it presents will be discussed. Finally, the state of commodities law in the Seventh Circuit will be analyzed and the probable impact on that law of the Commodity Futures Trading Commission Act will be considered.

THE FUNCTIONS AND FUNCTIONING OF THE COMMODITY MARKETS

Trading in the commodities markets has become an important part of the economy of this country. The futures markets now perform essential

7. See discussion following note 32 infra.
9. Commodity Regulation, supra note 6, at 27. Johnson states therein:
   By one popular measure, the dollar value of the items traded, it is a half-trillion-dollar business. By the same standard, the largest exchange in the
   world is not on Wall Street, but in Chicago, where the Board of Trade, according
   to its 1973 annual report, consummated in that year transactions with an
   estimated worth of approximately $270 billion.
11. Under the Commodity Exchange Act before 1974 many commodities were
totally unregulated and option contracts were not within the scope of the Act.
12. Active commodity exchanges operate in Chicago (Chicago Board of Trade,
Chicago Mercantile Exchange, MidAmerica Commodity Exchange); Kansas City (The
Board of Trade of Kansas City); Minneapolis (Minneapolis Grain Exchange); New
functions for agricultural producers, manufacturers, exporters, consumers, users of the products of agricultural commodities, participants in the investment community and others. This vital role will no doubt continue to expand. As noted above, commodities markets began as a place to sell the agricultural products produced by the farmer to consumers. As industrialization swept the nation, farmers were required to increase their rate of production to meet the needs of city dwellers. This meant that the individual farmer took to market vastly larger quantities of produce. If the farmer over-estimated demand for his goods or arrived at the market after the demand had been met, he could be left with a surplus of produce or be forced to sell at a lower price than he had expected. The farmer took all the risks.

To minimize these risks the producers of commodities developed the concept of offering to sell contracts to deliver a specified quantity of a commodity at a designated place within a specified period of time at a price agreed upon in advance. Such contracts were the forerunners of futures, the economic function of which now is "to provide price protection to persons dealing in the actual commodity or related products." This innovation put the risk of price fluctuations on the buyer of such a contract, usually a businessman, such as a grain elevator operator, who stocked large quantities of a particular commodity for business operations. These buyers and other traders who wished to protect themselves developed a way to minimize their risks—a devaluation of their inventory or sharp increase in the price of a raw material—by a process known as "hedging". In essence, hedging is a process in which the businessman uses the sale or purchase—or both the sale and purchase—of commodities futures to set a given price at which he can sell his commodity or buy a raw material at a future date. This allows him to predict more accurately what future costs will be and to operate his business more efficiently.


14. It is estimated that by 1974, the volume of commodities futures trading had exceeded the $500 billion mark, a value which exceeds that of securities trading on all the stock exchanges in the nation. See S. REP. No. 92-1131, 93d Cong., 2d Sess. 18-19 (1974).
15. See discussion following note 1 supra.
16. KROLL & SHISKO, supra note 1, at 4.
17. Id, at 6-8.
18. Commodity Regulation, supra note 6, at 29.
19. An example of a hedging transaction is described in Commodity Regulation, supra note 6, at 30. A manufacturer needs certain raw material for production in June but does not want to buy it now. But the cost of the material now is relatively low and if he waits until the production date to buy he will face a possible increase in the price of the material. If he acquires a "long" futures contract to accept delivery of the material...
The speculator, as opposed to the hedger, has no real interest in the underlying commodity which is being traded on the commodities market. He puts his capital in the commodities market in anticipation of reaping a profit on the basis of his knowledge of when prices will rise and fall. In essence, the speculator voluntarily takes on the risk which the hedger is seeking to avoid.\textsuperscript{20}

The most common method of trading is to "assume a direct position in a futures contract."\textsuperscript{21} In this type of transaction a trader believes that the price of a particular commodity will rise, for example, in the next six months. He places an order through his broker to buy a specified quantity of the commodity at the current market price for delivery six months hence. If a seller, who believes the price for that commodity will drop during the same period, can be found, the transaction will take place. The buyer has promised to buy a specified quantity of the commodity at a given price and the seller has agreed to deliver that quantity at that price at the time stated. The buyer is now said to be "long" and the seller "short" the commodity. If, in six months, the price has risen, the buyer will have his commodity at the lower price and can realize a profit by selling at the current market price\textsuperscript{22} and the seller will have locked in his profit or minimized his anticipated loss.

Fewer than one percent of commodities futures contracts are settled, however, by actual physical delivery of the commodity underlying the contract.\textsuperscript{23} To meet his obligation to accept delivery\textsuperscript{24} the trader may make a trade which offsets the original trade.\textsuperscript{25} If the trader who takes a
long position (the buyer of the contract who will accept the goods) in July corn wishes to offset the position he then assumes a short position (sells a futures contract) in July corn at a different price, thereby ending his contractual obligations by entering into an identical but opposite transaction. Since payment is not due in a futures trade until delivery is made, there is a risk that the parties to the contract will not perform. Thus, both parties are required to provide a margin, which is in the nature of a performance bond. The parties may be called upon to provide additional margin as the market price of the commodity involved fluctuates.

The requirement of margin is the reason for the development of another method of risk-shifting, the commodity option contract. The necessity for putting up margin means that the trader must be ready to produce more capital or sell out his futures in the event of price fluctuations. Many traders were not willing to take this risk. A person who trades in commodity options pays a nonreturnable premium to an underwriter (one who issues commodity options). In turn that person gets the option to buy or sell the specific futures contract at a stipulated price for a given time period. He can either exercise his option within the time given or let the option lapse. Since there is no commitment on the part of the trader in an option contract to buy or sell, no margin is required. Thus, there is no risk of margin calls and the resulting increased demand for capital. If the market does not move as predicted, the option trader need not exercise his option and has limited his loss to the amount of the premium paid for the option.

26. For instance, if a buyer ("long") acquires a futures contract at $2 per bushel and thereafter the worth of that contract increases to $2.50, he will have a gain of about 50 cents per bushel. When he 'offsets' by selling a new contract at $2.50, it is as if he had taken delivery at the original contract price of $2 and re-sold at the current value of $2.50. *Id.* at 29.

27. *Id.* at 32. The description of margin as a performance bond is somewhat simplistic. Margin originated as a performance bond when the concept of futures contracts first developed. Now, margin is intimately connected with the relationship between the clearinghouses and their members. [For a brief discussion of the functions of clearinghouses, see S. REP. No. 93-1131, 93d Cong., 2d Sess. 16-17 (1974).] All members of a clearinghouse are required to deposit "maintenance" to provide a cushion against price fluctuations, to work as a performance bond and to secure the member firm's transactions. The firm in turn requires that its customers provide a similar cushion which is called a margin. *Commodity Regulation*, supra note 6, at 32.

28. *Federal Legislation: A Proposal*, supra note 5, at 1425. However, it should be pointed out that margin need not always be provided in the form of cash. If there is open equity in a customer's account, e.g. profits in contracts held in the account, additional margin may not be required.

29. A margin call comes about automatically because of a deteriorated equity situation in the customer's account. When the equity in his account falls below the margin required by the broker, the customer is "called" to provide the additional capital or other equity necessary to meet these requirements. *Id.*

30. The price of the premium is determined by the price of the underlying commodity, the historical price volatility of the commodity and the length of the option term, among other factors. *See KROLL & SHISKO*, supra note 1, at 259.

31. *Id.* at 258.
The commodity exchanges now provide a regulated forum upon which commodities transactions such as those described above can take place. Their development has kept pace with the needs of commodities futures traders and consumers, so that they now represent a major economic force in our nation. The growth from the days of the spot markets to the modern exchange occurred relatively rapidly and relatively recently. The suddenness of the growth and the very size of the current operation has of course led to certain types of problems.

