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PREEMPTION AND THE COMMODITY EXCHANGE ACT

BY KEVIN T. VAN WART*

The Commodity Futures Trading Commission Act of 1974¹ extensively amended the Commodity Exchange Act.² Prior to these amendments, the CEA applied only to transactions involving certain agricultural commodities³ and was administered by the Commodity Exchange Authority, a unit within the Department of Agriculture. The CFTC Act, however, enlarged the definition of "commodity" to include not only agricultural products but also "all other goods and articles . . . and all services, rights and interests in which contracts for future delivery are presently or in the future dealt."⁴ The Act also created the Commodity Futures Trading Commission (CFTC) as an independent federal regulatory agency to administer and enforce the Act's provisions.⁵

As amended, the CEA requires boards of trade⁶ to secure from the CFTC designation as a "contract market" for each futures contract⁷ in

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1. Pub. L. No. 93-463, 88 Stat. 1389 (codified in scattered sections of 5, 7 U.S.C. (1976)) [hereinafter referred to as the CFTC Act]. For an excellent general review of the 1974 legislation, see Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L. REV. 1 (1976) [hereinafter cited as Johnson].

2. Pub. L. No. 675, ch. 545, 49 Stat. 1491 (1936) (current version at 7 U.S.C. §§ 1-24 (1976 & Supp. IV 1980)) [hereinafter referred to as the CEA].

3. Prior to the 1974 amendments, section 2(a)(1) of the Commodity Exchange Act defined "commodity" to mean "wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, onions, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice." 7 U.S.C. § 2 (1970).

4. 7 U.S.C. § 2 (1976). This amendment eliminated any distinction between regulated and nonregulated commodities and brought within the regulatory embrace of the Act such actively traded commodities as cocoa, coffee, copper, foreign currencies, iced broilers, lumber, mercury, palladium, platinum, plywood, propane gas, silver, sugar and silver coins. See S. REP. NO. 1131, 93d Cong., 2d Sess. 94, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5891.

5. 7 U.S.C. § 4a (1976 & Supp. IV 1980). The sponsors of this legislation expressed their intent that the CFTC would be "comparable in stature and responsibility to the Securities and Exchange Commission." 120 CONG. REC. 34,996 (1974) (statement of Sen. Talmadge).

6. 7 U.S.C. § 2 (1976) defines "board of trade" to include "any exchange or association, whether incorporated or unincorporated, of persons who shall be engaged in the business of buying or selling commodity [sic] or receiving the same for sale on consignment."

7. The CEA does not specifically define or use the term "futures contract." However, it is generally regarded as a contract "for the purchase and sale of commodities for delivery some time in the future on an organized exchange and subject to all terms and conditions included in the

which they wish to trade.⁸ In recent years, the futures industry has undergone tremendous growth as these boards, in seeking contract market designation status, have taken advantage of the more expansive definition of commodity now contained in the CEA. They have proposed futures contracts for risk-oriented business enterprises which, although not traditionally involved in futures markets, could potentially benefit from the hedging mechanism⁹ uniquely afforded by futures contracts.

Among the more unconventional proposals submitted to the CFTC by boards of trade applying for designation as contract markets are those involving contracts based on financial futures.¹⁰ These proposals include interest rate futures¹¹ and contracts based on stock indices.¹² The latter are perhaps the most controversial of all the applications awaiting approval by the CFTC. Critics contend that stock index futures do not constitute " 'contracts of sale of a commodity for future delivery' " under section 2(a)(1) of the CEA.¹³ Some have charged that such futures are essentially "dressed up" forms of wagering on the price movements of financial instruments and are designed

Rules of that Exchange." S. Rep. No. 1131, 93d Cong., 2d Sess. 102, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5892.

8. 7 U.S.C. § 8 (1976). To obtain and preserve designation as a contract market, a board of trade must satisfy those standards enumerated in 7 U.S.C. §§ 7, 7a (1976). 7 U.S.C. § 6 (1976) expressly prohibits trading in futures except through members of a board of trade designated by the CFTC as a contract market.

9. Hedging is either the *sale* of futures against the *purchase* of the cash commodity or its equivalent or the *purchase* of futures against forward sales or anticipated requirements of the physical commodity. In each instance, hedging serves as protection against either a price decline or advance. *See* S. Rep. No. 1131, 93d Cong., 2d Sess. 102, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5892. Hedging is generally credited with reducing business risks in commodities which are subject to volatile price movement. *See generally* H. WORKING, *Hedging Reconsidered*, in *SELECTED WRITINGS OF HOLBROOK WORKING* 123 (1977).

10. At present, there are as many as thirty financial futures proposals awaiting CFTC approval. *Chicago Tribune*, June 10, 1981, § 3, at 3, col. 2.

11. Interest rate futures would be used by banks to shield themselves against interest rate fluctuations in transactions involving such balance sheet liabilities as certificates of deposit and Eurodollars. *Id.* Although this variation of interest rate futures is unprecedented, interest rate futures themselves are not. Interest rate futures have been available for Treasury bonds and bills as well as Government National Mortgage Association (GNMA) securities. *Id.*

12. Applications presently pending before the CFTC include proposals based on the Value Line Index submitted by the Kansas City Board of Trade on June 15, 1979, and Standard and Poor's 500 Stock Price Index submitted by the Chicago Mercantile Exchange on February 29, 1980. A Portfolio Futures Complex proposal was submitted by the Chicago Board of Trade on February 20, 1980, and is based on ten separate indices according to industry groupings and one overall index. Architzel & Connolly, *Delivery on Futures Contracts as a Legal Requirement*, 36 *BUS. LAW.* 935, 935 n.1 (1981).

13. Letter from Walter Auch, Chairman and Chief Executive Officer of the Chicago Board Options Exchange, to Jane Stuckey, Secretary of the CFTC (May 1, 1981) at 6 [hereinafter cited as Auch Letter].

to circumvent state and federal securities laws.¹⁴ These critics have also argued that state "bucket-shop" laws¹⁵ and other anti-gambling legislation would prohibit any transactions involving such futures regardless of whether the CFTC approves stock index futures and designates contract markets on which they can be traded.¹⁶

Such objections have resurrected the jurisdictional disputes which stalked the CFTC with dogged persistence from the passage of the CFTC Act in 1974 until the renewal of that legislation in 1978.¹⁷ As the CFTC prepares to act on these financial futures proposals,¹⁸ and as Congress readies for its quadrennial review of the CFTC,¹⁹ the proponents of state regulatory authority over commodities trading are once again posturing for an assault on the exclusive jurisdiction which the 1974 amendments conferred on the CFTC.

Part I of this article will consider some of the arguments which critics of financial futures have raised in opposition to CFTC approval of stock index futures. Part I will also discuss the controversy regarding the presumed delivery requirement of section 2(a)(1) of the CEA and trace the development of, and judicial response to, the nineteenth-century bucket-shop laws which are now being cited as obstructions to trading in stock index futures. Part II will review, in some detail, the legislative history of the 1974 amendments to the CEA and identify evidence of congressional intent regarding state regulation of commod-

14. *Id.* at 3.

