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## THE EXCLUSIVE JURISDICTION OF THE COMMODITY FUTURES TRADING COMMISSION

*Thomas A. Russo\* and Edwin L. Lyon\*\**

In 1974, Congress substantially amended the Commodity Exchange Act<sup>1</sup> (the Act), and created a new, independent federal regulatory agency, the Commodity Futures Trading Commission (CFTC). The congressional purpose was to remove the regulation of commodities from the Department of Agriculture and place it under the auspices of the CFTC. Interestingly, however, the most controversial and ambiguous provision in the 1974 amendments concerns the jurisdiction of the CFTC, and more specifically, the parameters of its "exclusive jurisdiction." This exclusive jurisdiction provision, section 2(a)(1) of the Act, states:

That the [Commodity Futures Trading] Commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is the character of . . . an 'option' . . .), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to Section 7 of this title or any other board of trade, exchange, or market . . . .<sup>2</sup>

Difficult questions have arisen as to the meaning of exclusive jurisdiction as defined by the amendment. In addition, uncertainty has arisen because Congress vested the CFTC with jurisdiction over areas which had not been regulated by its predecessor, the Commodity Exchange Authority (CEA). This jurisdictional expan-

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1. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. §§ 2-22 (Supp. V 1975)).

2. 7 U.S.C. § 2 (Supp. V 1975).

sion was accomplished by broadening the definition of the term "commodity" to include not only agricultural products but also "all other goods and articles, except onions . . . , and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in . . . ."<sup>3</sup>

3. *Id.* Understanding the scope of the term "commodities" is important because this scope defines the objects over which the Commodity Futures Trading Commission (CFTC) has jurisdiction. The critical issue is whether the phrase "in which contracts for future delivery are presently or in the future dealt in" modifies "all other goods and articles . . . and all services, rights, and interests," or only "all other services, rights, and interests." A literal reading of the language of the definition is not particularly helpful. The legislative history of § 2(a)(1) is more informative, however. For example, Senator Talmadge stated that "[a]ll goods, articles, services, rights, and interests traded for future delivery are brought under Federal regulation" by the amendments to the Commodity Exchange Act (the Act). STAFF OF SENATE COMM. ON AGRICULTURE AND FORESTRY, 93D CONG., 2D SESS., REPORT ON THE COMMODITY FUTURES TRADING COMMISSION ACT OF 1974, at 3 (Comm. Print 1974) (statement of Senator Talmadge on Conference Report) [hereinafter cited as TALMADGE STATEMENT]. See S. REP. NO. 1131, 93d Cong., 2d Sess. 3, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5845. In addition, Dr. Clayton Yeutter, Assistant Secretary of Agriculture, stated:

The bill would bring within the purview of the Act, in addition to the commodities now covered, all commodities, goods, articles, services, rights, and interests which are or may be the subject of futures contracts. In other words, the intent of this provision would be to cover all futures trading that might now exist or might develop in the future.

H.R. REP. NO. 975, 93d Cong., 2d Sess. 76 (1974). See also *id.* at 7-8: "Section 201 of the Bill enlarges the definition of 'commodity' to include all goods and articles, except onions, and 'all services, rights and interests in which contracts for future delivery are presently or in the future dealt in.'"

Moreover, in § 16(a) of the Act, Congress provided that "[t]he Commission may conduct regular investigations of the markets for goods, articles, services, rights, and interests which are the subject of futures contracts. . . ." 7 U.S.C. § 20(a) (Supp. V 1975). It would have been illogical for Congress to give the CFTC jurisdiction over all "goods and articles," and then specify elsewhere in the Act that the Commission could only investigate the markets for goods and articles which are the subject of futures contracts. The CFTC has not announced an opinion as to the scope of the term "commodity." However, at a May 6, 1977, American Bar Association panel discussion on "The Exclusive Jurisdiction of the CFTC," CFTC Acting General Counsel Richard Nathan asserted that the definition of "commodity" gave the CFTC jurisdiction over all goods and articles and over those intangibles (services, rights, and interests) on which futures contracts are traded. If this is the case, then the CFTC's regulatory arm reaches even to toothpicks, towels, and tie tacks. There is nothing in the legislative history of the 1974 amendments which hints that such broad jurisdiction was intended, unless the good or article is somehow related to the futures markets.

A second issue with respect to the scope of the "commodity" definition is the meaning of the phrase "in which contracts for future delivery are presently or in the future dealt in." It is unclear whether this language pertains to contracts for future delivery domestically or worldwide. The question would appear to be answered by

The jurisdictional provisions of the Act were structured very broadly to assure that there were no gaps in the regulation of commodities, commodity futures, and commodity options.<sup>4</sup> In addition, the provisions attempted to avoid overlapping and conflicting regulation, such as that in the securities industry,<sup>5</sup> by authorizing a single agency to regulate commodities trading.

The effect of the expanded definition of the term "commodity," together with the exclusive jurisdiction provision, is to grant the CFTC exclusive jurisdiction over areas previously regulated by state and federal agencies. For example, options on futures contracts, previously subject to the jurisdiction of the Securities and Exchange Commission (SEC) and the state blue sky commissioners, are now "exclusively regulated" by the CFTC. Thus, it was inevitable that the exclusive jurisdiction of the CFTC would produce jurisdictional conflict. Since the amendments to the Act became effective in 1975, the CFTC, the SEC, and the various state securities and commodities regulators have engaged in a running dialogue as to who can do what to whom.

This article sets forth some of the background against which the "exclusive jurisdiction" provisions were drafted; describes the jurisdictional dispute between the CFTC on the one hand, and the SEC and state blue sky commissioners on the other, over the regulation of commodities trading; delineates specific jurisdictional issues relating to the various forms of commodities trading and commodities trading professionals; and, finally, proposes a test for resolving some of these jurisdictional issues.

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referring to the provisions in the exclusive jurisdiction section which indicate that the Commission shall have exclusive jurisdiction "with respect to accounts, agreements (including . . . 'option[s]' . . . ), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market . . . or any other board of trade, exchange, or market . . ." 7 U.S.C. § 2 (Supp. V 1975). The legislative history of that provision indicates that the drafters of the 1974 amendments intended to give the Commission jurisdiction over futures contracts purchased and sold in the United States but executed on a foreign board of trade, exchange, or market. See TALMADGE STATEMENT, *supra* at 6. Congress must have intended the modifying language of the commodities definition to mean commodities for future delivery on any board of trade, whether domestic or foreign. Otherwise, there would have been a "regulatory gap" with respect to those commodities not traded for future delivery domestically but sold in the United States for future delivery on a foreign board of trade or exchange.

4. See, e.g., TALMADGE STATEMENT, *supra* note 3, at 6-7; 120 CONG. REC. 34,736 (1974) (remarks of Rep. Poage).

5. See text accompanying notes 31-38 *infra*.

## I. FACTORS LEADING TO AMENDMENT OF THE COMMODITY EXCHANGE ACT

It is important to delineate the various factors which led to the amendment of the Act in 1974 to understand the scope of the exclusive jurisdiction provision. In the late 1960's and early 1970's, trading in futures of unregulated commodities increased substantially. For example, in 1970 a new exchange, the International Monetary Market, was formed to provide a market for futures transactions in various international currencies, including deutsche marks, Japanese yen, Swiss francs, French francs, Canadian dollars, Mexican pesos, Dutch guilders and pounds sterling. In addition, volume on other exchanges in unregulated futures transactions in silver, copper, platinum, palladium, crude oil, liquefied propane gas, industrial fuel oil, heating oil, Belgian francs and Italian lire increased.<sup>6</sup> There was much concern that persons trading in these "unregulated" markets did not receive the same protection as persons trading either in the securities markets or in futures contracts regulated by the CEA.<sup>7</sup>

Perhaps the most important impetus for the extensive revision of the Act was the perpetration of frauds upon investors by Goldstein, Samuelson, Inc.,<sup>8</sup> through the sale to the public of "naked" options<sup>9</sup> on unregulated commodities. In effect, the Goldstein, Samuelson operation was nothing more than a Ponzi scheme, in which

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6. The Association of Commodity Exchange Firms, Inc. (since renamed the Futures Industry Association Inc.), reported the following statistics regarding the number of trades in both regulated and nonregulated commodities:

	1973	1972	1971	1970	1969
Total					
Regulated	18,285,377	14,345,711	11,810,383	11,547,271	9,345,191
Contracts					
Total					
Nonregulated	7,541,370	3,986,344	2,752,948	2,075,336	1,861,494
Contracts					
Total					
Futures	25,826,747	18,332,055	14,563,331	13,622,607	11,206,685
Contracts					

ASSOCIATION OF COMMODITY EXCHANGE FIRMS, INC., BULL. NO. 1302—COMMODITY FUTURES CONTRACTS TRADED, 1969-73, INCLUSIVE, reprinted in *Hearings Before the House Comm. on Agriculture on H.R. 11955*, 93d Cong., 2d Sess. 268-70 (1974).

7. See, e.g., H.R. REP. NO. 975, 93d Cong., 2d Sess. 61-64 (1974).

8. Goldstein, Samuelson, Inc., was a Los Angeles commodity option firm established by Harold Goldstein.

9. A commodity option is often defined as "naked" when the writer of the option does not own the underlying commodity or commodity futures contract.

persons who purchased options that became profitable were paid with money received from subsequent option purchasers.<sup>10</sup> As in Ponzi schemes, the Goldstein, Samuelson incident led to substantial losses incurred by subsequent purchasers. It is estimated that the amount of money lost by investors in the Goldstein, Samuelson fraud was approximately \$70 million.<sup>11</sup>

The SEC and the state securities commissioners reacted to this debacle predictably. Various states soon characterized commodity options as "securities" or adopted legislation which had that effect.<sup>12</sup> Some states distinguished "naked" options from covered options,<sup>13</sup> while others simply deemed all commodity options securities.<sup>14</sup> The SEC indicated that it considered "naked" commodity options to be securities.<sup>15</sup>

A group of New York commodity option firms formed an association, the Commodity Exchange Member Firm Option Dealers Association, to respond to this patchwork regulatory approach.<sup>16</sup> This association had discussions with several state blue sky commissioners to encourage the states to enact legislation geared to commodity options. The association believed that placing the regulation of commodity options under federal and state securities law was inappropriate, and that commodity options should be dealt with by separate legislation. Although the group proposed federal legislation which provided for self-regulation of the commodity option industry under the oversight of the CEA, its efforts were unsuccessful.