The History of Regulation of the Commodities Markets

The need for regulation of commodity trading markets and the development of regulation schemes was initially determined and then influenced by the way the trading industry grew and by the techniques utilized to effect the trades on individual exchanges. Regulation began as a way to protect the farm interests—specifically, futures contracts in grains. The Grain Futures Act of 1922 resulted from the belief that the farmers who produced the grain were not realizing the profits to which they were entitled because the speculators in grain futures were reaping large profits at the expense of the farmers. The 1922 Act required the licensing of grain markets and made trading through anyone not a member of a licensed market an unlawful act. Regulations defining the requirements for becoming a licensed market were provided and rules were developed to prevent certain abuses. The Act was to be administered by the Secretary of Agriculture.

As a response to the economic upheavals that the country experienced between 1922 and 1933, Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934. These measures provided protection for investors who, as a group, had suffered remarkably during those years. Some of this sentiment for the investor carried over to 1936 when Congress considered amendments to the Grain Futures Act.

The result of these considerations, the Commodity Exchange Act, marked the beginning of the recognition that commodities trading was

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32. See discussion following note 1 supra.
34. A similar comment relating to the current situation of consumers was voiced recently by Senator George McGovern when he introduced S. 2578, 93d Cong., 1st Sess. (1973):
   The people's interests in commodity trading transcends the orderly functioning of those markets and the prevention of outright fraud. For every time a speculator turns an unreasonable profit by trading futures, the housewife and the customer pay the price. And since it is the speculator, not the producer who received the windfall profit, the higher wholesale and retail prices do not act as a stimulant to production.
developing into an integral part of the investments business. The relationship between broker and customer was regulated under the Act so that customer funds would be segregated from those of the broker and held in trust for the customer. New licensing requirements were enacted and the definition of a contract market which could be licensed was liberalized. Although the Act clearly recognized a changing role in commodities trading, it made no attempt to regulate anything but agricultural products and was still administered by the Secretary of Agriculture. A Commodity Exchange Commission was created to oversee the regulation and had the power to set limits on trading for "speculators" but not for farm or food interests engaged in hedging.

Numerous amendments were enacted between 1936 and 1968, but it was not until 1968 that major changes were made in the Commodity Exchange Act. In the 1968 provisions, the customer was further protected and it became possible for new market participants to be licensed. In addition, the anti-fraud provision which had been enacted in the 1936 Act was expanded, provision was made for setting minimum financial requirements for the various markets, and the regulatory ability of the Commission was strengthened. New commodities were also added to those regulated by the Commodity Exchange Commission. Clearly, even in 1968, the focus of the federal legislation was agricultural and although it provided some protection for both producers and investors, there were entire phases of the commodities futures industry which remained untouched by any federal regulatory standards.

For this reason state regulatory agencies, legislatures and the judiciary attempted to step into the gap to prevent some of the abuses which were

42. Perimeters, supra note 38, at 5.
45. Perimeters, supra note 38, at 6.
46. Thus, by 1968, regulated commodities included wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain, sorghums, mill feeds, butter, eggs, Irish potatoes, wool, wool tops, fats and oils, cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products and frozen concentrated orange juice. See 7 U.S.C. § 2 (1970). But, it should be noted that trading was occurring in commodities which were not regulated under the Act. These included, cocoa, coffee, copper, foreign currency, iced broilers, lumber, mercury, platinum, plywood, propane gas, silver, sugar and silver coins. S. Rep. No. 93-1131, 93d Cong., 2d Sess. 94 (1974).
47. As pointed out in note 46 supra, in 1968 only certain designated commodities were directly regulated under the Commodities Exchange Act. Although 7 U.S.C. § 6c of the Act prohibited options trading, that prohibition was only applicable to regulated commodities. In addition, commodity option underwriters were not regulated under the Act, because their function was, of course, prohibited.
developing. The efforts of these agencies has been intensified since 1971 when the trading of “naked” commodity options began to develop as a meaningful segment of the commodities industry. The main thrust of the attempts made by such agencies to exert some control over the otherwise unregulated aspects of commodities trading was to define the commodity option as a security. If that could be done, the unregulated trading could then be brought within the purview of state securities laws (Blue Sky Laws). Relying in most cases on the “risk capital” test of determining whether a transaction comes within the regulatory purpose of the securities laws, many state courts did find that the commodity options were securities under their Blue Sky laws. Some states have approached the same problem through administrative and legislative channels with similar results.

The year 1967 marked the first break in the sharp distinction made by federal courts between securities and commodities. In Maheu v. Reynolds & Co., a New York federal district court found that a discretionary account in commodities opened by the plaintiffs with the defendant was an “investment contract” and therefore within the definition of a security under federal law. Other cases followed the reasoning of Maheu and came to the same

48. “Naked” commodity options are options which are not backed by a physical stock of the underlying commodity or by a contract to buy such a stock.

49. See Federal Legislation: A Proposal, supra note 5, at 1426. This article summarizes the experience of Goldstein-Samelson, Inc., a corporation formed to sell commodity options on a large scale. The firm was formed in 1971 and did a $1,000,000 business in option sales that year. By the end of 1972 the gross income of the firm had reached $45,000,000. The success of the firm prompted others to enter the business and by 1973 the sales of commodity options in California had reached $200-300 million per year. The success was short-lived, however, as Goldstein-Samelson was put into involuntary receivership in 1973 and trading of commodity options was stopped in California. Other states soon followed suit. Id. at 1426-29.

50. The “risk capital” test is a modification of the Howey test and was designed to broaden the scope of the definition of an investment contract. The emphasis in the test is that even though the investor looks like a participant in the business venture involved, it is clear that he is actually providing the initial risk capital being used in the offeror’s business. See Silver Hills Country Club v. Sobieski, 55 Cal. 2d 811, 361 P.2d 906 (1961).

For a discussion of the various tests used and one analysis which urges a combination of the risk capital test and the Howey test, see Coffey, The Economic Realities of a ‘Security’: Is There a More Meaningful Formula?, 18 W. Res. L. Rev. 367 (1967).

51. It has been suggested that the argument that commodity options are securities can be logically justified in the case of naked commodity options but that the argument won’t hold up in the case of options backed by a contract for the purchase of the commodity. See Federal Legislation: A Proposal, supra note 5, at 1434-35.


53. See Abuses in the Commodity Markets, supra note 20, at 793, 798-99; and Federal Legislation: A Proposal, supra note 5, at 1431.


However, in the only court of appeals case to consider the question, *Milnarik v. M-S Commodities, Inc.*, a Seventh Circuit decision, the arguments of the *Maheu* court were rejected. The plaintiff in *Milnarik* opened a discretionary account with the defendant for trading in commodities futures and argued that the rule of *Maheu* and subsequent cases in that line should be followed. In response, the court stated:

"Nevertheless, we do not believe every conceivable arrangement that would fit a dictionary definition of an investment contract was intended to be included within the statutory definition of a security. . . . Judicial analyses of the question whether particular investment contracts are 'securities' within the statutory definition have repeatedly stressed the significance of finding a common enterprise." The *Milnarik* court went on to find that the essential element of commonality was not present in this situation and that the action could not be governed by the securities acts.