15. The term "bucket shop" refers to firms that offer customers the opportunity to bet on changes in futures market prices without actually entering into futures transactions on the contract market. See text accompanying notes 34-72 *infra*.

16. Auch Letter, *supra* note 13, at 12-17. See also Letter of Irving Pollock, SEC Commissioner, to William Bagley, Chairman of the CFTC (Aug. 21, 1978) at 7-8.

17. Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865 (codified at 7 U.S.C. §§ 1-24 (Supp. IV 1980)).

18. On June 30, 1981, the CFTC approved trading of bank certificates of deposit on the New York Futures Exchange. See Chicago Tribune, July 1, 1981, § 3, at 3, col. 2. On July 21, 1981, the Chicago Board of Trade received approval to open trading in bank certificates of deposit futures contracts; trading was opened the following day. See Chicago Tribune, July 22, 1981, § 3, at 3, col. 2. Soon thereafter, the Chicago Mercantile Exchange received similar CFTC approval and entered into futures trading in bank certificates of deposit. *Id.* See generally Chicago Tribune, Sept. 16, 1981, § 3, at 3, col. 2. Action on the more controversial stock index futures proposals is still pending.

19. The 1974 amendments contained a "sunset" provision which provided for CFTC funding only through 1978. Commodity Exchange Act § 12(d), 7 U.S.C. § 16(d) (1976). The reauthorization legislation extended this funding another four years. Futures Trading Act of 1978, § 20, 7 U.S.C. § 16(d) (Supp. IV 1980). For a comprehensive review of this reauthorization process, see Johnson, *The Commodity Futures Trading Commission Reauthorization Process: A View from the Trenches*, 1 DET. C.L. REV. 1 (1979). See also Schneider & Santo, *Commodity Futures Trading Commission: A Review of the 1978 Legislation*, 34 BUS. LAW. 1755 (1979); Guttman, *The Futures Trading Act of 1978: The Reaffirmation of CFTC-SEC Coordinated Jurisdiction Over Security/Commodities*, 28 AM. U.L. REV. 1 (1978).

ity futures trading. Part III will then discuss the preemption doctrine relative to the CEA and conclude that Congress did not intend the states to perform any independent regulatory function. Finally, Part IV will review the legislative history of the 1978 amendments to the CEA and assess their effect on the preemption issue and the controversy over stock index futures. This section will reason that state bucket-shop laws and other anti-gambling legislation—in addition to being anachronistic in an era of modern regulated exchanges—are at variance with this congressional intent to preempt state regulation of commodity futures trading.

I. THE CONTROVERSY

Delivery Requirement of Futures Contracts

The use of the phrase “contracts of sale of a commodity for future delivery” in section 2(a)(1) of the CEA permits an inference that a provision for delivery of the underlying commodity is a necessary element of a futures contract. However, even though futures contracts have traditionally provided for delivery of the underlying commodity, the CEA has never explicitly mandated that, as a prerequisite to designation as a contract market, a board of trade must include such a delivery provision in its proposed contract. Accordingly, scholars, consistent with the broader concepts of “delivery” and “commodity” implicit in the 1974 amendments to the CEA, have begun to reconsider this presumed delivery requirement.

The authors of one recent study, after reviewing both the development of futures trading and the legislative history of the CEA, conclude that Congress never intended to require that futures contracts provide for the delivery of the underlying commodity in all circumstances.²⁰ They cite traditional congressional reluctance to enact a provision explicitly imposing delivery as a mandatory means of settlement.²¹ Emphasizing the distinction between regulating and mandating delivery, these authors note that some references to delivery in the CEA simply represent congressional attempts to refine trading practices in traditional commodities.²² They also demonstrate that other delivery references in the CEA resulted from a general congressional desire to minimize the price distortions which can arise when a futures contract

20. Architzel & Connolly, *Delivery on Futures Contracts as a Legal Requirement*, 36 BUS. LAW. 935 (1981).

21. *Id.* at 948.

22. *Id.* at 946-47.

does not fairly reflect the general value of the underlying commodity.²³ Consequently, observing that delivery is not always necessary to ensure that the cost of the future accurately reflects the price of the commodity, these authors argue that delivery is not a legal requirement of a futures contract.²⁴

Other scholars have expressed similar doubts as to the validity of delivery requirements. Professor Holbrook Working has suggested that delivery is a problem only in the United States.²⁵ He observes that exchanges began to require delivery of the commodities to enable brokerage firms to collect fees from speculators who, having lost money, sought to avoid payment by charging that, under state bucket-shop laws, their commodity transactions were merely wagers on price movement.²⁶ Professor Working, however, believes that such provisions have outlived their usefulness and has urged their elimination. Writing prior to the 1974 CFTC Act, he suggested, instead, permitting exchanges to decide whether to accept settlement by either delivery or some equivalent financial instrument.²⁷ This would be possible if Congress were to amend the CEA and declare that all futures contracts executed on an organized exchange are enforceable commercial contracts.²⁸ This would not only ease the bucket-shop law burden of American exchanges, which Working perceived to exist at the time he made his recommendation, but would also bring the United States into line with other countries which, according to Professor Working, boast efficiently operating exchanges but do not impose any delivery requirement on futures contracts. Since approximately only two to three percent of all futures contracts are ever settled by delivery anyway,²⁹ such an amendment would not disrupt trading in these markets but would clarify and candidly acknowledge the vital hedging role which they perform.³⁰

Despite these forceful challenges to the delivery concept, opponents of stock index futures have used the presumed delivery requirement to assail pending stock index proposals. Under section 2(a)(1) of the CEA, the CFTC has exclusive jurisdiction with respect to accounts,

23. *Id.* at 947-48.

24. *Id.* at 947-49.

25. H. WORKING, *Economic Functions of Futures*, in SELECTED WRITINGS OF HOLBROOK WORKING 279 (1977) [hereinafter cited as H. WORKING].

26. *Id.*

27. *Id.*

28. *Id.* at 280.

29. See note 87 *infra*.

30. H. WORKING, *supra* note 25, at 279.

agreements and transactions involving "contracts of sale of a commodity for future delivery." Traditionally, contracts for sale of a "commodity" for future delivery have involved tangible products, such as wheat or corn, which could be transferred physically from seller to buyer. Under the 1974 amendments to the CEA, however, the term "commodity," as defined in section 2(a)(1), now includes "services, rights, and interests." Thus, futures contracts can now be written on intangible items as well.

Stock index futures contracts would take advantage of this enlarged definition of commodity. They would reflect expected changes in the market value of groups of equity securities. Proponents of these futures envision that "delivery" would consist of the transfer of an instrument representing the total cash market value of a particular securities group at the time of delivery. However, the index upon which the market value of a securities grouping is measured would not create a direct interest in the ownership of the stock. The price of the stock index future would simply be a statement of the anticipated market value of each group of stocks in designated futures months. Since the stock index contract is entered into in order to participate in value changes, the true commodity would not be the stock itself, but the value represented by the index.