The involvement of the Federal Home Loan Mortgage Corporation (FHLMC) in the development of a futures market in mortgages also contributed to the creation of the exclusive jurisdiction provision. In 1972, FHLMC prepared a detailed memorandum for

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10. A Ponzi scheme is impossible where a customer's money is segregated, because this money could not be used to pay prior purchasers.

11. H.R. REP. NO. 975, 93d Cong., 2d Sess. 37 (1974).

12. See, e.g., 1973 Cal. Stats. 1525.

13. See, e.g., [1973] 208 SEC. REG. & L. REP. (BNA) A-4 to A-6.

14. See, e.g., Georgia Securities Commissioner's Release No. 1 (Sept. 18, 1973) (on file at the offices of Cadwalader, Wickersham & Taft, Washington, D.C.).

15. See, e.g., Address by Hugh F. Owens, SEC Commissioner, NASAA Convention, San Antonio, Texas (Oct. 8, 1973), reprinted in [1973] 222 SEC. REG. & L. REP. (BNA) G-1; Brief for Appellee, *In re Traders Int'l, Ltd.*, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,529 (D. Nev. 1974) (brief for SEC).

16. The association included Bache & Co., The Ore and Chemical Corp., Mocatta Metals Corp., Hornblower & Weeks-Hemphill, Noyes, Inc., and Rudolf Wolff & Co. Later, the name of the group was changed to the Commodity Options Departments Association.

the SEC's Division of Corporation Finance concerning the development of a mortgage futures market.<sup>17</sup> Essentially, the FHLMC indicated that there was a need in the mortgage market for a vehicle to hedge inventories in mortgages and mortgage commitments. However, during the development of a futures market in mortgages, it became increasingly apparent to the FHLMC that numerous problems with the federal securities laws would arise because a mortgage futures contract would be considered a security by the SEC. Indeed, the SEC's Division of Corporation Finance replied to the FHLMC memorandum, indicating that these numerous problems with the federal securities laws could be solved only by legislation.<sup>18</sup> The initial discussions regarding the development of extensive amendments to the Act provided the FHLMC with a vehicle for solving these problems. The FHLMC encouraged Congress to place the regulation of all futures trading in a single agency.<sup>19</sup>

Finally, the existence of a group of companies which sold "leverage" or "margin" contracts<sup>20</sup> on gold and silver was instrumental in developing the CFTC's exclusive jurisdiction. After the Goldstein, Samuelson scandal, these companies, like the commodity option dealers, found themselves subject to differing and sometimes conflicting securities regulation by the various states and by the SEC.<sup>21</sup> These companies also viewed amendment of the Act as a means of resolving the problem of a multiplicity of regulatory schemes; thus, they encouraged Congress to entrust the regulation of all commodities trading to one agency.<sup>22</sup>

Therefore, there were several independent forces urging Congress to vest an agency other than the SEC, or the state blue sky

17. Memorandum by the Federal Home Loan Mortgage Corporation (FHLMC) (May 12, 1972) (on file at the offices of Cadwalader, Wickersham & Taft, New York, New York).

18. Memorandum by the Securities and Exchange Commission (Nov. 1972) (on file at the offices of Cadwalader, Wickersham & Taft, New York, New York).

19. See Letter from Thomas R. Bomar, Chairman, FHLMC, to Senator Herman E. Talmadge, Chairman, Committee on Agriculture and Forestry (May 20, 1974), reprinted in *Commodity Futures Trading Commission Act of 1974: Hearings Before the Senate Comm. on Agriculture and Forestry on S. 2485, S. 2578, S. 2837 and H.R. 13113*, 93d Cong., 2d Sess. 665 (1974) [hereinafter cited as *Senate Hearings*].

20. "Leverage" or "margin" contracts on gold or silver are bulk gold or silver or bags of coins sold on margin, delivery to be made only when full payment is received.

21. See, e.g., [1974] 255 SEC. REG. & L. REP. (BNA) A-12; [1974] 253 SEC. REG. & L. REP. (BNA) A-2 to A-3.

22. See *Senate Hearings*, supra note 19, at 748-53 (statement of M. Martin Rom, Chairman, International Precious Metals Corp.).

commissioners, with exclusive jurisdiction over trading in commodity futures and commodities in general.<sup>23</sup> The SEC, aware that broad exclusive jurisdiction provisions were being drafted as amendments to the Act, opposed these forces. Prior to the adoption of the amendments, the SEC reviewed the exclusive jurisdiction language; it was, however, dissatisfied with the language finally adopted.<sup>24</sup>

This dissatisfaction was demonstrated by events subsequent to the passage of the 1974 amendments. Representative Harley O. Staggers, Chairman of the Committee on Interstate and Foreign Commerce, the SEC's oversight committee in the House, wrote to Ray Garrett, Jr., then Chairman of the SEC, articulating his concern that:

[b]ecause of the Act's broad definition of commodity, this grant of exclusive jurisdiction to the new Commission could apply both to transactions on national securities exchanges which obtain designations as contract markets and to transactions in securities structured to include a contract for future delivery on any other board of trade, exchange or market (including a national securities exchange).<sup>25</sup>

After the passage of the 1974 amendments, Chairman Garrett recommended that the Securities Exchange Act of 1934<sup>26</sup> be amended

23. The commodity exchanges also advocated that futures trading regulation be vested exclusively in one federal agency. *Commodity Futures Trading Commission Act of 1974: Hearings on H.R. 11955 Before the House Comm. on Agriculture*, 93d Cong., 2d Sess. 168 (1974) (testimony of Frederick G. Uhlmann, Chairman, Chicago Board of Trade).

24. Section 2(a)(1) provides:

*except as hereinabove provided* [the "exclusive jurisdiction" provision], 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.

7 U.S.C. § 2 (Supp. V 1975) (emphasis added).

25. Letter from Representative Harley O. Staggers to Ray Garrett, Jr. (Nov. 20, 1974), reprinted in *COMMODITIES AND FUTURES TRADING* 99, 100 (Practising Law Institute 1975). For example, United States Treasury bonds are securities under the definition of that term in the federal securities laws. However, because the 1974 amendments broadened the definition of "commodities" to include all "services, rights, and interests in which contracts for future delivery are presently or in the future dealt in," and because the Chicago Board of Trade (CBOT) was designated as a contract market to trade United States Treasury bonds futures, these bonds became commodities as well as securities ("securities/commodities").

26. 15 U.S.C. §§ 78a to 78hh-1 (1970).



to specify that the definition of "commodity" and the grant of exclusive jurisdiction to the CFTC not be construed to limit the SEC's jurisdiction.<sup>27</sup> Subsequently, Chairman Garrett testified before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, urging that limits be placed on the CFTC's exclusive jurisdiction.<sup>28</sup> At this time, Congress was considering substantial amendments to the federal securities laws.<sup>29</sup> Thus, in the 1975 legislation amending the securities laws, Congress had the opportunity to incorporate the SEC's suggestions which opposed CFTC exclusive jurisdiction; however, it failed to do so.

The fundamental intent of Congress is perhaps best summarized in the Conference Reports on the 1974 amendments to the Act:

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 . . . .<sup>30</sup>

## II. THE JURISDICTIONAL CONFLICT

Prior to the 1974 amendments to the Act, the regulation of commodities markets was shared by the CEA, the SEC, and various state regulatory agencies. Consequently, the "exclusive jurisdiction" provision of the amendments necessarily resulted in almost immediate confusion and a fair measure of "turf-fighting."

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27. Letter from Ray Garrett, Jr., to Representative Harley O. Staggers (Feb. 14, 1975), reprinted in *Hearings on S. 249 Before the Subcomm. on Securities of the Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 209-11 (1975).

28. *Hearings on S. 249 Before the Subcomm. on Securities of the Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 204 (1975).

29. See *id.* at 197.

30. S. REP. NO. 1194, 93d Cong., 2d Sess. 35 (1974); H.R. REP. NO. 1383, 93d Cong., 2d Sess. 35, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5894, 5897.

### A. *The CFTC vs. the SEC*

Questions concerning the scope of the CFTC's jurisdiction as it affected the SEC arose shortly after the CFTC began operation. Trading in futures on mortgages became the focus of the issue. In September 1975, the CFTC designated the Chicago Board of Trade (CBOT) as a contract market for futures trading in mortgage-backed certificates guaranteed by the Government National Mortgage Association (GNMA).<sup>31</sup> Shortly thereafter, the SEC raised various questions arising from jurisdictional overlap and conflict.<sup>32</sup> In response, the CFTC's Office of General Counsel prepared a memorandum regarding the scope of the CFTC's exclusive jurisdiction, particularly as applied to mortgage futures.<sup>33</sup> The CFTC asserted that futures trading in mortgages was not subject to the federal securities laws.<sup>34</sup> The SEC, however, argued that both regulatory agencies appeared to have jurisdiction, since "contracts for future

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31. Commodity Futures Trading Commission, Release No. 48-75 (Sept. 11, 1975) (on file at the offices of the CFTC, Washington, D.C.). GNMA certificates are mortgage-backed instruments supported by the full faith or credit of the United States as to the timely payment of principal and interest. The GNMA security is an "exempted security" as that term is defined in the federal securities laws. Securities Exchange Act of 1934, § 3(a)(12), 15 U.S.C. § 78c(a)(12) (1970).

32. Letter of Roderick M. Hills, Chairman, SEC (Nov. 13, 1975), *reprinted in* [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,117.