In a different approach to the problem, the court in *Goodman v. H. Hentz & Co.* held that a violation of the Commodity Exchange Act could be a tort “for which plaintiffs, as members of the class Congress sought to protect from the type of harm they allege here, have a federal civil remedy even in the absence of specific mention of a civil remedy in the Commodity Exchange Act.” The plaintiffs alleged that they were defrauded by defendants while investing in commodities regulated under the Commodity Exchange Act, in violation of Section 6b of the Act, which makes it unlawful for an employee of a commodity market to defraud a customer.

The Eighth Circuit in *Booth v. Peavey Co. Commodity Services* also held that a civil remedy existed under the anti-fraud provision of the Commodity Exchange Act or under the securities laws. The charge by plaintiff in this case was that the broker-dealer was churning his commodity account. The opinion is not a strong one because a directed verdict for

57. 457 F.2d 274 (7th Cir. 1972).
58. Id. at 275.
59. Id. at 276.
60. 265 F. Supp. 440 (N.D. Ill. 1967).
61. Id. at 447.
63. 430 F.2d 132 (8th Cir. 1970).
65. In general 'churning' signifies in the securities business the practice by a broker of advancing his own interest (his commissions based on trading volume) without regard to his customer's objective by a course of trading which is excessive in light of the size and character of the customer's account.
the defendant was affirmed and the analysis of the basis of the cause of action was not stringent.

In *Deaktor v. Schreiber & Co.*, the Seventh Circuit Court of Appeals, approved the result in both *Goodman* and *Booth*, finding that although no express provision is contained in the Commodities Exchange Act for private damage actions they should be maintainable. The court further noted that their conclusion appeared to be uniformly accepted.

By 1973 the Securities and Exchange Commission had stepped out of the shadows and had begun to take a more active role in attempting to police certain aspects of the commodities industry. Typical of this action, perhaps, are cases where investigations were undertaken by the SEC of firms which were not registered with the SEC and engaged solely in commodities trading. In such cases the courts held that the Commission was not required to establish its jurisdiction by showing that the companies were engaging in commodities transactions which met the definition of a security under the Securities Acts. During this same period of time the SEC began to issue releases which indicated that certain types of arrangements, not previously regulated by the Securities Acts, were considered investment contracts. Some courts found such indications of expanding SEC jurisdiction persuasive in the argument that certain types of contractual arrangements in the commodities field were investment contracts. It was clear, however, that these actions by the SEC and other attempts to regulate commodities through access to securities laws was not a satisfactory answer to the problem of abuses in the industry.

Another attempted method of control of the abuses in the commodities markets is the most enduring one—self-regulation by the exchanges them-
selves. Since the organized exchanges began operating they have adopted and enforced a "code of business ethics" and the private law which governs the conduct of exchange members is a major part of the operation of any exchange. These attempts at self-regulation reflect a recognition on the part of the futures industry that public confidence is a vital element in their success. Such regulation has not been totally effective, as is evidenced by the abuses which have developed in the markets. In addition, as courts have been increasingly prone to permit the possibility of private rights of action based on such rules, exchanges have grown increasingly wary of expanding regulatory efforts.

This historical background illuminates the reason that the federal government embarked on the arduous process of enacting a comprehensive regulatory act for the commodities industry. The mechanics of trading in the commodity markets worked relatively well. As long as the markets were frequented by sophisticated businessmen who were trading commodities as a way of operating a more efficient business, the self-regulation by the individual exchanges and the minimal supervision by the Department of Agriculture were adequate measures of control. It was not until trading in commodities futures became viewed as a substitute for trading on the stock market that the industry began to experience serious difficulties in regulating abuses. By the early 1970's it had become imperative that every phase of the commodities futures trading industry be subjected to rigorous review and more efficient and stringent regulation. The legislators who undertook the task recognized the sources of the problem and proposed a comprehensive solution.

74. Commodity Regulation, supra note 6, at 33.
75. Id.
76. See discussion following note 169 infra.
77. Commodity Regulation, supra note 6, at 33-34.
78. The Senate Committee which considered the proposals for regulation of the commodities industry, summarized the need as follows:

The shift to market oriented economy has brought the general public into the futures markets in growing numbers. Speculators are attracted to the futures markets by the wide price swings and the possibility of large profits. Such an increase in trading by the speculative public, while useful to hedgers, brings with it potential market problems. If individual speculators or groups operating in concert obtain control of the futures markets, price manipulations, corners and squeezes can occur, with adverse effects on producers and consumers alike.

In recent years, the consumer has become increasingly aware that futures markets have a direct effect on such matters as his grocery bill and the cost of his home. Properly operating futures markets help to hold down consumer prices by reducing middleman costs. However, improperly operating futures markets can have the opposite result. In order to assure that the futures markets operate properly and that the prices consumers pay are not artificially high, careful and efficient supervision of the market is essential.

It is apparent that a regulatory agency cannot be expected to oversee the rapidly expanding and complex futures markets without additional tools with which to do the job and proper organization and funding. In addition to providing the tools that the regulatory body would need in preventing violations and disciplining violators directly, its role in supervising exchanges must be
THE COMMODITIES FUTURES TRADING COMMISSION ACT OF 1974

The Commodities Futures Trading Commission Act of 197479 amends and makes additions to the Commodity Exchange Act. The changes introduced by the Act are expansive. The scope of regulation encompasses every aspect of the industry, from the definition of a commodity to the provision for the formation of a national commodities futures trading association. Of particular interest to anyone involved in the commodities industry are both the establishment of an independent commission with comprehensive regulatory powers and the emphasis on protecting the commodities customer.

The Provisions of the CFTCA

A five member Commodities Futures Trading Commission, similar in status to the Securities and Exchange Commission, was established in title I of the Act.80 All authority which previously was vested in the Secretary of Agriculture and the Commodity Exchange Commission will now reside in the CFTC, which has additional powers. In title II the Commission is given wide latitude in its authority to regulate futures trading and exchange activities. A major addition to the Commodity Exchange Act and the scope of the Commission’s power is the new definition of commodities, which adds a catch-all phrase to the listed regulated commodities: “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 with.”81

There are several aspects of the Act which emphasize the power of the Commission in various phases of its regulatory capacity. These include: (1) the authority of the Commission to review by-laws, rules, regulations and resolutions of contract markets;82 (2) the power to assess a civil penalty against a contract market or certain individuals for failure to enforce its rules of government or for other violations of the Act;83 (3) the power to bring an action for an injunction to enjoin acts prohibited by the law or to enforce compliance with the law;84 (4) the power to review exchange decisions substantially expanded. Unquestionably, exchanges are going to have to perform their regulatory role better in order to provide a viable market in which the public can have confidence. The federal regulatory agency must be given the authority to require that exchanges do so.

81. This addition was made in response to new proposed futures trading in plywood, shipping space and mortgages as well as other commodities which may be proposed for trading on contract markets. See Commodity Regulation, supra note 6, at 37.
regarding disciplinary action or denial of access to an exchange; \(^8\) (5) the provision in the Act for a reparations procedure; \(^8\) (6) the authorization by Congress for the Commission to conduct investigations of various aspects of the industry \(^8\) and to initiate research into more efficient and more modern trading techniques; \(^8\) and (7) the authority of the Commission to permit, deny or suspend registration to an association as a registered futures association under the Act. \(^8\)

Title IV contains the so-called housekeeping provisions of the Act, providing for penalties and criminal prosecution in the event that a Commissioner or employee of the Commission participates in transactions in commodities futures or options or gives out information on such transactions. \(^8\) This title provides that the ban on options trading in the previously regulated commodities will continue, but options trading in newly regulated commodities will be permitted unless banned by the Commission. \(^9\) The Commission is also authorized to conduct research and studies and to make reports to Congress on the state of the industry. \(^9\) Title III provides for the possibility of the formation of “national futures associations”, \(^9\) which could, perhaps, function in ways similar to the manner in which the National Association of Securities Dealers operates.