Critics of stock index futures proposals contend that such contracts could not satisfy the delivery requirement of section 2(a)(1) of the CEA. They insist that if shares of stock in the security groupings are not being bought or sold or delivered, then "the proposed contracts are nothing more than a dressed-up form of wagering on the price movements of stocks traded on the NYSE."³¹ These critics also argue that elimination of physical delivery of the underlying stock certificates would, by protecting futures from more stringent and costly securities regulations, coax capital from the securities industry to the futures markets.³² Finally, they assert that Congress never envisioned futures trading on groups of common stocks and that such contracts are a form of gambling on stock market prices which are illegal under state bucket-shop laws.³³

Bucket-Shop Laws

The term "bucket shop" refers to a firm that purports to conduct a

31. Auch Letter, *supra* note 13, at 3.

32. *Id.* at 3-4.

33. *Id.* at 4, 12-17. As will become clear in Part IV of this article, Congress was fully aware of the probability and desirability of trading in futures based on stock indices.

legitimate exchange business but which actually accepts bets and wagers on the price movement of stocks and commodities.³⁴ Although bucket-shop transactions were void at common law, many states responded to the "speculative spirit which . . . prevailed pre-eminently" during the last quarter of the nineteenth century by enacting bucket-shop legislation.³⁵ These statutes treated "bucketing" as a form of gambling and made futures contracts criminally illegal where the parties to the agreement never intended delivery of the underlying commodity but were dealing only for its prospective rise or fall in price.

The advent of organized and regulated exchanges has long since rendered this turn-of-the-century legislation anachronistic. Indeed, an understanding of the nature of bucket shops and an appreciation of the circumstances which prompted the enactment of these statutes offer convincing evidence of the folly in comparing bucket-shop transactions to trading in stock index futures.

John Hill, a commentator during the heyday of bucket shops, insisted: "There is no room for doubt as to the character of the bucket-shop. It is a gambling den, and nothing else."³⁶ Mr. Hill expressed concern that the bucket-shop "evil" was unfairly impugning the reputation of legitimate exchanges and brokers. He noted that the victims of bucket shops were having

their experiences cited as horrible examples and conclusive evidence of the harmful moral and social effects of speculation; when, in fact, both loss and harm resulted, not from speculation, but from betting as to what would or would not occur on the New York Stock Exchange or on the Chicago Board of Trade.³⁷

Thus, he emphasized that "bucket shops have no connection with *legitimate* exchanges. They buy from the telegraph companies or steal by tapping wires, the quotations of the leading exchanges, and these they post on the blackboards as the basis of bets made in their shops."³⁸

One early court, in discussing the urgency for anti-bucket-shop legislation, also elaborated on the unique character of bucket shops. The judge lamented that:

The mischief and evil consequences resulting to the state from the operations of the bucket shop are almost beyond computation. It

34. See, e.g., *Gatewood v. North Carolina*, 203 U.S. 531, 536 (1906). For a comprehensive study of bucket shops, see J. HILL, *GOLD BRICKS OF SPECULATION* (1975 reprint of 1904 ed.) [hereinafter cited as HILL]. See also T. HIERONYMUS, *ECONOMICS OF FUTURES TRADING* 89-94 (2d ed. 1977) [hereinafter cited as HIERONYMUS].

35. See *MacDonald v. Gessler*, 208 Pa. 177, 181, 57 A. 361, 362 (1904).

36. HILL, *supra* note 34, at 20.

37. *Id.* at 20-21.

38. *Id.* at 20.

assumes an air of legality and respectability, and insidiously ensnares many innocent victims before the public learn of their danger. Its nefarious practices are directly responsible for innumerable bankruptcies, defalcations, embezzlements, larcenies, forgeries, and suicides. It ought to be outlawed by statute, as its existence is a menace to society, and its operations immoral, contrary to public policy, and illegal.³⁹

Fortunately, the critics of stock index futures have not yet charged that trading in such instruments would similarly provoke suicide, defalcation and other "immoral" acts. Nor have they characterized modern commodity exchanges as "gambling dens." Nevertheless, since these opponents of financial futures have adopted the extreme position that bucket-shop laws pose an obstacle to CFTC approval of stock index futures, it is useful to review, in greater detail, the traditional application of such statutes to futures transactions.

Most bucket-shop statutes embraced the common law standard of illegality and prohibited futures transactions where the parties did not actually intend to deliver or receive the contract's underlying commodity.⁴⁰ The United States Supreme Court elaborated on this "intent to deliver" test:

[A] contract for the sale of goods to be delivered at a future day is valid . . . when the parties really intend and agree that the goods are to be delivered by the seller and the price to be paid by the buyer; and, if under guise of such a contract, the real intent be merely to speculate in the rise or fall of prices, and the goods are not to be delivered, but one party is to pay to the other the difference between the contract price and the market price of the goods at the date fixed for executing the contract, then the whole transaction constitutes nothing more than a wager, and is null and void.⁴¹

Unfortunately, as popular as this intent test was at common law and with state legislatures, it was ill-suited to determining the validity of commodity futures contracts entered into on organized exchanges.⁴² Since, as today, actual delivery on futures contracts occurred on less than three percent of all such transactions,⁴³ the judiciary experienced great difficulty in trying to distinguish between valid commodity transactions and those which were simply wagers on the price movement of specified commodities.

The Supreme Court confronted this dilemma in *Board of Trade v.*

39. *Western Union Tel. Co. v. State*, 165 Ind. 492, 512, 76 N.E. 100, 107-08 (1905).

40. These statutes are collected and analyzed in *Legislation*, 45 HARV. L. REV. 912 (1932).

41. *Irwin v. Williar*, 110 U.S. 499, 508-09 (1884).

42. See Taylor, *Trading in Commodity Futures—A New Standard of Legality?*, 43 YALE L.J. 63, 67 (1933) [hereinafter cited as Taylor].

43. See note 87 *infra*.

*Christie Grain & Stock Co.*⁴⁴ *Christie* involved an action brought by the Chicago Board of Trade (CBOT) to prevent a bucket shop from using CBOT commodity price quotations in its bucket transactions. As a defense, the bucket shop, relying on the clean hands doctrine, charged that the CBOT had no standing to bring the suit. The bucket shop argued that, under the 1887 Illinois bucket-shop statutes, the CBOT—then the largest grain exchange in the world—was itself the greatest of bucket shops: it was a place in which was permitted “the pretended buying and selling of grain, etc., without any intention of receiving and paying for the property so bought, or of delivering the property so sold.”⁴⁵ To support their position, the defendants noted that delivery is not intended in ninety-five percent of all transactions on the CBOT.⁴⁶

Justice Holmes responded by defending futures transactions which do not result in delivery. He recognized that:

Hedging . . . is a means by which collectors and exporters of grain or other products, and manufacturers who make contracts in advance for the sale of their goods, secure themselves against the fluctuations of the market by counter contracts for the purchase or sale, as the case may be, of an equal quantity of the product, or of the material of manufacture. It is none the less a serious business contract for a legitimate and useful purpose that it may be offset before the time of delivery in case delivery should not be needed or desired.⁴⁷

Accordingly, Justice Holmes pronounced that “set-off is in legal effect a delivery.”⁴⁸ The result of this decision was to exempt from state bucket-shop laws those transactions executed on exchanges between brokers. Although this “grant of immunity” did not extend to futures contracts between brokers and customers, it was nevertheless a major step forward in eliminating the confusion which had resulted from the unfocused application of state bucket-shop laws.