33. Memorandum of the Office of the General Counsel of the Commodity Futures Trading Commission Concerning the Exclusive Jurisdiction of the Commission over Futures Transactions, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,117, at 20,831 (Dec. 3, 1975) [hereinafter cited as CFTC Memorandum]. This memorandum provides an extensive review of the legislative history of the exclusive jurisdiction provision of the 1974 amendments as it relates to the regulation of commodity futures trading. This legislative history indicates that the drafters of the 1974 amendments contemplated futures trading in mortgages. The House Report on the proposed legislation noted:

Exchange and other knowledgeable officials stated that new contract markets were planned to be established in the near future in such areas as ocean freight rates, mortgages, and possibly petroleum products.

With the number of nonregulated futures contracts traded being a significant percentage of the total futures market, and with the planned establishment of additional futures markets, we believe that it is vital that these commodities and services be regulated in order to protect the public and to instill confidence in the market.

H.R. REP. NO. 975, 93d Cong., 2d Sess. 62 (1974), *quoted in* CFTC Memorandum, *supra* at 20,832. The Senate Report similarly stated: "[T]ransactions in . . . government securities or mortgages and mortgage purchase commitments would not be subject to the [Commodity Exchange] Act unless they involve the sale thereof for future delivery conducted on a board of trade." S. REP. NO. 1131, 93d Cong., 2d Sess. 31, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5870, *quoted in* CFTC Memorandum, *supra* at 20,832.

34. CFTC Memorandum, *supra* note 33, at 20,831-32.

delivery of [GNMA] securities are also 'securities.'<sup>35</sup> Nonetheless, trading in GNMA futures on the CBOT began on schedule without interference from the SEC.<sup>36</sup>

Finally, the SEC and the CFTC established an informal liaison to discuss jurisdictional conflict. The agencies agreed to cooperate in litigation and on other matters in which jurisdictional issues were raised, because the SEC and the CFTC shared the goal of protecting the public.<sup>37</sup> However, no lasting agreement on jurisdictional conflict has been reached, and the CFTC has continued to stress the exclusivity of its jurisdiction. While the CFTC maintains a cooperative attitude, it has never lost sight of the original position enunciated in its exclusive jurisdiction position paper.<sup>38</sup>

## B. *The CFTC vs. State Regulation*

### *The Federal Preemption Doctrine*

As discussed above, the CFTC has exclusive jurisdiction over accounts, agreements (including options), transactions involving a futures contract,<sup>39</sup> and gold and silver leverage contracts covered

35. Letter of Roderick M. Hills, Chairman, SEC (Nov. 13, 1975), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,117, at 20,829.

36. Subsequent to trading GNMA futures on the CBOT, the CFTC designated the Chicago Mercantile Exchange as a market in 90-day Treasury bills. CFTC Release No. 92-75 (Nov. 26, 1975) (on file at the offices of the CFTC, Washington, D.C.). It also designated the CBOT as a contract market in commercial paper loans and in Treasury bonds. CFTC Release No. 311-77 (July 12, 1977) (on file at the offices of the CFTC, Washington, D.C.); CFTC Release No. 323-77 (Aug. 2, 1977) (on file at the offices of the CFTC, Washington, D.C.).

37. As early as 1974, reference to such anticipated cooperation appeared in Representative Poage's comments:

To the extent that the language of [amended § 2(a)(1)] subjects rights and interests or transactions involving rights and interests to the concurrent jurisdiction of the new Commodity Futures Trading Commission and the Securities and Exchange Commission, the conferees intended that the two Commissions would consult and cooperate in determining what approaches to the exercise of their respective jurisdictions will best serve the public interest.

120 CONG. REC. 34,737 (1974) (remarks of Rep. Poage). See also Letter of Roderick M. Hills, Chairman, SEC (Nov. 13, 1975), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,117, at 20,831.

38. CFTC Memorandum, *supra* note 33.

39. The Senate Conference Report stated:

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act . . . would preempt the field insofar as futures regulation is concerned. Therefore, if any substantive State law regulating 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 Commis-

by section 217 of the Commodity Futures Trading Commission Act of 1974.<sup>40</sup> However, an analysis of the extent to which the Commodity Exchange Act, as amended, supersedes state securities laws must consider not only the exclusive jurisdiction provision, but also the federal preemption doctrine. It is insufficient merely to conclude that a particular area of regulation falls outside the parameters of exclusive jurisdiction if, in fact, federal regulation of that area is pervasive.

Prior to the adoption of the 1974 amendments, courts had construed the Act as not totally preempting state regulation of futures trading. In *Rice v. Board of Trade*,<sup>41</sup> plaintiff claimed that various rules of the CBOT were unreasonable and that they should have been approved by a state commission as required by Illinois law. At issue was whether the Act superseded Illinois law.

At that time, the authority of the Secretary of Agriculture over the rules of commodity exchanges was more limited than the CFTC's authority. With respect to the CBOT rules at issue in *Rice*, the Court stated that "while there is provision in some instances for disapproval of the Board's rules by the Secretary of Agriculture . . . , there is no provision for his approval or disapproval of the rules challenged in the Illinois proceeding."<sup>42</sup> In addition, section 4c of the Act<sup>43</sup> contained a provision stating: "Nothing in this section or section 6b of this title shall be construed to impair any State law applicable to any transaction enumerated or described in such sections."<sup>44</sup> In view of this provision, the Supreme Court in *Rice* stated: "Where Congress used such care to preserve specific state authority, even when it duplicated federal regulation, it is a fair inference not only that supersedure was to take its natural course where rights not saved to the States were involved . . . but also that non-conflicting state authority was left undisturbed."<sup>45</sup> The Court noted that the Act's authorization of the Secretary of Agriculture to cooperate with the states "support[ed]

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sion to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States.

S. REP. NO. 1194, 93d Cong., 2d Sess. 35-36 (1974).

40. 7 U.S.C. § 15a (Supp. V 1975).

41. 331 U.S. 247 (1947).

42. *Id.* at 254.

43. 7 U.S.C. § 6c (1970).

44. *Id.* This provision was deleted by the Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 402(d), 88 Stat. 1389 (amending 7 U.S.C. § 6c (1970)).

45. *Rice v. Board of Trade*, 331 U.S. 247, 255 (1947) (citation omitted).

the inference that Congress did not design a regulatory system which excluded state regulation not in conflict with the federal requirements."<sup>46</sup>

Essentially, the Supreme Court in *Rice* held that the Act did not preempt state regulation. The 1974 amendments, however, deleted the reference to continuing state jurisdiction in section 4c and granted the CFTC exclusive jurisdiction. Therefore, Congress overruled *Rice* at least within the four corners of the grant of exclusive jurisdiction in section 2(a)(1).<sup>47</sup>

Nevertheless, the states may have limited overlapping jurisdiction with the CFTC in commodities regulation.<sup>48</sup> Concurrent jurisdiction would, however, be subject to the federal preemption doctrine. Thus, an analysis of a recent case, *Great Western United Corp. v. Kidwell*,<sup>49</sup> is helpful in applying the preemption doctrine to commodities regulation.

In *Great Western* the District Court for the Northern District of Texas struck down an Idaho statute regulating cash tender offers, holding that the statute was preempted by the Williams Act.<sup>50</sup> The

46. *Id.*

47. 7 U.S.C. § 2 (Supp. V 1975). The language in § 4c, 7 U.S.C. § 6c (1970), was deleted at the request of Senator Curtis of Nebraska. On the floor of the Senate, Senator Curtis stated:

Mr. President, I understand that the intent of the bill is to grant exclusive jurisdiction over commodity futures trading to the new Commission, except to the extent the bill specifies that other Federal and State agencies and Federal and State courts are to retain jurisdiction. However, as I understand it, it is also the intent of the bill that, even in the cases where the State agencies and State courts retain jurisdiction, the Federal substantive law embodied in the Commodity Exchange Act as amended by the bill would preempt the field completely, so that if any substantial State law were contrary to or inconsistent with Federal law, the Federal law would govern.

Section 4c of the existing Commodity Exchange Act contains the following sentence:

"Nothing in this section or section 4b shall be construed to impair any State law applicable to any transaction enumerated or described in such sections."

All of the transactions referred to in that sentence are covered by the existing act as amended by the bill. In order to assure that Federal preemption is complete, I believe that the sentence I quoted should be deleted from the act.

120 CONG. REC. 30,464 (1974) (remarks of Senator Curtis). Senator Talmadge stated: "Mr. President, I have studied the amendment of the distinguished Senator from Nebraska. I agree with its import. I urge the Senate to adopt it." *Id.* (remarks of Senator Talmadge).

48. See text accompanying notes 52-63 *infra*.

49. [1977] 419 SEC. REG. & L. REP. (BNA) M-1 (N.D. Tex. Sept. 2, 1977).

50. The Williams Act was enacted in 1968 as an amendment to the Securities Exchange Act of 1934. Pub. L. No. 90-439, 82 Stat. 454 (1968), *amending* 15 U.S.C.

court discussed the doctrine of preemption:

In order to effect the Supremacy Clause, the courts have developed the doctrine of federal preemption. . . .

. . . .

First, a state statute is preempted if it is apparent from federal statutes, their legislative histories, or the pervasiveness of the federal regulatory scheme that Congress intended to occupy the field and displace state regulations. Second, a state statute is preempted if it affects a field in which the federal interest is so dominant as to preclude state laws regulating the same subject. Finally, a state statute is preempted if it conflicts with the federal law to such an extent as to be an obstacle to the accomplishment of the federal scheme.<sup>51</sup>

When the preemption analysis of *Great Western* is applied to the area of commodities law not covered by the exclusive jurisdiction provision of the Act, there appears to be little room for state regulation of registrants. Congressional concern with conflicting state regulation, the pervasive regulatory scheme established by the Act, statements by members of Congress and others that they envisioned little need for supplemental state regulation, and the specific removal of the "saving" language of section 4c suggest that Congress intended pervasive federal regulation. Certainly where a particular area of regulation is specifically covered by the CFTC, any state regulation which contradicts the CFTC's decision would be invalid under the preemption doctrine. Moreover, it is arguable that even if there are gaps in the CFTC's regulatory program permitting supplemental state regulation, federal preemption nevertheless applies where the CFTC specifically *declines* to implement

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§§ 78m-78n (1964) (codified at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (Supp. V 1965-1969)), as amended, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1970).