The measures described above, in addition to other provisions of the Act, are designed to protect each phase of the futures trading process—the mechanics of the industry. There was much emphasis in the committee hearings and reports on protection of members of the general public who have begun to invest in the commodities markets in large numbers in anticipation of large profits. \(^9\) Therefore, while all of the Act’s provisions will help protect the brokerage house customer directly or indirectly, new provisions for their protection are available under the CFTCA. Noteworthy among these are the provisions for ongoing research and informational

94. The popularity of commodity investments is due in large part to the lure of large profits with relatively little initial capital outlay. In a commodities futures transaction, by putting $5,000 into futures contracts with a commodities broker the customer can control, for example, $50,000 worth of futures. A similar amount of money put in a margin account with a stockbroker controls only about $10,000 worth of stock. See Federal Legislation: A Proposal, supra note 5, at 1428. What many of these investors appear not to recognize is that the system also works in reverse. The degree of leverage is the same whether the price of the commodity goes up or down. One can earn much more than he puts in but can likewise lose a lot more than he put in and even more than he has.
programs to modernize the industry and educate and inform the public,\textsuperscript{95} the reparations procedure,\textsuperscript{96} and the requirement that contract markets are to provide an "equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances."\textsuperscript{97}

While the provision for the development of materials for the education of producers, market users and the general public is a relatively minor provision of the Act, it is to be hoped that vigorous use will be made of it by the Commission. There is much confusion and misconception about the commodities business\textsuperscript{98} which has resulted in uninformed speculation by many people. Their ignorance, especially when combined with the less than scrupulous business practices of some firms, has often resulted in unnecessarily large financial loss.\textsuperscript{99} A concerted effort on the part of the Commission and of the established commodity firms to educate the public (and the employees of the firms) as to the risks involved, the mechanics of the market, and their responsibilities therein will certainly have an impact in reducing the number of people who suffer substantial losses in the trading of commodity futures.

The requirement that contract markets provide arbitration procedures for settlement of customer claims is certainly not a new concept,\textsuperscript{100} but perhaps the requirement of its availability will refine the procedures currently in use and make the procedure more effective. The Act makes the use of such a procedure voluntary by the customer and limits its applicability to claims under $15,000. An effective internal procedure of this sort would help resolve the majority of customer claims against brokers.

While the arbitration procedure is limited in its availability to customers, there is no such limitation in the reparations procedure added by section 106 of the Act.\textsuperscript{101} The procedure is initiated by the filing of a petition within two years after a cause of action accrues by any person who complains of a violation of any provision of the Act or rules, regulations or orders promulgated thereunder.\textsuperscript{102} The Commission will forward the claim

\textsuperscript{98} Commodity Regulation, supra note 6, at 27.
\textsuperscript{99} See Federal Legislation: A Proposal, supra note 5, at 1426-29 for a discussion of one such example, the experience with Goldstein-Samuelson, Inc.
\textsuperscript{100} Such procedures are now available on securities exchanges and on some of the commodities exchanges.
to the respondent for a response if such action is deemed appropriate. Where the amount contested is in excess of $2,500 and the Commission believes reasonable grounds exist therefor, an investigation may be conducted and a hearing held before an Administrative Law Judge. After such a hearing (or on the basis of sworn statements if no hearing is held), if the Commission determines that the respondent has violated any of the Act's provisions or the rules, regulations and orders issued pursuant thereto, the Commission shall determine the damage the complainant is entitled to and order payment of that sum by the respondent. The Commission's order may be enforced in the event of non-payment by the filing within two years of a certified copy of the order in a federal district court. All orders of the Commission are appealable to the United States Court of Appeals. Provisions are also made for penalties against a non-complying registrant in the form of prohibition of trading and a suspension of registration.

Problems Raised by the CFTCA

Manifestly, the CFTCA provides extensive particularized regulation of the mechanics of the trading process on commodities exchanges. Many of the weaknesses in the old regulatory system have been corrected. There are, as there must be with any legislation, aspects of regulatory procedure yet to be worked out with time and experience. For litigants in the commodity field, two areas of concern remain somewhat indeterminate. First, there may be some circumstances in which the jurisdiction of the CFTC conflicts or is confused with that of the SEC. The second problem area is one which will confront the customer who has been defrauded in the commodity market or alleges other violations of the regulatory laws—where he should bring his action.

The jurisdictional question was a troublesome one, which was not ultimately resolved until the final version of the bill was hammered out in

103. Id.
104. If the amount is less than $2500, the hearing procedure may be dispensed with and a determination made on the basis of depositions or verified fact statements.
107. 7 U.S.C.A. § 18(e) (Supp. I Feb. 1975). A similar order may be entered by the Commission where the respondent admits to a portion of the liability claimed against him. The order may be entered as to the undisputed amount.
111. Perimeters, supra note 38.
the conference committee. The difficulty with this issue should not be incomprehensible, given the history of the regulatory struggle. A consciousness of this history is reflected in the legislative history of the jurisdiction provision, with which it is important to be acquainted.

The House bill had provided for exclusive jurisdiction of the Commission over all futures transactions but also provided that such jurisdiction would not supersede or limit the jurisdiction of the SEC or other regulatory authorities. It has been pointed out that there were at least three major problem areas with the House provision. First, the jurisdiction already developed by the SEC was to be left intact. Second, the House bill did not specifically address the problem of jurisdiction of the Commission to regulate accounts or agreements between customer and broker, option contracts or aspects of the futures business other than market transactions themselves. Finally, no mention was made of the relationship between the Commission and state regulatory agencies.

The Senate amendments to the House bill attempted to clear up these omissions. Section 201 of the bill as proposed by the Senate provided that the Commission's jurisdiction was to be exclusive as to all futures transactions on designated contract markets. Where such jurisdiction existed it was to supersede the jurisdiction of all other agencies, both state and federal. The Senate amendment added that no provision of the Act should be interpreted as superseding or limiting jurisdiction of state and federal courts.

113. See discussion following note 32 supra.
114. Joint Explanatory Statement of the Committee of Conference, CONG. REP. No. 93-1383, 93d Cong., 2d Sess., (1974) 1974 U.S. CODE CONG. & AD. NEWS 5894, 5897. This characteristic of the House bill appears consistent with the original House proposal for a five person regulatory Commission made up of four public members plus the Secretary of Agriculture. The Commission's public members would have served on a part time basis and the ties of the Commission to the Department of Agriculture would have remained strong.
116. Id. at 10-11.
117. Id. at 11.

While the Committee did wish the jurisdiction of the Commodity Futures Trading Commission to be exclusive with regard to the trading of futures on organized markets, it did not wish to infringe on the jurisdiction of the Securities and Exchange Commission or other government agencies. Therefore, the Committee adopted clarifying amendments to the House bill. The Committee wished to make clear that where the jurisdiction of the Commodity Futures Trading Commission is applicable, it supersedes State as well as Federal agencies.
119. Id. This addition is interesting in light of the confusion existing in both state and federal courts as to where their jurisdiction begins and ends.
The Senate proposals regarding jurisdiction were adopted by the conference committee, except in one particular. The conference version rejected the Senate's proposal vesting the Commission with exclusive jurisdiction only over futures transactions on a designated contract market by a member of the market. Instead, it adopted the broader House version which vested the CFTC with exclusive jurisdiction over all futures activities, even on unlicensed markets.