According to one scholar, the *Christie* opinion was the first instance of institutional recognition of organized trading in commodity futures as an essential mechanism in the marketing of commodities and the providing of protection against market fluctuations.⁴⁹ This scholar concluded that this decision triggered the “modern attitude” of avoiding the rigid, if not unthinking, application of legislation such as bucket-shop statutes and, instead, encouraged examining “the trading as a

44. 198 U.S. 236 (1905).

45. *Id.* at 246.

46. *Id.* at 242.

47. *Id.* at 249.

48. *Id.* at 250.

49. Irwin, *Legal Status of Trading in Futures*, 32 ILL. L. REV. 155, 166 (1937).

whole in the effort to determine which practices are socially desirable and which should be eliminated or controlled."⁵⁰ Another commentator reviewing the *Christie* decision similarly averred:

The real basis of Mr. Justice Holmes' distinction can be stated only in terms of institutions and the policy of the government in dealing with them. Produce exchanges, in which the "set-off" settlement is used, *are* different from "bucket shops," in which a direct payment or collection of price differences is employed. A small fraction of exchange contracts, while virtually none of the bucket shop contracts, are settled by delivery of grain. What is more important, the exchange is an important and useful business institution; and not the least of its usefulness is in the machinery which it provides for legitimate hedging.⁵¹

Bucket-shop operations declined in the years following the *Christie* decision. According to one author, bucket-shop activity, which had begun in the United States about 1876, began to cease about 1915.⁵² This elimination was made possible by decisions, such as *Christie*, that enabled the legitimate exchanges to control the access of bucket shops to price quotations.⁵³

Perhaps because of these notable efforts of exchanges to deal with bucket-shop abuses, other instances of institutional recognition of the social and economic value of organized trading in futures began to abound. Consequently, Congress, in 1922, enacted the Grain Futures Act, expressing the view that transactions involving the sale of grain are affected with a public interest.⁵⁴ The Act, which sought to prevent manipulation of grain prices, established a form of limited regulation of futures trading and prohibited all transactions which did not comply with the prescribed regulations.⁵⁵ It also made it a misdemeanor to execute certain futures contracts in grain except through members of exchanges which had been designated as "contract markets" by the Secretary of Agriculture. The Supreme Court upheld the constitutionality of this Act in 1923.⁵⁶

Despite the demise of bucket shops and notwithstanding evidence of continuing recognition of the economic and social importance of

50. *Id.*

51. Patterson, *Hedging and Wagering on Produce Exchanges*, 40 YALE L.J. 843, 867 (1931) (footnote omitted).

52. HIERONYMUS, *supra* note 34, at 90.

53. *Id.*; see also J. BAER & O. SAXON, *COMMODITY EXCHANGES AND FUTURES TRADING* 291-94 (1949).

54. Grain Futures Act, Pub. L. No. 331, ch. 369, § 3, 42 Stat. 998 (1922) (current version at 7 U.S.C. § 5 (1976)).

55. For a discussion of this legislation, see Taylor, *supra* note 42, at 94-102.

56. *Chicago Board of Trade v. Olsen*, 262 U.S. 1 (1923).

trading on organized exchanges, problems with surviving state bucket-shop legislation and the "intent to deliver" test persisted. This became particularly apparent in 1933 in *Dickson v. Uhlmann Grain Co.*⁵⁷ *Uhlmann* was an action brought by the Uhlmann Grain Company to collect the balance of fees due it for brokerage services it had provided the defendants for various futures transactions.⁵⁸ Uhlmann's former customers defended on the basis that the transactions for which payment was sought constituted gambling under Missouri law and, hence, were illegal; they argued that in entering the transactions they had intended only to settle for the difference in price, not to deliver or receive the commodities underlying the futures contracts. The Uhlmann Company disputed these charges by countering that all contracts entered into with the defendants had been executed on federally approved and regulated exchanges and that the Grain Futures Act had superseded all state laws relating to futures dealings on designated contract markets.

Writing for the Court, Justice Brandeis rejected the Uhlmann contentions. He believed that the controversy involved two separate agreements—one between the customer and the company, and the other between the company and the exchange brokers. Although acknowledging that contracts corresponding exactly to those entered into between the Uhlmann Company and the defendants had been executed on exchanges, he determined that the primary issue was "[w]hether the customer, in his agreement with the company, ordered that the contracts be entered into in his behalf on the exchange."⁵⁹ Justice Brandeis found that this had not been the case. He noted that the customers had received assurances from the company that they would never have to receive or deliver any grain as a result of their speculations and that, in fact, no grain ever was delivered by or to these customers. Thus, Justice Brandeis concluded that the only purpose of the agreement was to exact a profit solely from fluctuations in the market price of grain.

Justice Brandeis avoided the *Christie* decision upholding CBOT transactions between brokers by finding that the only relevant agreement was that between the company and the defendants. Since these transactions had all occurred in Missouri, he ruled that Missouri law governed. As to the issue of preemption, Justice Brandeis determined that the Grain Futures Act "did not supersede any applicable provisions of the Missouri law making gambling in grain futures illegal."⁶⁰

57. 288 U.S. 188 (1933).

58. The *Uhlmann* case is extensively treated in the classic article by Taylor, *supra* note 42.

59. 288 U.S. at 194.

60. *Id.* at 198.

According to Justice Brandeis:

The federal act declares that contracts for the future delivery of grain shall be unlawful unless the prescribed conditions are complied with. It does not provide that if these conditions have been complied with the contracts, or the transactions out of which they arose, shall be valid. It does not purport to validate any dealings. Nor is there any basis for the contention that Congress occupied the field in respect to contracts for future delivery; and that necessarily all state legislation in any way dealing with that subject is superseded. The purpose of the Grain Futures Act was to control the evils of manipulation of prices in grain. Such manipulation, Congress found, was effected through dealings in grain futures. Many persons had advocated, as a remedy, that all future trading be abolished. Congress took a less extreme position. It set up a system of regulation and prohibited all future trading which did not comply with the regulations prescribed. But it evinced no intention to authorize all future trading if its regulations were complied with. Both the language of the act and its purpose are clear; and they indicate the contrary. The Missouri law is in no way inconsistent with the provision of the federal act. It does not purport to legalize transactions which the federal act has made illegal. It does not prescribe regulations for exchanges. Obviously, manipulation of prices will not be made easier, or the prevention of such manipulation be made more difficult, because the State has declared that certain dealings in futures are illegal and has forbidden the maintenance within its borders of places where they are carried on. Since there is nothing in the state law which is inconsistent with, or could conceivably interfere with the operation or enforcement of, the federal law, the statute of Missouri was not superseded.⁶¹

The portion of Justice Brandeis' decision relating to the application of the "intent to deliver" test under the Missouri anti-bucket-shop statute aroused much concern. He had premised his conclusion that there had been a "lack of intent to deliver" on evidence that Uhlmann officials had simply explained to the defendants the operation of the set-off mechanism characteristic of virtually all futures transactions.⁶² Further, he had purposefully avoided finding that the plaintiff had acted as agent of the defendants in executing their transactions on the CBOT. Professor Taylor, in a now classic article, expressed his fear that, under this strained Brandeisian analysis, state bucket-shop statutes, if enforced, would "render speculation impossible, hedging illegal, and subject all brokers to criminal liability."⁶³ Professor Taylor also believed that the decision of Justice Brandeis on the supersedure issue was, although analytically sound, wholly at variance with the Grain

61. *Id.* at 198-200 (citations and footnotes omitted).