51. *Great W. United Corp. v. Kidwell*, [1977] 419 SEC. REG. & L. REP. (BNA) M-1, M-7 (N.D. Tex. Sept. 2, 1977). See also *Northern States Power Co. v. Minnesota*, 447 F.2d 1143 (8th Cir. 1971), *aff'd*, 405 U.S. 1035 (1972), where the court stated:

Key factors in the determination of whether Congress has, by implication, preempted a particular area so as to preclude state attempts at dual regulation include, *inter alia*: (1) the aim and intent of Congress as revealed by the statute itself and its legislative history . . . (2) the pervasiveness of the federal regulatory scheme as authorized and directed by the legislation and as carried into effect by the federal administrative agency . . . (3) the nature of the subject matter regulated and whether it is one which demands "exclusive federal regulation in order to achieve uniformity vital to national interests" . . . and ultimately (4) "whether, under the circumstances of [a] particular case [state] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

*Id.* at 1146-47 (citations omitted).

an aspect of this state regulation. For example, where the CFTC determines implementation of a regulation would place an undue burden on the registrant and the industry, state regulation which contradicts the CFTC decision not to regulate would be invalid. To resolve preemption questions in future litigation, the CFTC should enunciate its position in the *Federal Register* when adopting rules which fall within the CFTC's jurisdiction, but are outside the scope of the grant of exclusive jurisdiction.

### *The States' Regulatory Role*

The question of the states' role in the regulation of the commodities industry also arose shortly after the 1974 amendments became effective. In a speech before the North American Securities Administrators Conference, CFTC Vice Chairman John V. Rainbolt, II emphasized the congressional concern with the patchwork state-federal regulation of commodities which had led to the exclusive jurisdiction provision. Commissioner Rainbolt concluded:

[I]t is clear, beyond any reasonable dispute, that the Act totally preempts any state licensing or registration provisions. Further . . . it is clear that any form of state regulation, as such, of any persons, entities or activities affecting or involving trading in commodity futures contracts, the sale of gold and silver coin and bullion on margin, or commodity options would be inconsistent with the pervasive regulatory scheme established by Congress. Today, state regulation of any sort would be preempted under the Supremacy Clause of Article VI of the Constitution.<sup>52</sup>

The Vice Chairman acknowledged that the states retained some regulatory authority over the commodities industry because (1) the states were not preempted from prosecuting under general state antifraud statutes<sup>53</sup> and (2) the states could sue as *parens pa-*

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52. Address by John V. Rainbolt, II, North American Securities Administrators Conference (Sept. 9, 1975), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,075, at 20,706-07.

53. *Id.* at 20,707. Vice Chairman Rainbolt stated, however, that state antifraud statutes "must be of general application and . . . not part of some narrower state regulatory scheme." *Id.* See also S. REP. NO. 73, 94th Cong., 1st Sess. 5-6 (1975): "[The CFTC Act] does not prevent the States from enforcing their criminal antifraud statutes."; Memorandum Prepared by the CFTC's Office of General Counsel to All State Securities Administrators (Oct. 8, 1976), [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,218, at 21,187: "It would be anomalous, however, if the states were found powerless to prevent behavior which, if consummated, would violate their criminal laws; and it is unreasonable to suppose that Congress could have intended such a result." This memorandum noted, however, that "[a]ctivities permit-

*triae*<sup>54</sup> to enjoin fraud or other violations of the Act or the regulations thereunder.<sup>55</sup> The Vice Chairman encouraged states to cooperate with the CFTC in enforcing the CFTC's regulations, and promised that the CFTC would "conduct regional meetings to promote and coordinate this cooperative enforcement program."<sup>56</sup> Furthermore, the CFTC proposed a model state statute which would authorize a state securities commissioner to sue as *parens patriae*,<sup>57</sup> either to enjoin business activities within the state which violate the Act, or to enforce compliance with the Act.<sup>58</sup>

Various state blue sky commissioners have indicated to the CFTC that enforcement of state antifraud statutes or use of the *parens patriae* concept are impractical alternatives. State officials are reluctant to proceed under general antifraud statutes or as *parens patriae* because proof of fraud or of the validity of a *parens patriae* suit is extremely time- and resource-consuming. Instead, they prefer to proceed under the more specific state broker/dealer registration requirements or blue sky provisions. Indeed, the Central Securities Administrators Council proposed extensive regulatory guidelines for commodity pool programs.<sup>59</sup> To date, no state

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ted under the federal act or by federal regulation may not be impeded through an unreasonably broad interpretation of what might constitute fraud under state law." *Id.*

54. Under the doctrine of *parens patriae*, the state sues for the benefit of its citizens.

55. Address by John V. Rainbolt, II, North American Securities Administrators Conference (Sept. 9, 1975), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,075, at 20,707. See Memorandum Prepared by the CFTC's Office of General Counsel to All State Securities Administrators (Oct. 8, 1976), [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,218, at 21,187.

56. Address by John V. Rainbolt, II, North American Securities Administrators Conference (Sept. 9, 1975), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,075, at 20,707. In an attempt to foster a cooperative state-federal regulatory effort, an Advisory Committee on State Jurisdiction and Responsibilities under the Act was formed to act as liaison organization between CFTC and state officials on matters of joint concern. See 41 Fed. Reg. 13,393 (1976). In September 1977, John G. Gaine, the new CFTC General Counsel, William A. Briggs, and Stanley J. Aronoff, were added as members of the Advisory Committee. COMM. FUT. L. REP. (CCH) REPORT LETTER NO. 57 at 4 (Sept. 27, 1977).

57. While a statute is unnecessary to authorize a state to sue under the doctrine of *parens patriae*, the drafters of the model statute believed that statutory authorization would provide additional encouragement to the states to regulate commodities through *parens patriae* suits.

58. See Memorandum Prepared by the CFTC's Office of General Counsel to All State Securities Administrators (Oct. 8, 1976), [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,218, at 21,191.

59. Central Securities Administrators Council, Proposed Guidelines for the Registration of Commodity Pool Programs (Nov. 8, 1976), [1975-1977 Transfer Binder]



has adopted a statute, such as that suggested by the CFTC, which authorizes its securities administrator to proceed as *parens patriae* to enforce the Act. The states' reluctance to use the *parens patriae* theory to assist in enforcing the Act and its regulations is of concern to the CFTC. Because of the CFTC's limited manpower, it has been unable fully to police commodity-related trading nationwide.

There are two alternatives to merely encouraging states to pursue causes of action on behalf of their citizens. The most obvious alternative is to amend the Act to include a provision similar to section 28 of the Securities Exchange Act of 1934,<sup>60</sup> which permits states to adopt securities regulations insofar as they do "not conflict with the provisions" of the Securities Exchange Act of 1934 and its regulations. However, such a provision would be contrary to the congressional aim of preventing overlapping regulations<sup>61</sup> and is not, therefore, a realistic alternative.

Another perhaps more practical approach in view of the congressional intent is to amend the Act to contain a provision similar to newly enacted section 4C(a) of the Clayton Act.<sup>62</sup> This provision establishes a cause of action for the states on behalf of their citizens in the antitrust area.<sup>63</sup> The advantage of amending the Act to create explicitly a similar *parens patriae* cause of action is that this amendment would both apply the doctrine to the Act and provide congressional impetus to the states to pursue violations of the Act and its regulations.

### III. UNRESOLVED ISSUES RAISED BY EXCLUSIVE JURISDICTION

As noted, the grant of exclusive jurisdiction to the CFTC produces jurisdictional conflict between the CFTC on the one hand,

COMM. FUT. L. REP. (CCH) ¶ 20,244. These proposals contain a registration provision, suitability requirements for both the operator and participants, disclosure and minimum financial standards, and prospectus requirements. See text accompanying note 81 *infra*.

60. 15 U.S.C. § 78bb(a) (Supp. V 1975).

61. See text accompanying note 30 *supra*.

62. Hart-Scott-Rodino Antitrust Improvements Act of 1976, § 301, Pub. L. No. 94-435, 90 Stat. 1383 (amending 15 U.S.C. § 15c (1970)).

63. This amendment to the Clayton Act overruled *Hawaii v. Standard Oil Co.*, 405 U.S. 251 (1972), which had held that the Clayton Act does not authorize a state to sue for injuries to the general economy which are attributable to antitrust violations. See *Illinois Brick Co. v. Illinois*, 97 S. Ct. 2061 (1977).

and the SEC and the states on the other. Areas of regulation formerly within the purview of the SEC or the states have now become subject, with varying degrees of clarity, to the jurisdiction of the CFTC. In the past there has been conflicting regulation and uncertainty resulting from the diffuse jurisdiction over commodities. However, the exclusive jurisdiction provision has not totally resolved the uncertainty. To understand this problem, it is necessary to examine the major areas of regulatory conflict. Then, a test to resolve this uncertainty will be proposed.

### A. *Commodity Options*

Section 2(a)(1) of the Act states that the CFTC has exclusive jurisdiction over the trading of options which involve any commodity for future delivery on a contract market, or other board of trade, exchange, or market.<sup>64</sup> In addition, section 4c(b) of the Act gives the CFTC broad power to determine whether, and under what conditions, options on commodities are to be traded, including options involving the commodity itself and options involving futures in that commodity. This section provides in part:

No person shall offer to enter into, enter into, or confirm the execution of, any transaction . . . involving any commodity . . . not specifically set forth in section 2 of this [Act] . . . which is of the character of, or is commonly known to the trade as, an 'option' . . . contrary to any rule, regulation or order of the Commission prohibiting any such transaction . . . under such terms and conditions as the Commission may prescribe . . .<sup>65</sup>

This broad and apparently clear grant of authority is obscured by its legislative history, at least as applied to options on securities which also come within the definition of "commodity" (securities/commodities).<sup>66</sup> The Senate Report stated: "[T]he Commission would not have the authority to regulate trading in puts and calls for securities. Where traded on exchanges, the puts and calls are regulated by the Securities and Exchange Commission. Where

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64. 7 U.S.C. § 2 (Supp. V 1975). In addition to the obvious statutory resolution of this issue, the nexus between the regulatory problems regarding the trading of the option and the underlying future, including exercise and delivery questions, requires a single regulatory structure.