The result of the legislation is that a clear policy was expressed by Congress that in light of the spate of legislation, regulation and court decisions which have proliferated in recent years, it was time to consolidate the regulation of commodities futures transactions in one agency with pervasive authority. Thus, the Commission, under the authority of the CFTCA and the regulations it will promulgate, will regulate every conceivable sort of commodities transaction. It is expressly prohibited from acting only in direct transactions involving financial instruments which are routinely traded among sophisticated financial institutions.

The regulatory jurisdiction of the CFTC over commodities transactions has been established. There can be no doubt concerning the breadth of its jurisdiction in most areas of the commodities industry. The conflict or confusion which may arise between the CFTC and the SEC will be with respect to those dimensions of the commodities industry which have been blurred or absorbed into the securities field. The struggle to create a cause of action for defrauded commodities traders has, as discussed previously, led certain courts to define some kinds of transactions in commodities as investment contracts. But a careful reading of the legislative history of the Act should clarify any doubt that such a construction is no longer justified. The possibility of conflict between the SEC and the CFTC was not overlooked in the development of the legislation as is evidenced by the following statement:

> It is not intended that the jurisdiction of the Securities and Exchange Commission with respect to investment contracts be superseded, except to the extent that jurisdiction is granted to the CFTC with respect to contracts for future delivery or options relating . . . to tangible commodities, or which are effected on a contract market . . .

If such jurisdiction is granted to the CFTC, then the rationale which has brought earlier cases under the securities laws will no longer be necessary or applicable. Courts which heed this intent and the additional comment that

121. Id. See also Perimeters, supra note 38, at 14.
122. Perimeters, supra note 38, at 15.
124. 120 CONG. REC. H10248 (daily ed. Oct. 9, 1974).
where the CFTC's jurisdiction is applicable it is to supersede both state and federal agencies\textsuperscript{125} must come to the conclusion that the securities laws are no longer a necessary crutch for the maintenance of an action based on commodities futures trades which take place on a contract market.

The second area of difficulty is not so easily resolved. The dilemma facing an aggrieved customer in the commodities market was not clarified by the failure of the Act to specifically deal with the availability of a private damage action in the federal courts. With the enactment of the CFTCA such a person has several possible avenues for a remedy. A disconcerted customer may conceivably pursue his complaint through grievance procedures provided by a contract market,\textsuperscript{126} or a registered futures association,\textsuperscript{127} the reparations procedure administered by the Commission,\textsuperscript{128} and presumably all judicial remedies previously existing in both state and federal courts.\textsuperscript{129} The new remedies provided in the Act will probably streamline the process of righting many of the wrongs done to customers. However, although some federal courts have determined that there is a right of action for private damages under the Commodities Exchange Act,\textsuperscript{130} the CFTCA neither denies nor confirms that such a private action exists.

One writer has observed:

Although both the House and the Senate sought to centralize regulatory jurisdiction over futures trading in the new Commission they did not wish to foreclose injured persons from seeking redress in the federal and state court.

\ldots

When H.R. 13313 reached the Senate Agriculture and Forestry Committee, concern arose over whether the Commission's exclusive jurisdiction would impair the right of an injured investor to bring suit in the courts for relief. The concern was heightened by a new provision [§14] in the Act authorizing the Commission to hear investor complaints and to award damages ("reparations").\textsuperscript{131} To meet this concern the Senate added the provision in section 2(a) which provides that nothing therein is to supersede or limit the jurisdiction of either federal or state courts.\textsuperscript{132} The writer concludes that "[I]t is clear that

\begin{itemize}
  \item 130. See discussion following note 60 supra.
  \item 131. Perimeters, supra note 38, at 16-17.
  \item 132. It is unclear why the Congress did not in this instance provide for exclusive jurisdiction of federal courts for actions brought for violations of this Act. In the Securities and Exchange Act of 1934, 15 U.S.C. § 78a \textit{et. seq.}, which set up comprehensive regulation of the securities exchanges and could perhaps be considered a counterpart of the CFTCA, exactly such a provision is made. The parallel seems obvious.
\end{itemize}
injured persons may initiate actions in the courts and are not confined to a proceeding before the Commission.”

While this conclusion is indisputably correct, it defeats at least part of the very purpose Congress had in mind in consolidating regulation in one agency. Strictly speaking, regulation of the market mechanics is absolutely within the Commission’s jurisdiction. But the degree of control which can be exercised by the Commission is limited by the fact that actions may be brought by customers, as a result of breakdowns in those mechanics, in any court which will exercise jurisdiction over the case. Had proceedings before the Commission been made mandatory at least in certain cases and exclusive federal jurisdiction for violation of the CFTCA been provided for, the Commission’s control would have been more effective.

In addition to this opportunity for the dilution of the CFTC’s control of the commodities industry, the failure to prescribe limits on jurisdiction gives rise to the continuation of the problem of multiple and concurrent litigation and administrative procedures arising from the same set of facts and transactions. It presents the plaintiff-customer with a problem of deciding which forum is the appropriate one before which to seek his remedy. It also presents the brokerage house or contract market member with the unpalatable prospect of defending itself against attacks in the courts and investigations by multiple supervisory agencies, including the CFTC, the proposed national futures association and the contract market of which it is a member.

The recent Supreme Court decision in Ricci v. Chicago Mercantile Exchange will no doubt set the tone for situations where simultaneous administrative and court actions are in progress. In that case the Court, invoking tenets of the doctrine of primary jurisdiction, held that a district court action based on antitrust laws should be stayed until administrative proceedings had been conducted before the Commodity Exchange Commission. In the opinion the court recognized that the expertise of the Commodity Exchange Commission would be of immense value in determining many of the questions of fact which would be determinative of the case. But this is only a partial solution to the over-all problem. There remain the difficulties of simultaneous state and federal court actions which cannot be

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133. *Perimeters, supra* note 38, at 18.

134. This is one of the few areas in which state and federal actions cannot be forced to be consolidated.

135. The brokerage house or member of a contract market is in the unenviable position of being subject to investigation and possible penalties from the CFTC, any exchange to which he belongs and all the sub-units and committees of these exchanges which may have any relevant interest in supervising particular aspects of exchange operations.


137. *Id.* at 305.
consolidated and the barrage of penalties to which the brokerage house may be subjected until such time as the rules of all the exchanges and associations can be revised and approved by the Commission. The latter problem can be alleviated by a concerted effort on the part of the CFTC and the contract markets and member associations to coordinate and simplify the types of internal proceedings which may be taken against a member accused of wrongdoing by a customer. The former problem would seem to be incurable without the addition of a new provision in the Act for exclusive federal jurisdiction of claims arising from violations of its provisions.

The provisions and problems outlined in this section have universal applicability. The following section will analyze the impact of the CFTCA on litigation in the Seventh Circuit where, because of the fact that the heart of the commodities industry resides within its confines, much of the law construing the new Act will very likely be delineated.

**THE IMPACT OF THE COMMODITIES FUTURES TRADING COMMISSION ACT OF 1974 ON LITIGATION IN THE SEVENTH CIRCUIT**

With the exception of its refusal to recognize a discretionary commodities futures trading account as a security, the decisions of the Seventh Circuit in the area of commodities litigation have resembled those of most other jurisdictions, although it has generally been more difficult to persuade the Seventh Circuit courts that there is a cognizable action. The decisions have enunciated several possible grounds for private recovery, including violations of securities laws, violations of the Commodity Exchange Act, violations of exchange rules, common law fraud and tort actions, and actions based on a fiduciary duty between the broker and the customer. It would seem to be a fair summary of the history of such litigation to say that the courts have tried to find a remedy for a customer who has suffered a loss, using whatever theory is most suitable to the fact situation presented in a given case. This is not a predictable state of affairs for the plaintiff. Unfortunately, the CFTCA has not relieved this uncertainty in any significant degree. To comprehend this state of affairs a close examination of the theories heretofore used for recovery and the possible impact on them of the CFTCA is necessary.