62. Taylor, *supra* note 42, at 84.

63. *Id.* at 101.

Futures Act. Referring to the upholding of the Missouri bucket-shop legislation, he noted: "It is difficult to conceive of a statute which would more completely thwart the purposes of the Act than would the Missouri statute if enforced in all cases. It is to be hoped that the final word on this question remains to be spoken."⁶⁴

STATES ACCEDE TO FEDERAL REGULATION

Shortly after the *Uhlmann* decision, Congress again asserted a federal interest in the regulation of commodities trading. It enacted, in 1936, the Commodity Exchange Act,⁶⁵ which established a regulatory system described as "*strong* exchange self-regulation with *weak* federal oversight."⁶⁶ Nevertheless, the CEA was more comprehensive than its predecessor, the Grain Futures Act. It subjected "to regulation not only the operation of commodity futures exchanges, as did the Grain Futures Act, but the commodity futures transactions and dealings of brokers and of customers, and certain activities which, while not directly involving futures trading, may affect such trading on the futures exchanges."⁶⁷

In addition, the CEA contained its own anti-bucketing provision which was to be enforced by each exchange.⁶⁸ Failure to do so would result in the federal government withholding designation of the exchange as a contract market. Significantly, the CEA also carved out a congressional position on the issue of speculation in futures transactions. The CEA provided that: "*Excessive* speculation in any commodity under contracts of sale . . . for future delivery . . . causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity."⁶⁹ Thus, Congress tacitly acknowledged that speculation—in and of itself—is an inevitable, if not necessary, aspect of futures transactions. It recognized that speculators generally participate in futures markets only to profit on price movement and rarely intend to receive or deliver the goods underlying those

64. *Id.* at 102.

65. Pub. L. No. 675, ch. 545, 49 Stat. 1491 (1936) (current version at 7 U.S.C. §§ 1-24 (1976 & Supp. IV 1980)).

66. Rainbolt, *Regulating the Grain Gambler and His Successors*, 6 HOFSTRA L. REV. 1, 11 (1977).

67. Bachrach, *The Cloverleaf Case and Suspension of State Gambling Statutes as Applied to Commodity Futures Transactions*, 7 J. MAR. L.Q. 457, 461 (1942) [hereinafter cited as Bachrach].

68. Commodity Exchange Act § 5, Pub. L. No. 675, 49 Stat. 1491 (1936) (current version at 7 U.S.C. §§ 6a, 6c (1976 & Supp. IV 1980)).

69. *Id.* (emphasis added).

contracts.⁷⁰ Congressional concern was simply with the degree of speculation, not the fact of speculation. For Congress, speculation was excessive only when it caused sudden or unreasonable fluctuations in the price of a commodity. This legislative embrace of causation as determinative of the legality of speculation represented a significant refutation of the "intent to deliver" test which had proved so popular among the states and which had seemingly been sanctioned by the Court in *Uhlmann*.

This policy position advanced by Congress, and the prospects for more effective regulation promised by the CEA, accelerated the demise of the bucket-shop controversy. States, with judicial assistance, increasingly began to moderate the zealous application of their bucket-shop statutes.⁷¹ Gradual state retreat from the use of bucket-shop legislation and, indeed, from the entire field of commodities futures regulation, coincided with the development of organized and regulated exchanges. This process did not abate even after the Supreme Court affirmed that the states were entitled to regulate commodities trading concurrently with the federal government.⁷²

STATE REGULATORY ROLE AFFIRMED

*Rice v. Chicago Board of Trade*⁷³ involved an attempt to invalidate warehousing rules and regulations promulgated by the CBOT without prior approval of the Illinois Commerce Commission. The CBOT defended on the basis that the CEA had superseded Illinois law requiring review of CBOT regulations. The United States Supreme Court re-

70. However, as Professor Taylor notes, "[T]he difference between intent to set off on the one hand and intent to make a fictitious contract on the other is a real one, and the fact that a future contract standing by itself requires delivery, is of importance, even though any particular parties to a future contract intend to avoid delivery by setting off." Taylor, *supra* note 42, at 89. The *Uhlmann* Court ignored this distinction.

71. Pre-CEA cases which refused to apply bucket-shop laws to transactions entered into on exchanges include *Dickson v. Uhlmann Grain Co.*, 288 U.S. 188 (1933) (decision did not affect CBOT transactions); *Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 263 (1905); *Lyons Milling Co. v. Goffe & Carkener, Inc.*, 46 F.2d 241 (10th Cir. 1931); *Gettys v. Newburger*, 272 F.2d 209 (8th Cir. 1921). In the aftermath of the CEA, some states began statutorily to validate transactions executed on a "commodity or stock exchange." See, e.g., ILL. REV. STAT. ch. 38, § 28-8(a) (1979); *Albers v. Lamson*, 380 Ill. 35, 43, 42 N.E.2d 627, 630-31 (1942). The courts also sanctioned futures agreements entered into for risk-shifting purposes and increasingly avoided the rigid application of bucket-shop laws. See, e.g., *Bomeisler v. M. Jacobson & Sons Trust*, 118 F.2d 261 (1st Cir. 1941) (construing New York and Massachusetts law); *Hoover Grain Co. v. Amundson*, 70 N.D. 186, 293 N.W. 196 (1940); *Boillin-Harrison Co. v. Lewis & Co.*, 182 Tenn. 342, 187 S.W.2d 17 (1945) (per curiam) (hedging different from gambling in that hedger has a legitimate business interest to protect).

72. *Rice v. Chicago Board of Trade*, 331 U.S. 247 (1947). Since *Rice*, no case has held that bucket-shop statutes apply to valid, exchange-traded contracts.

73. 331 U.S. 247 (1947).

jected this view. Section 4c of the 1936 CEA provided that "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."⁷⁴ Referring to this provision, the Court observed that:

[Section] 4c serves the function of preventing supersedure and preserving state control in . . . areas where state and federal law overlap. 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.⁷⁵

Thus, the Court held that the CEA did not preempt state regulation of commodities trading. To buttress its finding, the Court compared the CEA to the United States Warehouse Act, a congressional enactment which the Court, in a companion case, had held preempted state authority to regulate warehouses.⁷⁶ The Court noted that unlike the Warehouse Act, the CEA did not contain "a declaration by Congress that the system which it has adopted for the regulation of trading on contract markets is exclusive of state regulation."⁷⁷

The Court also found persuasive the absence of any provision within the CEA for federal government approval of CBOT rules.⁷⁸ Since the Act had only supplied general standards, the Court was able to conclude that approval of such rules by the state would not conflict with the federal regulatory scheme. The effect of this holding on state bucket-shop laws was uncertain. The opinion expressly reserved judgment on specific questions of supersedure until after states had taken actions which demonstrably conflicted with federal measures.⁷⁹ Although it seems unlikely that a court could have avoided finding a conflict where a state statute invalidated a transaction sanctioned by federal legislation,⁸⁰ the Court's caution nevertheless favored a liberal construction of state regulatory authority. The opinion deftly advised

74. Commodity Exchange Act, Pub. L. No. 675, § 4c, 49 Stat. 1491, 1494 (1936) (prior to 1974 amendment).

75. 331 U.S. at 255.

76. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947).

77. 331 U.S. at 253.

78. *Id.* at 253-54.

79. *Id.* at 254-55.

80. Prior to *Rice v. Chicago Board of Trade*, 331 U.S. 247 (1947), one commentator had concluded:

If a state gambling statute renders illegal a form of trading in commodity futures on commodity futures exchanges that under the Commodity Exchange Act is lawful, such state law would be suspended, as hampering and interfering with the operation of the federal legislation by changing the regulatory base of the federal statute.

Bachrach, *supra* note 67, at 464.

that "even action which seems pregnant with possibilities of conflict may, as consummated, be wholly barren of it."⁸¹

It is clear that *Rice* both sanctioned and invited a strong state regulatory presence in the field of commodities trading. The states, however, declined the *Rice* invitation and, with the concurrence of the courts, many began to either dismantle or disregard their archaic bucket-shop enactments. Each year, progressively fewer actions were brought under state bucket-shop statutes. The paucity of such litigation suggested a general contentment with the system of federal regulation under the CEA. Indeed, it was not until just prior to the enactment of the 1974 amendments to the CEA that the states began to exercise the hitherto unclaimed concurrent regulatory jurisdiction sanctioned in *Rice*. However, by then they had largely abandoned their bucket-shop statutes and, instead, were turning to their securities laws as a means of securing regulatory jurisdiction over commodities trading.

II. LEGISLATIVE HISTORY OF 1974 AMENDMENTS

Impetus for CEA Reform

Throughout the summer and early autumn of 1973, the House Subcommittee on Special Small Business Problems conducted hearings which Congressman Neal Smith hoped would begin "the most comprehensive and the most inclusive study and investigation of the grain marketing system in this country that we have ever had."⁸² As discussed in these early hearings, an untimely convergence of circumstances accounted for this congressional interest in the commodity futures markets. Grain shortages had caused food prices to soar. One witness explained these higher prices as a consequence of an "extraordinary coincidence of global events."⁸³ Another witness raised the

81. 331 U.S. at 256.

82. *Small Business Problems Involved in the Marketing of Grain and Other Commodities: Hearings Before the Subcommittee on Special Small Business Problems of the House Permanent Select Committee on Small Business*, 93d Cong., 1st Sess. 3 (1973) [hereinafter cited as *Subcommittee Hearings*] (statement of Rep. Neal Smith).

83. *Id.* at 135 (statement of Frederick Uhlmann). "Global events" cited by this witness included the systematic reduction of grain reserves in the United States, massive crop failures in the Soviet Union which caused that country to become a major buyer of American grain, severe droughts in India and Africa, the mysterious disappearance of anchovies—the world's second-most important protein source for livestock feed—off the coast of Peru and severe crop damage in the United States due to heavy rains and flooding. These circumstances reducing grain supplies converged at the same time that worldwide demand for American grain soared as a result of a wave of economic prosperity in Europe and Japan and two sharp devaluations of the U.S. dollar.

spectre of foreign intervention in commodities markets.⁸⁴ Despite such proffered justifications, consumers and farmers, buffeted by these cost increases and groping for a more plausible explanation, accused commodity traders of manipulating prices.⁸⁵ They charged that there was a direct relationship between futures trading and increases in food costs and, as evidence, recounted how the price of soybeans had nearly tripled without any change in supply.⁸⁶

Coincidental with these rising food costs, trading in commodities had surged.⁸⁷ This not only taxed the enforcement resources of the Department of Agriculture (DOA),⁸⁸ but also left many actively traded commodities in a regulatory limbo. By this time, state regulation of commodities trading was almost nonexistent. As to federal regulation, prior to 1974 the DOA had jurisdiction only over certain farm-related commodities specified in the CEA.⁸⁹ Consequently, as investors began trading in futures contracts based on currencies, fuels, metals and other commodities not embraced by the CEA, they found themselves without any regulatory protection. Their vulnerability became spectacularly apparent in the financial ruin which accompanied the collapse of the "naked options" swindle perpetrated by the California firm of Goldstein & Samuelson.⁹⁰ The Goldstein scandal smirched the entire commodities trading industry. It also encouraged futures officials, concerned with the reputation of futures trading, to join in the call for regulatory reform.

Although these hearings elicited numerous comments which supported strengthening federal regulation of the futures industry, surprisingly little testimony was heard on the subject of state regulatory efforts in the field of commodities trading. Indeed, the only reference to state regulation was in relation to a discussion of the Goldstein scandal. One witness noted that after the "Goldstein bubble" had burst, California had prohibited trading in certain options.⁹¹ For the subcommittee,

84. *Id.* at 382 (statement of Rep. Neal Smith).

85. *Id.* at 48-49 (statement of Harry Fortes).

86. *Id.* The cost of July soybeans soared from \$3.31 to \$12.90 a bushel.

87. In fiscal year July 1, 1972, through June 30, 1973, futures trading in regulated commodities reached a record 35,642,514 transactions, compared to 25,054,684 transactions a year earlier. Similarly, the value of these transactions increased from approximately \$184 billion in 1971-72 to nearly \$400 billion in 1972-73. Note, however, that "dollar value" is a somewhat theoretical index as it represents the value not of actual deliveries made on contracts, but the value of all deliveries *if* made. Actual delivery is made on only a small percentage (2-3%) of all contracts. *Id.* at 399-400.

88. *Id.* at 333 (statement of Alex Caldwell).

89. *See* note 3 *supra*.

90. *Subcommittee Hearings, supra* note 82, at 51-52 (statement of Harry Fortes).

91. *Id.*

the significance of these remarks was not their exposure of renewed state regulatory efforts, but their observation that certain commodities were not subject to federal jurisdiction and regulation.⁹²

Initial Hearings Before House Committee on Agriculture

In late August of 1973, the House Committee on Agriculture announced it would conduct hearings relative to its review of the Commodity Exchange Act.⁹³ Although it invited written and oral comments addressing any aspect of commodities regulation, the committee did identify certain subjects it felt were worthy of special consideration. These included the creation of an independent Commodity Exchange Commission and "[b]ringing all futures trading under federal regulation."⁹⁴ The committee concluded its announcement by expressing its interest "in hearing any other suggestions defining the appropriate federal role in the regulation, if any, or protection of the integrity of the practice of forward contracting of agricultural commodities."⁹⁵

The first person to testify at these hearings was Congressman Neal Smith. He informed the Committee on Agriculture that, based on the earlier hearings conducted by his Small Business Subcommittee, he was recommending "that trading in all futures should be under Federal regulation."⁹⁶ However, he did not express any opinion on the issue of a state regulatory role. Another witness expressed concern that, with regard to nonregulated commodities, "traders have no Federal protection against fraud or embezzlement in the handling of their futures trades and funds."⁹⁷

Other participants in these hearings echoed Congressman Smith's call for a stronger federal role in commodities trading and suggested the dimensions of the problem. One witness expressed doubt that "anyone outside the industry can grasp the magnitude of the fraud which is daily perpetrated upon the small trader. Yet the self-dealing, bucketing, and general cheating which goes on in unregulated commodities is matched by such activity in regulated commodities."⁹⁸

92. *Id.* (exchange between Harry Fortes and Rep. Neal Smith).