65. *Id.* § 6c(b). Section 4c(a)(B) of the Act provides that options on the commodities specifically listed in § 2(a)(1) are prohibited. 7 U.S.C. § 6c(a)(B) (Supp. V 1975).

66. See note 25 *supra* and accompanying text.

traded among banks, they are regulated by the bank regulatory agencies.”<sup>67</sup>

The drafters of the amendments did not want the CFTC to become involved in regulating the traditional securities option exchanges or markets. However, the language of section 4c(b), on its face, gives the CFTC jurisdiction over *all* options which involve any commodity, without restriction as to whether the option pertains to a futures contract or a commodity which is also a security.<sup>68</sup> One theoretical problem which could result from this broad authority is that the CFTC could inadvertently disrupt existing securities options markets by banning, restricting, or conditioning the trading of commodity options without regard to whether the underlying commodity is also a security.

As a practical matter, however, this problem may be resolved by section 2(a)(1):

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.<sup>69</sup>

The CFTC’s Office of General Counsel stated in its memorandum to the SEC regarding exclusive jurisdiction that this provision “was intended to make clear that the CFTC would not have any jurisdic-

67. S. REP. NO. 1131, 93d Cong., 2d Sess. 26, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5866.

68. In its Joint Explanatory Statement of the Committee of Conference, the House Conference Report articulated the broad scope of the CFTC’s authority with respect to commodity options:

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.

H.R. REP. NO. 1383, 93d Cong., 2d Sess. 40, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5894, 5901. This aspect of the House bill was adopted without change. *See* STAFF OF SENATE COMM. ON AGRICULTURE AND FORESTRY, 93D CONG., 2D SESS., REPORT ON THE COMMODITY FUTURES TRADING COMMISSION ACT OF 1974, at 5 (Comm. Print 1974).

69. 7 U.S.C. § 2 (Supp. V 1975).

tion with respect to the purchase and sale of the enumerated financial instruments themselves (the 'cash market'), but would have jurisdiction solely with respect to futures trading in those instruments."<sup>70</sup> Thus, section 2(a)(1) of the Act could be interpreted to exclude the CFTC from securities options markets, even though a literal reading of section 4c(b) appears to vest the CFTC with jurisdiction over all options involving commodities, including "securities/commodities."

The conflict between the CFTC and the states in the commodity options area is illustrated by CFTC Interpretative Letter No. 76-19.<sup>71</sup> In this letter, the CFTC's Office of General Counsel reasserted the exclusivity of CFTC jurisdiction as applied to state regulation of commodity options. With respect to the Indiana Securities Commissioner's attempt to regulate commodity options under the state's securities laws, the letter stated: "It is our view . . . that the Indiana securities laws and the regulations adopted thereunder have been preempted insofar as they seek to regulate commodity option transactions. Consequently, we cannot believe that [XYZ] Industries, Inc. is obligated to register as a broker-dealer under the securities laws of Indiana."<sup>72</sup>

### B. Commodity Trading Advisors<sup>73</sup>

CFTC Interpretative Letter No. 76-20<sup>74</sup> discussed the preemption of state regulation of commodity trading advisors. The Office

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70. CFTC Memorandum, *supra* note 33, at 20,834.

71. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,213 (Sept. 29, 1976).

72. *Id.* at 21,160.

73. A commodity trading advisor is statutorily defined as:

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.

7 U.S.C. § 2 (Supp. V 1975).

74. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,214 (Sept. 29, 1976).

of General Counsel stated:

[I]t would be inconsistent with the overriding Congressional desire to establish uniform national regulation in this area to allow any supplementary regulation by states. It is our view, therefore, that the California Commodity Law and the regulations adopted thereunder may not constitutionally be enforced insofar as they seek to regulate the activities of commodity trading advisors or other persons subject to the Commission's exclusive jurisdiction under the pervasive regulatory scheme of the Commodities [sic] Exchange Act.<sup>75</sup>

On February 15, 1977, the CFTC proposed a comprehensive regulatory scheme for commodity trading advisors.<sup>76</sup> If this regulatory package is adopted, the federal regulation for trading advisors would include: registration, including an investigation into the background of the applicant; disclosure of a trading advisor's futures position; an antifraud provision; recordkeeping and reporting requirements; advertising restrictions; and certain disclosure requirements.<sup>77</sup> This proposal would yield a pervasive regulatory scheme: The states could do little which would not either duplicate or conflict with federal requirements. Congress intended to eliminate such duplication and conflict through the 1974 amendments.

### C. Commodity Pool Operators<sup>78</sup>

On February 15, 1977, the CFTC published its proposed regulations for commodity pool operators.<sup>79</sup> The Commission's posi-

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75. *Id.* at 21,162.

76. 42 Fed. Reg. 9278 (1977).

77. *Id.*

78. A commodity pool consists of a group of persons who "pool" their money to trade commodity futures contracts. The most common form of commodity pool is the limited partnership where the limited partners provide the funds for trading and the general partner "operates" the pool. These limited partnership interests are considered securities requiring registration under the Securities Act of 1933, and under the comparable state blue sky laws. See SEC Opinion Letter *re* Thomas Beard, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,279 (Nov. 30, 1976). A commodity pool operator is statutorily defined as:

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.

7 U.S.C. § 2 (Supp. V 1975).

79. 42 Fed. Reg. 9266 (1977).

tion on its exclusive jurisdiction in this area was set forth in the *Federal Register* notice accompanying these proposals:

The activities of commodity pool operators necessarily concern accounts, agreements and transactions involving futures contracts [over which section 2(a)(1) of the Act gives the CFTC exclusive jurisdiction]. In addition, Congress has granted the Commission pervasive authority under Sections 4l, 4m, 4n, 4o and 8a of the Act, to register and otherwise to regulate the activities of commodity pool operators.

. . . .

Notwithstanding this congressional intent, the Commission understands that there remain among the laws of several of the states provisions which purport to regulate pool operator activities. But one of the major reasons that prompted Congress to amend the Act in 1974 was to avoid overlapping and duplicative regulation, which might result from the application of diverse and often conflicting laws of the various states . . . .

In view of this Congressional purpose, and the unambiguous language of the Act, as amended, there is no basis in law for any supplementary regulation by the states of the activities of commodity pool operators except, to the extent that pool operators also engage in securities-activities subject to the jurisdiction of the state regulatory authorities.<sup>80</sup>

Subsequent to the publication of its proposed regulations, the CFTC's Office of General Counsel discussed the guidelines for commodity pool programs proposed by the Central Securities Administrators Council:<sup>81</sup> "We note that several aspects of the Council's proposed guidelines appear to regulate the activities of commodity pool operators. We believe, however, that the states have been preempted from imposing regulatory requirements on commodity pool operators through adoption of the Council's guidelines or otherwise."<sup>82</sup>

The CFTC has consistently stated that its exclusive jurisdiction over accounts, agreements, and transactions involving commodity futures contracts preempts state regulation of commodity pools. However, it has not taken a position on the exclusivity of its jurisdiction over the capital formation of commodity pools. When asked whether section 2(a)(1) precludes the necessity of registration under

80. *Id.* at 9270 n.14.

81. Letter from Richard Nathan, CFTC Deputy General Counsel, to John R. Larson, Minnesota Commissioner of Securities (July 5, 1977), *reprinted in* COMM. FUT. L. REP. (CCH) ¶ 20,445.

82. *Id.* at 21,808.

section 5 of the Securities Act of 1933 or similar state securities laws, the CFTC's Office of General Counsel declined to take a position. In an Interpretative Letter,<sup>83</sup> the Office of General Counsel stated:

It is apparently the view of the Securities and Exchange Commission and some state regulatory agencies . . . that the organizational stage of commodity pools concerns only "capital formation" which may and should be separately considered from regulation applicable to the conduct of the pool's trading activity. . . . Of course, the concept of "capital formation" arises under, and has specific relevance to, securities laws; it is a concept having no necessary relevance to the Commodity Exchange Act or to the proper interpretation of the exclusive jurisdiction provision that Act contains . . . . [R]elationships between commodity trading pools and their participants are, from their inception, quite literally, "accounts, agreements . . . [or] transactions involving contracts of sale of a commodity for future delivery . . . ." On this basis it would not be surprising, in view of the intended breadth and remedial purpose of the exclusive jurisdiction provision, if the courts should ultimately hold that this Commission's exclusive jurisdiction encompasses all matters "touching" upon commodity futures.<sup>84</sup>

Although the Office of General Counsel declined to take a position regarding the exclusivity of the Commission's jurisdiction over commodity pools which also fall within the definition of "investment contracts," it has expressed its opinion on exclusive jurisdiction over discretionary commodity trading accounts, which have been held by some courts to be "investment contracts."<sup>85</sup> The rationale with respect to exclusive jurisdiction should be the same for commodity pools and discretionary accounts.<sup>86</sup>

#### *D. Discretionary Commodity Accounts*

Another form of trading vehicle for commodity speculators is the discretionary commodity account. In these accounts, a speculator gives a power of attorney to his broker or to a commodity

83. CFTC Interpretative Letter No. 77-14, COMM. FUT. L. REP. (CCH) ¶ 20,486 (Sept. 16, 1977).

84. *Id.*

85. See text accompanying notes 87-99 *infra*.

86. For a further discussion of commodity pools, see Saitlin, *Commodity Pools*, in *COMMODITIES AND FUTURES TRADING 1977* (Practising Law Institute 1977).

trading advisor to make all trading decisions with respect to the account. Frequently, these discretionary accounts are part of what brokerage houses call their "managed account programs," whereby the customer gives the brokerage house or an associated person discretion to trade his account pursuant to a special, usually computerized, trading program. In these managed account programs, each customer maintains an individual account with the brokerage house, and that account is traded pursuant to the buy-sell signals indicated by the trading program.