*Goodman v. Hentz & Co.* was the first case to consider an allegation of a violation of the Commodity Exchange Act and is therefore an important case to examine to elicit a sense of the direction the Seventh Circuit may take in construing the new Act. It involved a suit by all persons allegedly

138. Until such time as the rules of exchanges can be comprehensively evaluated by the CFTC, blanket approval of the old rules has been granted.
139. See Milnarik v. M-S Commodities, 457 F.2d 274 (7th Cir.), cert. denied, 409 U.S. 887 (1972).
defrauded by the defendant firm, which was a registered securities and commodities broker. The plaintiffs failed in their attempts to allege a class action because one of the plaintiffs had transacted with the defendant only in an unregulated commodity—copper. Because of the unregulated nature of the commodity, the plaintiff had “alleged no facts which could bring the matter complained of within the scope of the Act [Commodities Exchange Act], even if it be asumed that a civil remedy is available in the federal courts under the Commodity Exchange Act.”

Several of the plaintiffs traded in both commodities and securities. Based on the securities transactions, the court found that an action had been stated under the Securities Exchange Act of 1934. In addition, it was concluded that the securities and commodities transactions were part of a single fraudulent scheme. Therefore, all plaintiffs who had engaged in both securities and commodities transactions (regardless of whether the commodities were regulated or unregulated) could recover on the theory that the fraud was perpetrated as part of a single scheme.

Those plaintiffs who had traded only in regulated commodities presented a different problem for the court. Citing Rosee v. Board of Trade of the City of Chicago for the proposition that the Seventh Circuit Court of Appeals has left the question of a civil remedy for a defrauded investor under the Commodities Exchange Act an open one, the Goodman court found that a private right of action was available under the Act. The action sounded essentially in tort, with the court finding that there was

141. Id. at 443.
142. Id. at 445.
143. Id.
144. Id.
145. 311 F.2d 524 (7th Cir. 1963).
146. 265 F. Supp. at 447.
147. Id.
148. The tort action the court recognized was based on the Restatement (Second) of Torts § 286, which reads:

The court may adopt as the standard of conduct of a reasonable man the requirements of a legislative enactment or an administrative regulation whose purpose is found to be exclusively or in part,

(a) to protect a class or persons which includes the one whose interest is invaded, and;
(b) to protect the particular interest which is invaded, and;
(c) to protect that interest against the kind of harm which has resulted, and;
(d) to protect that interest against the particular hazard from which the harm results.

The court notes:

the violation of a legislative enactment by doing a prohibited act makes the actor liable for the invasion of the interests of another if: (1) the intent of the enactment is exclusively or in part to protect the interest of the other as an individual; and (2) the interest invaded is one which the enactment is intended to protect . . . . Violation of the standard of conduct set out in Section 6b of the Commodity Exchange Act is a tort for which plaintiffs, as members of the class Congress sought to protect from the type of harm they allege
"no indication in the Commodity Exchange Act that Congress intended not
to allow private persons injured by violations access to the federal
courts."\textsuperscript{140}

The case led to the dismissal of the claim of one plaintiff who alleged
precisely the same scheme to defraud as the other plaintiffs. Because the
particular commodity in which he traded was not regulated under the
Commodity Exchange Act, his claim was not cognizable. Those plaintiffs
who alleged trades in non-regulated commodities and alleged trading in
securities were permitted to recover for damages suffered as a result of both
kinds of trades, even though they could not have recovered for the unregu-
lated commodities trades under the rule set out by the same court to dismiss
the first plaintiff. And those plaintiffs who had traded only in regulated
commodities were permitted to recover under the Commodities Exchange
Act, while the plaintiff who had entered into essentially the same kind of
transaction, albeit in an unregulated commodity, was not permitted to
recover under that act. Thus, this single plaintiff who alleged the same type
of wrongdoing as his fellow litigants was denied a federal court forum for his
action.

The result of this case would be only slightly different under the
CFTCA. The plaintiff who traded in copper and was denied recovery
would now be covered under the Act because of the expansion of the
definition of commodities.\textsuperscript{150} The Act does not clarify the existence or non-
existence of a private action for violation of its provisions, but the argument
of the \textit{Goodman} case that Congress did not intend to deprive private persons
of a remedy is clearly a stronger one now than it was in 1967.\textsuperscript{151} The
legislative history of the CFTCA indicates that the purpose of Congress was
to further protect the exchange customer, not to deprive him of protection.
The proviso in the Act\textsuperscript{152} that the jurisdiction of state and federal courts is
not superseded supports the presumption that the customer was intended to
be further protected by the Act. The only significant impact of the CFTCA
on this type of situation would be to eliminate the anomaly presented therein
of one plaintiff who alleged only transactions in unregulated commodities
being dismissed from the case while three others who alleged such trades, but
also had engaged in securities trades, were permitted to maintain their
action.

\begin{itemize}
\item here, have a federal civil remedy even in the absence of specific mention of
a civil remedy in the Commodity Exchange Act.
\item 265 F. Supp. at 447.
\item 149. 265 F. Supp. at 447.
\item 151. But this is an example of how peculiar it is that a positive jurisdictional grant
has not been made by the CFTCA. The court had to go the length of turning a negative
presumption (no indication in the Commodities Exchange Act that Congress intended to
deprive an individual of a private action) into a positive theory of recovery under the
Act.
\end{itemize}
Even though Goodman clearly stated what other cases had implied—that there could be a private right of action for violation of some of the provisions of the Commodity Exchange Act—still other attempts were made to bring actions based on commodities transactions within the jurisdiction of the federal courts under the securities acts. Milnarik v. M-S Commodities, Inc.\textsuperscript{153} is a landmark Seventh Circuit decision representing an unsuccessful attempt to bring such an action where discretionary trading accounts were involved.\textsuperscript{154}

The Milnarik court focused on the fact that it was the relationship between the broker and the customer which had to be examined to determine whether an investment contract, as defined by the Securities Acts, existed. Its analysis of that relationship led the court to reject the reasoning of other decisions\textsuperscript{155} which had held that a discretionary trading account was an investment contract.\textsuperscript{156} Other cases brought in the Seventh Circuit have likewise rejected attempts to argue that contracts to purchase commodities futures are investment contracts within the meaning of the federal securities laws.\textsuperscript{157}

The CFTCA does not address this problem specifically. The Act, of course, vests jurisdiction over all regulation of accounts, agreements and trading in futures contracts in the Commission,\textsuperscript{158} which would include the discretionary accounts at issue in Milnarik. It also notes that the jurisdiction of the Securities and Exchange Commission is not to be limited by the Act.\textsuperscript{159} The SEC had not exercised its jurisdiction by recognizing discretionary accounts or options as securities prior to the enactment of CFTCA.\textsuperscript{160} Therefore, there should be little argument that the type of