93. Announcement reprinted in H.R. REP. NO. 975, 93d Cong., 2d. Sess. 53-55 (1974).

94. *Id.* at 54.

95. *Id.* at 55.

96. *Review of Commodity Exchange Act and Discussion of Possible Changes: Hearings Before the House Committee on Agriculture*, 93d Cong., 1st Sess. 10 (1973) (statement of Rep. Neal Smith).

97. *Id.* at 26 (statement of Alex Caldwell).

98. *Id.* at 79 (statement of Joel Bellows).

Although the subject of state regulatory jurisdiction was not directly addressed at these hearings, some comments did identify the hazards implicit in all dual regulatory schemes. As discussed in the submissions of one witness:

[I]t is extremely important that federal policy regarding commodities futures trading be uniform throughout the United States, and not be subject to the vagaries of different interpretations by different courts in different jurisdictions, especially in view of the technical and sophisticated nature of the subject being regulated and the high degree of foreign involvement.

Similar considerations in the past have impelled Congress to establish exclusive power to enforce a regulatory statute in the hands of a federal agency vested with the necessary expertise to formulate uniform national policy.⁹⁹

Filing of H.R. 11955

On the basis of these hearings, on December 13, 1973, Congressman Poage, Chairman of the House Committee on Agriculture, introduced H.R. 11955, a bill to "amend the Commodity Exchange Act, to strengthen the regulation of futures trading, to bring all agricultural and other commodities traded on exchanges under regulation, and for other purposes."¹⁰⁰ In his remarks to the House, Congressman Poage hinted at the need to reevaluate the regulatory structure of commodities trading. He observed that: "[T]here are great problems in the entire structure of Federal authority over futures trading which demands the attention of the Congress, inasmuch as they are problems that are a function of the system of self-regulation by the exchanges under a limited Federal 'umbrella' of authority."¹⁰¹ Chairman Poage then placed the states on notice that the stronger role the federal government was about to assert in the regulation of commodities trading might displace any previously concurrent state authority. He urged:

[T]he time is now upon us for a significant change in the parameters of Federal authority over the exchanges. Already, many State laws are exercising jurisdiction over these same markets to fill what had become a vacuum of regulation. *Varied and often conflicting regulation such as this could become a burden on commerce, if it is not already.* With States seeking additional authority, litigants challenging self-regulatory judgments, a weak system of Federal regulation, several recent examples of abuse within the present futures structure and the exchanges . . . it is incumbent on Congress to act, and act expeditiously through meaningful, thoughtful change that is well rea-

99. *Id.* at 121 (statement of Reed Clark).

100. 119 CONG. REC. 41,340 (1973).

101. *Id.* at 41,332.

soned and sure.¹⁰²

As presented to Congress on that date, H.R. 11955 proposed to enlarge the definition of commodity contained in the CEA.¹⁰³ The only provision, however, directly related to jurisdictional issues was one which preserved the jurisdiction of the Securities Exchange Commission (SEC).¹⁰⁴ Although the language of this provision was ambiguous, Congressman Poage was explicit and direct in expressing his committee's intent. He announced that under Title II of the bill, "All commodities trading in futures will be brought within federal regulation under the aegis of the new Commission, however, provision is made for preservation of Securities Exchange Commission jurisdiction in those areas *traditionally* regulated by it."¹⁰⁵

Hearings on H.R. 11955

After introducing H.R. 11955, the Committee on Agriculture scheduled hearings to receive comments on the specific proposed amendments to the CEA. Surprisingly, despite the ostensible interest of the states in the regulation of commodities trading, only one state official testified at these hearings. Although he did not express any view on the bill's potential preemption of state regulation, this official did note that both the SEC and state securities commissioners lacked the power to deal effectively with fraud involving commodities options.¹⁰⁶

Although conflicting SEC-CFTC authority was the jurisdictional issue receiving the most attention at these hearings, various witnesses did inform the committee of the continuing efforts of the states to regulate commodities trading under securities laws. For example, Iowa Securities Superintendent Clark urged the committee to distinguish between commodity funds which are "truly" securities, and commodity options which many of the state legislatures were treating as securities

102. *Id.* at 41,333 (emphasis added).

103. H.R. 11955 added to the listing of specific agricultural items the phrase: "and all [other] goods and articles and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." *Commodity Futures Trading Commission Act of 1974: Hearings Before the House Committee on Agriculture*, 93d Cong., 2d Sess. 348 (1974) [hereinafter cited as 1974 House Hearings].

104. Section 201 of H.R. 11955 read in part: "Provided, That nothing contained in this Act shall preclude the Securities and Exchange Commission from carrying out its duties and responsibilities in accordance with the laws of the United States under which it was established and currently functions." *Id.*

105. 119 CONG. REC. 11,354 (1974) (emphasis added).

106. 1974 House Hearings, *supra* note 103, at 185 (statement of Glen Willet Clark, Iowa Superintendent of Securities).

to obtain regulatory jurisdiction.¹⁰⁷

Another witness testified against enlarging the regulatory role of the federal government and suggested that the states could adequately police commodities trading.¹⁰⁸ During questioning by the committee, this same witness, perhaps unintentionally, illustrated the need for federal, rather than state, regulation of the commodities field. He noted that Oklahoma was the first state to enact legislation regulating commodities options.¹⁰⁹ As a consequence, option underwriters and their marketing organizations simply moved their operations to the neighboring state of Texas where there was no similar legislation. There they were able to continue, unfettered, their fraudulent option dealings.¹¹⁰ An obvious inference from this description was that isolated instances of state regulatory efforts were ineffective in dealing with commodity trading abuses of a more national scope. An appropriate response to the jurisdiction shopping by commodity swindlers would, therefore, be the application of a uniform federal policy. This would thwart the tendency of fraudulent trading operations to migrate to those areas where local regulation was relatively innocuous.

In addition to this oral testimony indirectly discussing conflicting state and federal regulatory authority, the committee received written comments which were more pointed in their treatment of this jurisdictional question. One such letter, received from the Continental Grain Company, warned:

Failure to clarify in Sec. 201 . . . the exclusive and preemptive jurisdiction of the CFTC over regulation of all aspects of commodities and commodity trading will result in major conflicts of policy and regulation between the CFTC and the S.E.C. and between Federal and State regulatory bodies.