Prior to the adoption of the 1974 amendments, these discretionary accounts and managed account programs had been characterized by many courts as "investment contracts" and thereby securities under the Securities Act of 1933.<sup>87</sup> Other courts, however, had held that discretionary commodity accounts and managed account programs were not investment contracts because they did not meet the "common enterprise" test set forth in *SEC v. Howey Co.*<sup>88</sup> For example, in *Milnarik v. M-S Commodities, Inc.*,<sup>89</sup> the district court held that a discretionary account is a security, but that the issuance of a number of discretionary accounts does not constitute a public offering and is therefore exempted from registration by the private offering exemption of section 4(2) of the Securities Act of 1933.<sup>90</sup> On appeal, the Seventh Circuit modified the lower court decision, holding that a discretionary commodity account does not constitute a security, but merely establishes an agency relationship.<sup>91</sup> In *SEC v. Continental Commodity Corp.*,<sup>92</sup> the Fifth Circuit reached the opposite conclusion. The court in *Continental* deemphasized the importance of the "common enterprise" element set forth in *Howey*, rejecting "the proposition that the pro rata sharing of profits is critical to a finding of commonality."<sup>93</sup> The court stated that "the critical inquiry is con-

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87. See, e.g., *Booth v. Peavey Co. Commodity Servs.*, 430 F.2d 132, 133 (8th Cir. 1970); *Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705, 709 (D. Minn. 1968); *Berman v. Orimex Trading, Inc.*, 291 F. Supp. 701, 702 (S.D.N.Y. 1968).

88. 328 U.S. 293 (1946). The Court in *SEC v. Howey Co.*, *id.*, articulated a "common enterprise" test, stating: "The test [for determining if an investment contract is present] is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 301.

89. 457 F.2d 274 (7th Cir.), *cert. denied*, 409 U.S. 887 (1972).

90. See *id.* at 276-79 (quoting *Milnarik v. M-S Commodities, Inc.*, 320 F. Supp. 1149 (N.D. Ill. 1970)).

91. *Milnarik v. M-S Commodities, Inc.*, 457 F.2d at 279.

92. 497 F.2d 516 (5th Cir. 1974).

93. *Id.* at 552.



fined to whether the fortuity of the investment collectively is essentially dependent upon promoter expertise.”<sup>94</sup>

In two more recent cases, *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,<sup>95</sup> and *Hirk v. Agri-Research Council, Inc.*,<sup>96</sup> the courts refused to follow *Continental*; they held that there must be a pooling of funds or a pro rata distribution of profits to possess the “common enterprise” element necessary to establish an investment contract under the *Howey* test. In *Curran* plaintiff opened accounts in the defendant’s “Specialized, Guided, Account Trading Program” in which plaintiff agreed to participate for at least eighteen months, and in which “Defendant made all trading decisions and exercised complete control over Plaintiffs’ accounts with complete reliance by Plaintiffs upon Defendants’ actions and decisions.”<sup>97</sup> After reviewing these facts, the court concluded that it was

unable to perceive how this sort of arrangement can be held to involve a common enterprise, regardless of how many other customers’ accounts were being handled by defendant under similar arrangements.

. . . [Therefore] no security was involved since there was no “investment contract” as that term has been construed by the Supreme Court in the *Howey* case.<sup>98</sup>

These cases established the law with respect to discretionary commodity accounts prior to the enactment of the 1974 amendments. The CFTC’s Office of General Counsel has asserted that section 2(a)(1) of the Act gives the CFTC exclusive jurisdiction over discretionary commodity trading accounts such as those involved in *Milnarik*, *Continental*, *Curran*, and *Hirk*. The Commission stated that section 2(a)(1) of the Act vests the CFTC with “exclusive jurisdiction with respect to accounts, agreements and transactions involving commodity futures contracts, both discretionary and nondiscretionary, and that the exclusivity of its jurisdiction is not affected by whether the account, agreement or transaction might otherwise be viewed as a ‘security.’ ”<sup>99</sup>

94. *Id.*

95. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,276 (E.D. Mich. 1976).

96. [1977] FED. SEC. L. REP. (CCH) ¶ 19,167 (7th Cir. 1977).

97. *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,276, at 21,504 (E.D. Mich. 1976).

98. *Id.* at 21,507.

99. CFTC Interpretative Letter No. 77-2, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,257, at 21,371 (Jan. 14, 1977).

E. *Gold and Silver Margin Transactions*  
—*Leverage Contracts*

The 1974 amendments gave the CFTC broad authority over transactions "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 . . ." <sup>100</sup> Under section 2(a)(1) of the Act, the CFTC was given exclusive jurisdiction over "transactions subject to regulation by the Commission pursuant to Section 217 . . ." <sup>101</sup> Under this exclusive jurisdiction provision, all regulation by the states and federal agencies of gold and silver margin transactions covered by section 217 is preempted. <sup>102</sup>

In correspondence relating to state litigation concerning transactions in gold and silver leverage contracts, the CFTC's Office of General Counsel stated that "no person may now be enjoined to comply with any regulations concerning Section 217 transactions other than those which the Commodity Futures Trading Commission may adopt." <sup>103</sup>

F. *GNMA Market*

The development of the GNMA <sup>104</sup> futures market highlights the jurisdictional conflict between securities laws and CFTC exclusive jurisdiction under section 2(a)(1) of the Act. Without section 2(a)(1), the GNMA futures market would most likely fall within the scope of securities laws. Moreover, the proper treatment of GNMA commitments for jurisdictional purposes is unclear.

CFTC Interpretative Letter No. 77-11 <sup>105</sup> discussed whether

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100. Commodity Futures Trading Commission Act of 1974, § 217a, 7 U.S.C. § 15a (Supp. V 1975).

101. 7 U.S.C. § 2 (Supp. V 1975). Section 217 of the Commodity Futures Trading Commission Act of 1974 is codified at 7 U.S.C. § 15 (Supp. V 1975).

102. See S. REP. NO. 1194, 93d Cong., 2d Sess. 35-36 (1974) (Conference Report): "[T]he *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 . . ."

103. Letter from CFTC, Office of General Counsel to Charles S. Zimmerman (Jan. 9, and Jan. 21, 1976), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,134, at 20,905.

104. Government National Mortgage Association.

105. COMM. FUT. L. REP. (CCH) ¶ 20,466 (Aug. 17, 1977).

the Commission has exclusive jurisdiction over certain transactions by a dealer in GNMA securities. The CFTC stated:

As we understand the relevant facts, ABC Corporation is a dealer in United States Government securities. It purchases GNMA's from underwriters, who are members of the GNMA Mortgage Backed Securities Dealers Association. It resells the GNMA's to its customers at a markup. These transactions are usually handled on a one business day settlement basis, with the seller's GNMA delivered to a bank against payment by the customer. It appears, however, that payment, and hence delivery, may occur up to 180 days after the date of the agreement with the company's customer, that this deferred delivery is the usual course of business and that delivery on other than a deferred basis is a rare exception.<sup>106</sup>

This discussion raised, without answering, whether the GNMA Mortgage-Backed Securities Dealers Association was a "board of trade" which must be designated as a contract market.<sup>107</sup>

In a separate Interpretative Letter issued simultaneously, the CFTC responded to the related question of whether transactions in the GNMA forward commitment market involved contracts for purchase or sale of a commodity for future delivery and were thus within the CFTC's jurisdiction.<sup>108</sup> After reviewing the legislative history of the CFTC jurisdiction over foreign currencies and government securities,<sup>109</sup> the letter concluded:

106. *Id.* at 21,907.

107. The letter noted:

Notwithstanding the broad significance the "exclusive jurisdiction" provision may have for these and other purposes, however, we do not believe that a person who, in violation of the Commodity Exchange Act, has failed to submit to the exclusive jurisdiction of the Commission by seeking or obtaining designation or registration should be permitted by any court to raise the Commission's exclusive jurisdiction as a defense against alleged violations of other statutes. The exclusive jurisdiction provision was designed by Congress to protect legitimate businessmen from duplicative regulation by the various states and the federal government. In view of this purpose, a person who has not submitted to the jurisdiction of this Commission is not entitled to the protection the Commodity Exchange Act would otherwise offer.

*Id.* at 21,908-09.

108. CFTC Interpretative Letter No. 77-12, COMM. FUT. L. REP. (CCH) ¶ 20,467 (Aug. 17, 1977).

109. The Senate Committee on Agriculture and Forestry commented that it had included

an amendment [to the House bill] to clarify that the provisions of the bill are not applicable to trading in foreign currencies and certain enumerated

We view these remarks by the Committee as an expression that regulation by the Commission is unnecessary where there exists an informal market among institutional participants in transactions for future delivery in the specified financial instruments only so long as it is supervised by those agencies having regulatory responsibility over those participants. However, where that market is not supervised and where those transactions are conducted with participation by members of the general public, we do not understand the Committee to have intended that a regulatory gap should exist. In these circumstances, we believe the Commodity Exchange Act should be construed broadly to assure that the public interest will be protected by Commission regulation of those transactions.

Notwithstanding these considerations, on the basis of the facts concerning your client's existing and proposed transactions in GNMA's and Treasury Obligations as set forth in your letter, particularly the lack of general public participation in the transactions, it may be reasonable to conclude, as you appear to have concluded, that your client's transactions do not involve contracts of sale of a commodity for future delivery traded or executed on a board of trade. If you should be misinformed concerning any material fact, however, for example, the lack of public participation in the transactions, a different conclusion may be required.<sup>110</sup>

This opinion emphasized that there was no regulatory vacuum in the GNMA market and no general public participation in transactions in that market. The implication was that should either of these factors change, the commitment market for GNMA certifi-

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financial instruments unless such trading is conducted on a formally organized futures exchange. A great deal of trading in foreign currency in the United States is carried out through an informal network of banks and tellers. The Committee believes that this market is more properly supervised by the bank regulatory agencies and that, therefore, regulation under this legislation is unnecessary.