\textsuperscript{153} 457 F.2d 274 (7th Cir.), cert. denied, 409 U.S. 887 (1972).
\textsuperscript{154} See discussion following note 57 supra.
\textsuperscript{156} The plaintiff in Milnarik did not attempt to allege violations of the Commodity Exchange Act. In light of the holding in Goodman it seems likely that such a cause of action might have been stated. The hesitation to do so may have been due to the fact that there was (and is) almost no case law under the Commodity Exchange Act with which to buttress such a cause of action.
\textsuperscript{157} See Glazer v. National Commodity Res. & Stat. Serv., Inc., 388 F. Supp. 1341 (N.D. Ill. 1974). (Plaintiffs purchased put and call options and the court found that although the options might be considered an investment contract even when the underlying futures contract couldn't be, the element of commonality was missing and so failed to come under the securities laws.); Stevens v. Woodstock, Inc., 372 F. Supp. 654 (N.D. Ill. 1974) (The allegation that the agreement between plaintiff and defendant, setting up plaintiff's commodities futures account, was an investment contract and thus a security, and the commingling of the several plaintiffs' funds created a common enterprise, was rejected by the district court.).
\textsuperscript{158} Perimeters, supra note 38, at 15.
\textsuperscript{160} See 457 F.2d at 278.
situation exemplified by Milnarik will come under the jurisdiction of the CFTC and the controversy over whether discretionary accounts are securities should become irrelevant.\(^{161}\)

If there was apprehension about the success of attempting to state a cause of action under the Commodity Exchange Act in 1972, it should have been alleviated the following year by the decision in Deaktor v. Schreiber.\(^{162}\) The court in that case quoted favorably from Goodman and ultimately concluded "that a private cause of action exists under the Commodity Exchange Act."\(^{163}\) The Seventh Circuit position has been buttressed by what is at this time the only case which has been decided since the enactment of the CFTCA. In Case & Co. v. Board of Trade of the City of Chicago,\(^{164}\) the court of appeals considered an action by a plaintiff who alleged he had suffered losses in the market as a result of the defendant's temporary suspension of one of its rules, in violation of the Commodity Exchange Act.\(^{165}\) Although the dismissal of the plaintiff's cause of action was affirmed, the court, without discussion, stated that "[i]t is undisputed that a private cause of action may be maintained under the Commodity Exchange Act."\(^{166}\)

The decision that a private action will lie under the Commodity Exchange Act (now the CFTCA) for violations of its provisions, combined with the initiation by the Commissions of anti-fraud rules which track those promulgated under the securities laws,\(^{167}\) should serve to protect the interests of plaintiffs who have had, in the past, to resort to attempts to bring their cases under securities laws.\(^{168}\)

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161. *Commodity Regulation*, supra note 6, at 39. However, as late as April 30, 1975, the United States District Court for the Southern District of New York held that allegations of unlawful activity relating to commodity futures trading support a cause of action under federal securities laws when the broker has control over investment decisions and represents that profits will result from his efforts. Scheer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 72 Civ. 3342 (WCC) (S.D.N.Y. April 30, 1975), *reported in CCH Commodities Futures Law Rep.* ¶ 20,039.

162. 479 F.2d 529 (7th Cir.), *rev'd on other grounds*, 414 U.S. 113 (1973).

163. *Id.* at 534. The court here determined that the Act was intended, at least in part, to protect those who trade on the commodity exchanges.

164. Civil No. 74-1464 (7th Cir. Sept. 12, 1975), *reported in CCH Commodity Futures Law Rep.* ¶ 20,079 at 10,720. Even though the decision was written after the enactment of the CFTCA the Court was construing the old Commodity Exchange Act.

165. 7 U.S.C. §§ 7a(1) and 7a(2) (1970).

166. Civil No. 74-1464 (7th Cir. Sept. 1, 1975), *reported in CCH Commodity Futures Law Rep.* ¶ 20,079 at 20,721.


168. The conclusion that a private right of action exists for violation of the Commodity Exchange Act will eliminate the problems presented in a case like Goodman v. Hentz, 265 F. Supp. 440 (N.D. Ill. 1967), where a plaintiff was left with no remedy in the federal courts. There are situations, however, where both securities and commodities transactions are involved and it may be deemed desirable to bring them under the aegis of only one applicable set of laws. Since the securities laws are the ones most litigants
There is one other possible basis for federal jurisdiction of a case involving commodities transaction in the Seventh Circuit. Violations of private exchange rules, such as those in the New York Stock Exchange (N.Y.S.E.) and the National Association of Securities Dealers (N.A.S.D.) have been used as the basis for alleging a cause of action in numerous securities cases. They have met with varying degrees of success. But and attorneys are familiar with and they are the ones which have been interpreted by the courts most extensively, it is conceivable that this degree of familiarity and predictability would prompt attorneys to state a cause of action under the securities laws. A successful example of this is the case of Powers v. Bouchard, Civil No. 75-417 (N.D. Ill. Aug. 11, 1975). In Powers the court determined that the allegation by plaintiff that she was induced to invest in commodities by misrepresentation and fraud and that her securities were sold in furtherance of the fraud was sufficient to confer jurisdiction on a federal court. The opinion concluded that this scheme to defraud the plaintiff was done "in connection with" the sale of the plaintiff's securities and was a violation of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and rule 10b-5 (17 C.F.R. 240.10b-5) promulgated thereunder.

No allegation was made that the sale of the securities was carried out in a way which violated securities laws. The charge, which was accepted by the court, was that because the proceeds of the securities sale were used to fund the fraudulently induced commodities transactions there was a violation of rule 10b-5.

The rationale for federal jurisdiction under these circumstances is that the rules are promulgated pursuant to authority granted in the federal law. See, e.g., Avern Trust v. Clarke, 415 F.2d 1238 (7th Cir. 1969).

169. See, e.g., Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, 410 F.2d 135 (7th Cir. 1969); Avern Trust v. Clarke, 415 F.2d 1238 (7th Cir. 1969); SEC v. First Securities Co., 463 F.2d 981 (7th Cir. 1972).

170. It has been held that rule 405, the "Know Your Customer" rule of the New York Stock Exchange, adopted pursuant to the Securities Exchange Act of 1934 (15 U.S.C. §§ 78f, 78s), may be the basis of a cause of action in the federal courts in certain situations. It was reasoned in Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, 410 F.2d 135 (7th Cir. 1969), that because the Rule has functions of public protection within the overall statutory regulatory scheme supervised by the Securities and Exchange Commission, such an action is justified. But Buttrey did not hold that a violation of rule 405 or other similar rules was a basis for a private right of action per se. This case must be read in light of the fact that the facts alleged in the complaint were "tantamount to fraud", 410 F.2d at 142, and that under those facts the defendant could be held liable for a violation of rule 10b-5 of the Securities and Exchange Commission.

In Avern Trust v. Clarke, 415 F.2d 1238 (7th Cir. 1969), the Seventh Circuit Court of Appeals considered a complaint which alleged violations of article III, sections 1, 2, and 18 of the Rules of Fair Practice of the National Association of Securities Dealers. Section 2 requires that when a member recommends to a customer "the purchase, sale or exchange of any security, he shall have reasonable grounds for believing that the recommendation is suitable for such customer on the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs". The court found that while section 2 was intended for the protection of investors and under Buttrey, supra, might be the basis for a private right of action, the dismissal of the count of the complaint alleging a violation of that section did not prejudice the plaintiff "because the same theory was incorporated under the claim for violation of section 15 of the Securities Exchange Act of 1934, 15 U.S.C. § 78.

In SEC v. First Securities Co., 463 F.2d 981 (7th Cir. 1972), the court considered a proceeding on the equitable receivership of the defendant firm in which the claims of certain parties had been denied. One of the bases of liability discussed was that based on the violation of rule 27 of the Rules of Fair Practice of the National Association of Securities Dealers. Rule 27 deals with the responsibility of member firms to supervise the activities of their registered representatives. The court concluded that the rule had
the few cases which have held that a private right of action may be maintainable for violations of the N.Y.S.E. and N.A.S.D. rules have considered them in conjunction with allegations of fraud under other sections of the securities act.