Likewise, the Committee believes that regulation by the Commission of transactions in the specified financial instruments (i.e., security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, mortgages and mortgage purchase commitments), which generally are between banks and other sophisticated institutional participants, is unnecessary, unless executed on a formally organized futures exchange.

S. REP. NO. 1131, 93d Cong., 2d Sess. 23, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5863-64, *quoted in* CFTC Interpretative Letter No. 77-12, COMM. FUT. L. REP. (CCH) ¶ 20,467, at 21,912 (Aug. 17, 1977).

110. CFTC Interpretative Letter No. 77-12, COMM. FUT. L. REP. (CCH) ¶ 20,467, at 21,912 (Aug. 17, 1977).

cates could be construed to be a futures market. In fact, the GNMA commitment market is, essentially, unregulated. Moreover, the market existed in this unregulated fashion at the time of the 1974 amendments, and there is no hint in the legislative history that Congress intended the CFTC to regulate this market. The Interpretative Letter referred to a statement by the Senate Committee on Agriculture and Forestry which revealed the Senate's intent that, unless traded "on a formally organized futures exchange," regulation of foreign currency was "'more properly supervised by the bank regulatory agencies and that, therefore, regulation under this legislation is unnecessary.'"<sup>111</sup> However, when referring to government securities, the Committee indicated its belief that "'regulation by the Commission of transactions in . . . government securities . . . which generally are between banks and other sophisticated institutional participants, is unnecessary, unless executed on a formally organized futures exchange.'"<sup>112</sup> One may thus conclude that when the 1974 amendments to the Act were adopted, it was known that this market was essentially unregulated.

The second major element in the CFTC's opinion letter was the concern with possible participation in the GNMA commitment market by the general public. Although public participation in a market is a legitimate concern of a regulatory agency charged with protecting the public, and partially determines if something is a futures contract, such participation has never been considered the touchstone in defining a futures contract.

A CFTC Advisory Committee Report<sup>113</sup> analyzes the differences among futures contracts, forward contracts, and leverage contracts. The analysis includes among the important characteristics of a futures contract that it (1) is traded publicly; (2) is priced by open outcry; (3) is rarely settled by delivery; (4) is cleared through a central clearinghouse; and (5) consists of uniform contract terms.<sup>114</sup> A forward market, such as the GNMA commitment mar-

111. *Id.* (quoting S. REP. NO. 1131, 93d Cong., 2d Sess. 23, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5863-64).

112. CFTC Interpretative Letter No. 77-12, COMM. FUT. L. REP. (CCH) ¶ 20,467, at 21,912 (Aug. 17, 1977) (quoting S. REP. NO. 1131, 93d Cong., 2d Sess. 23, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5863-64).

113. Report of the Advisory Committee on Market Instruments to the CFTC on Recommended Policies on Futures, Forward and Leverage Contracts and Transactions (July 16, 1976), reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,192.

114. *See id.* at 21,090.

ket, in which delivery is the rule rather than the exception and in which terms and conditions are privately negotiated, does not possess these established futures contract characteristics. These elements must always be analyzed to determine whether a commitment market is, in fact, a futures market.

CFTC Interpretative Letter No. 77-12<sup>115</sup> permits the GNMA commitment market to exist without threat of immediate CFTC intervention. However, the letter warns that should the public become more involved in trading commitments, the CFTC may examine the market to determine whether it is a futures market under the Act.<sup>116</sup>

#### IV. CASE LAW REGARDING CFTC JURISDICTION

Few cases have discussed the parameters of the jurisdictional and exclusive jurisdictional provisions of the Act, as amended by the CFTC Act of 1974; most of the cases to date have involved transactions occurring prior to April 21, 1975, the effective date of the 1974 amendments. The specific issue raised in these cases was whether the SEC or the states may bring an action, including an injunction request, against violation of the securities laws as to the sale, prior to April 21, 1975, of options on commodities for future delivery and of "leverage contracts" in gold and silver. However, the decisions, even on this narrow issue, have been inconsistent.

*State v. Monex International, Ltd.*<sup>117</sup> was an early decision involving this issue. In *Monex International* Texas sued to enjoin Monex from selling "leverage contracts" which had not been registered under the state securities laws. The lower court held that Monex was not selling securities within the meaning of the Texas Securities Act and the state appealed. While that appeal was pending, the 1974 amendments became effective. The Texas Court of

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115. COMM. FUT. L. REP. (CCH) ¶ 20,467 (Aug. 17, 1977).

116. Aside from the commodity law issues present in the GNMA commitment market, this market is also faced with various securities law questions. For example, whether either a mandatory commitment (a bilateral contract) or a standby commitment (an option) is a security apart from the GNMA security itself is an important issue. If either commitment is held to be a separate security, it might be subject to the registration provisions of the Securities Act of 1933. For a general discussion of some of the securities law problems present in the mortgage market, see Root & Russo, *Trading System for Mortgages Must Clear SEC Restrictions*, in 2 SEC '74, at 105 (1974).

117. 527 S.W.2d 804 (Tex. Civ. App. 1975).

Civil Appeals stated: "We think it is clear that the newly established Commodity Futures Trading Commission now has exclusive jurisdiction to regulate [Monex's] margin account sales."<sup>118</sup> In *Clayton Brokerage Co. v. Mouer*,<sup>119</sup> the Supreme Court of Texas, following *Monex*, held that the CFTC's jurisdiction with respect to London commodity options was exclusive and dismissed as moot the state suit against the brokerage company.<sup>120</sup>

In *SEC v. Univest, Inc.*,<sup>121</sup> the District Court for the Northern District of Illinois held similarly. The SEC charged defendant in *Univest* with violating the securities laws with respect to selling London options on commodities for future delivery prior to April 21, 1975. While the SEC was investigating the case, but prior to the time that it actually filed suit, the 1974 amendments became effective. In *Univest* the court stated that "[t]his new statute, which went into effect on April 21, 1975, serves to strip the SEC of standing to bring this suit."<sup>122</sup> Regarding section 412 of the 1974 amendments,<sup>123</sup> the court stated that "[t]he fact is that this action was not 'pending' prior to the effective date of the new statute. . . . [C]onsequently, the provisions of the new Act come into effect with regard to the actions which led to the filing of this complaint."<sup>124</sup>

Subsequent cases, however, have not followed *Monex*, *Clayton*, or *Univest*. Indeed, in *SEC v. Norton*,<sup>125</sup> the District Court for the Northern District of Illinois, with facts similar to those in *Univest* but without reference to its previous holding in that case, held that the SEC had standing to sue. The court relied "on the

118. *Id.* at 807. The court reviewed the provisions of § 412 of the 1974 amendments, Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. § 4a note (Supp. V 1975)), which provide that "[p]ending proceedings under existing law shall not be abated by reason of any provision in 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." The court held: "Section 412 pertains to matters pending under the Commodity Exchange Act before the 1974 amendments. Here, the State seeks to enjoin future conduct on the part of [Monex] under the Texas Securities Act. Section 412 is not applicable." *State v. Monex Int'l, Ltd.*, 527 S.W.2d 804, 807 (Tex. Civ. App. 1975).

119. 531 S.W.2d 805 (Tex. 1975).

120. *Id.*

121. 405 F. Supp. 1057 (N.D. Ill. 1975), *appeal docketed*, No. 76-1734 (7th Cir. July 26, 1976).

122. *Id.* at 1058.

123. See note 118 *supra* and accompanying text.

124. *SEC v. Univest, Inc.*, 405 F. Supp. 1057, 1059 (N.D. Ill. 1975), *appeal docketed*, No. 76-1734 (7th Cir. July 26, 1976).

125. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,204 (N.D. Ill. 1976).

House Report which clearly intended to leave undisturbed any matters under investigation by the Securities and Exchange Commission at the effective date of the new Act in April, 1975."<sup>126</sup>

In *State v. Coin Wholesalers, Inc.*,<sup>127</sup> the State of Minnesota brought an action for violation of the state securities laws with respect to the sale, prior to April 21, 1975, of silver coins on margin, constituting leverage contracts. Plaintiff sought a declaratory judgment that defendant's margin sales were sales of securities, and also sought a permanent injunction against such sales pursuant to state securities laws. The lower court denied all the requested relief, with one exception: It declared the sale of silver coins on margin to be an "investment contract" and, hence, a security under state securities laws.<sup>128</sup> On appeal, the Supreme Court of Minnesota reviewed the Texas cases which had held that section 412 of the 1974 amendments abated proceedings under state law. The court emphasized, however, that those cases dealt with requests for prospective injunctive relief under state blue sky laws. It affirmed the lower court decision, stating that the declaratory judgment action distinguished the instant case from the Texas cases: "We are persuaded that § 412 was not intended to abate pending actions under state law that seek remedies which, like declaratory judgments, are wholly retrospective. This construction in no way impinges on the exclusively Federal jurisdiction over margins sales after April 21, 1975 . . . ."<sup>129</sup>

In *SEC v. American Commodity Exchange, Inc.*,<sup>130</sup> defendants, prior to April 21, 1975, had engaged in transactions for options on commodities for future delivery which the SEC charged had violated the antifraud provisions of the federal securities laws. The lower court issued permanent injunctions against violations of the federal securities laws. Upon appeal, the issue before the Tenth Circuit was whether the 1974 amendments to the Act excluded the SEC from any jurisdiction which it might otherwise have had over the transactions in question. The court reviewed the legislative history of the jurisdictional provisions, including statements by Senator Talmadge and Representative Poage,<sup>131</sup> and con-

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126. *Id.* at 21,126-27.