There is no case on record yet which has considered whether violations of the rules of a commodities exchange would be the basis for a private right of action.\textsuperscript{172} Although many brokers are members of both securities and commodities exchanges, it cannot be assumed that violations of rules promulgated by one exchange can be used as a basis for a right of action for transactions which occur on another one. The Commodities Futures Trading Commission has recognized that the transactions regulated under the Commodity Exchange Act are not necessarily governable by the same principles as those regulated under the Securities Acts.\textsuperscript{173} Although it is likely that the principles which have been used to develop a private right of action under N.A.S.D. and N.Y.S.E. rules will likewise be developed based on rules of the commodity exchanges,\textsuperscript{174} such an action does not now exist.

The Seventh Circuit has steadfastly refused to expand the protection of securities laws to plaintiffs suffering losses in commodities futures trading.\textsuperscript{175}  

been violated by the defendants and further concluded that such a violation would "provide a basis for private damage actions where the rule violated serves to protect the public. [citing \textit{Buttrey} and \textit{Avern Trust, supra}.] First Securities is properly liable for Nay's fraud because of its violation of Rule 27 of the N.A.S.D.". 463 F.2d at 988. This is the most definitive statement of the three cases that such a private right of action exists. But it still must be noted that even in \textit{First Securities} a violation of rule 10b-5 was also determined by the court to have taken place.

172. There is now a case pending in the Circuit Court of Cook County, based on a violation of rule 813 of the International Money Market. International Currency, Ltd. v. Lamson Bros. & Co., Civil No. 75 L 3264 (Cir. Ct. of Cook County, filed Feb. 21, 1975).

173. \textit{See} 40 Fed. Reg. 26504 (1975) where the CFTC published a notice regarding its adoption of anti-fraud rules. The notice reads in pertinent part:

The operative language of the proposed rules tracked the antifraud provisions of Securities and Exchange Commission Rule 10b-5 under the Securities Exchange Act, 17 CFR 240.10b-5. While the Commission believes that the interpretive approach taken by the courts with respect to Rule 10b-5 would generally be satisfactory if applied to prevent deceptive acts and practices in connection with transactions covered by the options and foreign market anti-fraud rules, the Commission is persuaded, on the basis of comments it has received, that uniformity of rules in the commodity area is desirable. As a result, the Commission feels it would be inappropriate generally to apply the language of Rule 10b-5 to the commodity futures or other transactions regulated under the Commodity Exchange Act, as amended, since this might invite an uncritical application of security law, principals and practices.\textsuperscript{3}

The Commission is particularly concerned with the possibility that determinations reached on commodity cases might misapply non-disclosure-of-information standards taken from securities laws decisions, although it fully appreciates that a failure to disclose may operate as a fraud or deceit with respect to commodity transactions in certain circumstances.

174. The rules of the commodity exchanges will be strictly monitored by the CFTC according to the terms of the CFTCA, 7 U.S.C.A. § 7a (Supp. I Feb. 1975) and the CFTC has the power to impose penalties on boards of trade which do not comply with its orders.

\textsuperscript{3}The Commission is particularly concerned with the possibility that determinations reached on commodity cases might misapply non-disclosure-of-information standards taken from securities laws decisions, although it fully appreciates that a failure to disclose may operate as a fraud or deceit with respect to commodity transactions in certain circumstances.
Consistent with this position is the conclusion in this circuit that a claim for relief for damages may be asserted by an individual who has suffered losses in the commodities markets as a result of violations of the Commodity Exchange Act. This situation, combined with the emphasis in the CFTCA on protection of the customer, puts the plaintiff bringing an action in the Seventh Circuit in a position of strength. The paucity of law developed under the Commodity Exchange Act will make the task of interpreting the types of actions which will be cognizable under the CFTCA difficult. The legislative history of the Act and the rules and regulations to be promulgated by the Commission will be useful in this regard. It is also probable that the trend towards permitting an action based on violations of the rules of securities exchanges and associations will be expanded to include similar rules of the commodities exchanges. In short, the Seventh Circuit is certain to embrace this new regulatory act and will no doubt play an instrumental role in the construction of its provisions.

**CONCLUSION**

The Commodity Futures Trading Commission Act of 1974 was enacted in response to the recognition that the commodities futures industry had outgrown its regulatory structure. The complications began when traders who had no interest in the commodities underlying the contracts they dealt in entered the market. The high leverage in commodities trading holds out the promise of astronomical returns on the "investment" required to initiate a trading account. That sort of prognosis attracts many unsuspecting people uneducated as to the risks involved and others who see only a way to make money quickly. The lack of business sophistication of many customers is matched only by that of numerous employees of brokerage houses whose training and licensing is minimally regulated. All of these factors, combined with the volatility of the market, lead to an explosive situation. Although some mechanisms for control were available under the Commodity Exchange Act, they were neither vigorously enforced nor adequate to meet this new situation.

The CFTCA provides a vehicle for attacking many of these vices. The internal functioning of the exchanges will be more stringently supervised. Brokers, registered representatives and other brokerage house employees may be required to meet certain standards before being permitted to trade on the exchanges. Provisions have been made for programs which will educate all concerned parties. The basic lure of a high level of return on investment remains and will continue to attract to the market people whose capabilities for using it effectively are limited.

The high volume of litigation which has developed in this field in recent years will no doubt continue. The Act provides new forums for certain aggrieved parties, which will result in productive approaches to resolving many of the disagreements which have until this time been relegated to
the courts. Through these procedures new substantive rights which have been afforded customers in the Act can be pursued. No limitations have been placed on the right of any party to make use of remedies previously available in the courts. As the CFTC develops rules and regulations under the law, the substantive rights which may be vindicated in these old forums will no doubt increase.

Despite the dramatic new provisions of the CFTCA, there remain problematical areas. The major criticisms of the Act are its failure to specifically delineate a private action for violation of its terms, the omission of a grant of exclusive jurisdiction and the related possibility it leaves for the occurrence of multiple and concurrent litigation in actions brought for such violations. The first omission is not of great consequence in the Seventh Circuit. The expanded scope of the regulatory provisions will, however, make obsolete the arguments used outside the Seventh Circuit in the *Maheu* line of cases to define discretionary trading accounts as investment contracts under the Securities Act. However, these decisions remain valid law and the approach courts will now take in confronting similar actions brought after the passage of the CFTCA will be interesting to observe. Clearly, the definitions of the new law and the intent expressed in its passage indicate that discretionary accounts are within the purview of the CFTCA. The only rational alternative for any court to follow would be to deny future recovery in such cases if the action is founded on the theory that the account is an investment contract. Likewise, any foothold which the SEC might have attained in this area should be abandoned in favor of the jurisdiction of the CFTC.

The failure to grant exclusive federal court jurisdiction to vindicate rights protected by the Act is a major omission. The rationale for making such a provision is as justified in the commodities industry as it is in the securities areas, where such a provision is a reality. This failure of the Act leaves open the possibility of multiple and concurrent litigation upon which there is now no effective curb in this particular area. The CFTCA may even complicate the problem by raising the possibility of the existence of new substantive rights which may be enforced in whatever forum is most appealing to the plaintiff.

Viewed in its entirety the Act must be recognized as a major breakthrough in the control of an industry which has been subject to multiple abuses. Most courts should welcome the addition of guidelines for litigation which the provisions of the Act must incidentally provide and no doubt some courts, such as those in the Seventh Circuit, will be provided ample opportunity to further refine its import. All factions of the commodities industry should benefit from the new Act and the industry itself should be strengthened.

**Leida Slater**