127. COMM. FUT. L. REP. (CCH) ¶ 20,407 (Minn. 1977).

128. *Id.* at 21,636 (discussing lower court decision).

129. *Id.* at 21,637.

130. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,238 (10th Cir. 1976).

131. On the floors of the Senate and the House, respectively, Senator Talmadge



cluded:

Based on the history and the strong reasons of policy and legislative logic, it is to be concluded that the [Securities and Exchange] Commission retained jurisdiction to bring the suit and that the trial court had jurisdiction to entertain the case and to grant the relief prayed for. This view is in harmony with the legislative history. It carries out the Congressional intent to avoid overlapping, but it does not create a void period during which neither Commission can act.<sup>132</sup>

In *International Trading Ltd. v. Bell*,<sup>133</sup> a state appellate court considered the relationship of CFTC exclusive jurisdiction to activities occurring subsequent to the effective date of the 1974 amendments. Appellants had been enjoined by the lower court under the Arkansas Securities Act<sup>134</sup> from committing fraud in connection with the sale of "London commodity options." The Supreme Court of Arkansas reviewed the prior case law in this area and the legislative history of the Act. In response to the State Securities Commissioner's argument that he should not be prevented from enforcing the state securities regulatory scheme because the Arkansas Securities Act does not conflict with the federal act, the court stated: "Where . . . Congress has made it clear that authority conferred by it is exclusive in a given area the states cannot exercise concomitant or supplementary regulatory authority over the identical activity."<sup>135</sup> The court found that, in view of the CFTC's exclu-

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and Representative Poage stated:

[A]ll pending proceedings, including ongoing investigations, as well as court proceedings, should continue unabated by any provision of the Act. This also is necessary in order to prevent the creation of any regulatory gaps . . . . During the course of our deliberations, we learned, for example, that the SEC has a number of such matters currently under investigation. We would expect that those investigations will continue and any proceedings resulting therefrom will not be affected by the passage of this Act.

120 CONG. REC. 34,997 (1974) (remarks of Senator Talmadge); 120 CONG. REC. 34,737 (1974) (remarks of Rep. Poage), *quoted in* SEC v. American Commodity Exch., Inc., [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,238 (10th Cir. 1976).

132. SEC v. American Commodity Exch., Inc., [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,238, at 21,272 (10th Cir. 1976).

133. COMM. FUT. L. REP. (CCH) ¶ 20,495 (Ark. Oct. 3, 1977).

134. ARK. STAT. ANN. §§ 67-1235 to 67-1263 (West 1966 & Supp. 1975).

135. *International Trading Ltd. v. Bell*, COMM. FUT. L. REP. (CCH) ¶ 20,495, at 21,996 (Ark. Oct. 3, 1977) (citations omitted). The court reviewed the preemption test set forth in *Northern States Power Co. v. Minnesota*, 447 F.2d 1143 (8th Cir. 1971), *aff'd*, 405 U.S. 1035 (1972), and concluded: "Although we would be compelled to answer the fourth question in the negative, if we consider only the terms of the Arkan-

sive jurisdiction in this area, the lower court had no jurisdiction under the Arkansas Securities Act and the State Securities Commissioner had no standing to bring the action.<sup>136</sup>

Thus, courts have reached varying decisions on the issue of whether the SEC or the states can sue under securities laws for activities regarding the sale of commodity options or leverage contracts. There appears to be, however, a trend in the decisions indicating that, while the state and federal securities laws are applicable to commodity option and leverage contract sales activities occurring prior to the effective date of the 1974 amendments, the CFTC's exclusive jurisdiction makes the securities laws inapplicable to such transactions occurring after that date.

#### V. A PROPOSAL

The events leading to the adoption of the exclusive jurisdiction provision of the 1974 amendments indicated the necessity for one regulatory structure to deal with the growing problems and needs of the commodities industry. Yet, notwithstanding the CFTC's exclusive jurisdiction, states continue to propose and enforce substantive regulatory provisions regarding the commodities markets, and there has been no agreement between the SEC and the CFTC as to many aspects of the CFTC's exclusive authority.

The price of this uncertainty is the inability of the business community to determine the proper legal course to follow. For example, there are no certain answers to whether a commodity pool must abide by substantive state regulation governing such pools or whether it must comply with the disclosure requirements of the

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sas Securities Act as presently written, the potential for obstacles is just as important as their existence. . . . Commodity Futures Trading Commission regulations could change this answer. As to the other questions, our answers are in the affirmative. We have already mentioned the legislative history and the broad scope of the Commodity Futures Trading Commission Act. There was at least a Congressional finding that the nature of the subject matter demanded exclusive federal regulations and we cannot say that this finding was unfounded. . . . Even if we apply [the test articulated in *Northern States Power Co.*], we find a strong implication that federal preemption was intended." *International Trading Ltd. v. Bell*, COMM. FUT. L. REP. (CCH) ¶ 20,495, at 21,996 (Ark. Oct. 3, 1977) (citations omitted).

136. The court stated that, although the state could not prosecute under the Arkansas Securities Act, it could prosecute an offender under the state's Criminal Code and that "[t]here is no bar of actions by persons [who had been] defrauded to recover money [which had been] obtained from them by fraud. Such actions could not constitute any realistic threat of interference with the federal regulatory scheme and the act certainly does not afford protection of fraudulent conduct." *International Trading Ltd. v. Bell*, COMM. FUT. L. REP. (CCH) ¶ 20,495, at 21,996 (Ark. Oct. 3, 1977).

federal securities laws.<sup>137</sup>

Unfortunately, much of the difficulty in determining the parameters of exclusive jurisdiction results from "turf-fighting" between public agencies. Prior to the adoption of the 1974 amendments, there was no agency with specific authority to regulate many aspects of commodities trading. When public agencies confronted fraud or the potential for fraud in these unregulated areas, they sought in their enabling legislation a nexus to the questioned activity which would allow them to protect their constituency from the perpetrators of fraud. The nexus in the securities field derived from calling whatever is being sold a "security," or from requiring disclosure of the fraud under the disclosure provisions of the securities laws.<sup>138</sup> However, the grant of exclusive jurisdiction to the CFTC demonstrates the congressional intent that a single agency, the CFTC, should regulate commodities markets. Thus, it should no longer be necessary for other regulatory bodies to seek connections to their own regulatory systems for the purpose of regulating these markets.

Nevertheless, the unresolved issues described in this article demonstrate the lack of definitive guidelines for determining the bounds of the CFTC's exclusive jurisdiction. We suggest that a "rule of reason" be used to determine who governs what. The elements of such a rule of reason must be derived from the intent of Congress as revealed in section 2(a)(1). The fundamental congressional design was to avoid a duplicative or contradictory regulatory structure. In the 1974 amendments, Congress sought to create one federal agency with the expertise to regulate the commodities industry. In the numerous jurisdictional "gray areas," Congress' intent should be the touchstone in determining the scope of the CFTC's exclusive jurisdiction.

For example, the SEC maintains that the disclosure provisions of the Securities Act of 1933<sup>139</sup> apply to commodity pools. At present, the CFTC has acquiesced in this contention by not objecting

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137. Often, a commodity pool operator must decide whether to abide by substantive state regulations which may prove costly and which may limit the operations of the pool, or not to comply because he believes the particular regulations are within the CFTC's exclusive jurisdiction, thereby risking a costly lawsuit to prove his point.

138. Perhaps the best example of the use of the disclosure provisions to remedy a more fundamental problem is the SEC's attempt to prevent bribes to foreign officials by requiring disclosure of these bribes. See generally Note, *Foreign Bribes and the Securities Acts' Disclosure Requirements*, 74 MICH. L. REV. 1222 (1976); 49 TEMP. L.Q. 428 (1976).

139. 15 U.S.C. §§ 77a-77bbbb (1970).

to the application of such SEC disclosure provisions. Notwithstanding its acquiescence, the CFTC has proposed requiring commodity pool operators to furnish a disclosure statement to prospective pool participants on or before the date it solicits, accepts, or receives funds from such participants.<sup>140</sup> The CFTC proposed its disclosure requirements after reviewing SEC registration and equivalent state requirements, and decided that certain aspects of federal and state securities regulation, such as review of the disclosure statement by the CFTC prior to the sale of interests in commodity pools, were unnecessary. Because of the CFTC's expertise in understanding commodity pools and its expert judgment of how much disclosure and governmental review best protect the public, it contradicts the rule of reason to permit another public agency lacking this "commodities expertise" to regulate this area. In addition, the enforcement of disclosure provisions by different regulatory bodies will be duplicative where such provisions overlap, and will be contradictory where the regulatory decisions are at cross-purposes.

In view of the congressional concern with duplicative and contradictory regulation, the CFTC's expertise in the commodities area, and the equivalency of the CFTC's proposal to existing federal and state securities law regulation, a rule of reason resolution of this jurisdictional "gray area" favors the exclusive jurisdiction of the CFTC.<sup>141</sup> If used by the various regulatory bodies and the courts, the rule of reason can resolve many of the jurisdictional issues described in this article. Alternatively, Congress should clarify its intent in unambiguous language, so that contradictory and duplicative regulation, costly both to the commodities industry and to the public, can be avoided.

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140. See text accompanying notes 79-80 *supra*.

141. A rule of reason resolution would be necessary only where it is unclear whether the exclusive jurisdiction provision is applicable. However, it can be argued with respect to the capital formation stage of a commodity pool, that the issue is one that could be resolved by the language of § 2(a)(1). In an Interpretative Letter, the CFTC Office of General Counsel stated that the "relationships between commodity trading pools and their participants are, from their inception, quite literally, 'accounts, agreements . . . [or] transactions involving contracts of sale of a commodity for future delivery . . .'" CFTC Interpretative Letter No. 77-14, COMM. FUT. L. REP. (CCH) ¶ 20,486, at 21,975 (Sept. 16, 1977). Indeed, Congress was aware that the "inception" of a pool includes its capital formation. It defined a commodity pool operator as "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 . . .*" 7 U.S.C. § 2 (Supp. V 1975) (emphasis added).