A proliferation of conflicting state regulations could quickly adversely affect or even destroy the commodity futures markets ability to function.¹¹¹

House Approval

After "mark-up" by the House Committee on Agriculture, H.R. 11955 was reprinted as H.R. 13113,¹¹² and the committee's report was released on April 4, 1974.¹¹³ Recognition of the need for exclusive fed-

107. *Id.* at 207.

108. *Id.* at 282 (statement of Prof. William Morgan).

109. *Id.*

110. *Id.* at 299.

111. *Id.* at 322 (emphasis in original).

112. 120 CONG. REC. 9889 (1974).

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

eral jurisdiction pervaded this report. In chronicling the development of commodities regulation, the Committee on Agriculture characterized the futures regulatory framework as consisting of "weak federal oversight of some (but not all) commodity futures trading, coupled with self regulation by the exchanges, and varying state laws."¹¹⁴ It concluded that this regulatory approach to commodities trading—although adequate in earlier times—required revision in favor of a stronger federal role.¹¹⁵ The report insisted that "[i]t is abundantly clear that all futures trading must be brought under a single regulatory umbrella."¹¹⁶

Although, in context, this statement simply encouraged the elimination of a distinction between regulated and nonregulated commodities, the report also suggested that the enlargement of the federal role might be of a magnitude which would displace any parallel regulation by the states. In its report, the Committee on Agriculture noted that during the fifty-two year history of the CEA:

[The] legislative mandate of maintaining a status of limited federal regulation and self-regulation with the exchanges has remained unchanged. While the Committee bill does not envision an end to self-regulatory activities by the exchanges, it does replace the present limited federal authority with a more *comprehensive* grant of federal authority to make the overall regulatory pattern of the industry more appropriate to the times and the needs of the American public and the *international economy*.¹¹⁷

The report also referred to evidence of extensive trading abuses, including bucketing, which, despite state regulatory authority and some relevant state laws, persisted as a consequence of limited federal authority.¹¹⁸ The committee buttressed its position in support of a dominant federal role by citing the problem it perceived of "[a] growing list of proposed and actual state regulations and laws, moving into areas (such as commodity options in non-regulated commodities) where the Federal law, to date, has not entered."¹¹⁹

It is apparent that the committee intended that the proposed amendments to the CEA would serve as a check on renewed state regulatory efforts. It was the committee's express objective that the legislation would "put all exchanges and all persons in the industry under the same set of rules and regulations for the protection of all concerned."¹²⁰

114. *Id.* at 36.

115. *Id.*

116. *Id.* at 41-42.

117. *Id.* at 42 (emphasis added).

118. *Id.* at 46-47.

119. *Id.* at 48.

120. *Id.* at 76.

Clearly, such regulatory uniformity could not be achieved if each state were permitted to impose its own requirements on commodities trading. Even the dissenting members of the Committee on Agriculture impliedly acknowledged that these proposed amendments would eliminate any dual scheme of regulation. In its report, the minority charged that the federal legislation was so pervasive that it "gives sweeping government control over nearly every aspect of futures trading."¹²¹ On April 11, 1974, the House approved H.R. 13113 and submitted it to the Senate for action.

Senate Hearings

In May of 1974, the Senate Committee on Agriculture and Forestry began conducting its own hearings on four bills—including H.R. 13113—which would regulate commodity futures trading. Throughout these hearings, various witnesses apprised the Senate committee of the attempts by the states to regulate commodity transactions. Indeed, discussion of a state regulatory role was much more direct and extensive than that in the earlier House hearings.

PRO-PREEMPTION TESTIMONY

Among the first statements received by the committee was that of Tom Maher, the Director of the South Dakota Division of Securities and Consumer Protection.¹²² Although Mr. Maher reviewed various difficulties he had encountered in dealing with commodity option problems, he did not suggest that the remedy lay in more vigorous state enforcement measures. To the contrary, he indicated that regulation of commodity options exceeded state capabilities. He recounted how trading in "unregulated commodities" had forced his agency to attempt to secure jurisdiction by enlarging and expanding its securities laws, which, he averred, were obviously not intended to deal with such transactions. Consequently, he urged Congress to invigorate the CEA's enforcement capability, to bring all unregulated commodities under the new agency's jurisdiction and to implement strong and comprehensive regulations in the commodity exchange area.

In other testimony, a witness informed the committee of legislation pending in Nebraska which would have established a Nebraska Fu-

121. *Id.* at 165.

122. *Commodity Futures Trading Commission Act: Hearings Before the Senate Committee on Agriculture & Forestry*, 93d Cong., 2d Sess. 224-25 (1974) [hereinafter cited as 1974 *Senate Hearings*] (statement of Tom Maher).

tures Trading Commission and would have required the Minneapolis Exchange to establish a delivery point in Nebraska.¹²³ The bill purportedly provided that, if such a delivery point were not established, Nebraskan citizens would be prohibited from any futures trading on the Minneapolis Exchange. This disclosure prompted one senator to comment that such legislation would be a "real problem" if introduced throughout the states.¹²⁴ This senator then asked the witness whether he would "agree that this . . . Federal legislation really ought to preempt State legislation so that we do not have the 50 different States legislating in this area?"¹²⁵ Not surprisingly, the witness agreed, and added: "After the Nebraska bill came out we had other State departments of agriculture, Minnesota, for example, asking if we thought other States should have State legislation. And it seemed to me that State legislation would make an impossible situation for exchanges."¹²⁶

Other witnesses suggested that, unlike the Nebraska legislation, other state regulatory efforts were not motivated by self-interest, but simply by the absence of federal regulation. As one participant in these hearings testified relative to world commodities:¹²⁷

Due to the lack of specific Federal regulation, many States have been enacting special laws to prevent the abuses of recent years of which we are all aware. If there is a firm and clear Federal law on this subject, I think it would prove of great help to the individual States in preventing the misuse [of] options.¹²⁸

The first direct analysis of the preemption question was contributed by a representative of the commodities industry. Wary of the dif-

123. *Id.* at 391 (statement of Alvin Donahoo).

124. *Id.* at 396 (statement of Sen. Dick Clark).

125. *Id.* After mark-up of the exclusive jurisdiction provisions of H.R. 11955, section 201 was rewritten with two subsections. As reprinted in H.R. 13113, section 201(B) read, in relevant part:

Provided, That the Commission shall have exclusive jurisdiction of transactions dealing in, resulting in, or relating to contracts of sale of a commodity for future delivery, traded or executed on a domestic board of trade or contract market or on any other board of trade, exchange, or market: *And provided further*, That nothing herein contained shall supersede or limit the jurisdiction at any time conferred on the Securities Exchange Commission [sic] or other regulatory authorities under the laws of the United States or restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with the laws of the United States.

H.R. REP. NO. 975, 93d Cong., 2d Sess. 87 (1974) (emphasis in original). *Cf.* the earlier version of section 201(B) considered in H.R. 11955, *supra* note 104.

126. 1974 *Senate Hearings*, *supra* note 122, at 396 (statement of Sen. Dick Clark).

127. Also known as international commodities, world commodities include silver, silver coins, platinum, cocoa, plywood, copper, coffee and world sugar. Prior to the 1974 amendments, world commodities were not subject to regulation. See *Int'l Trading Ltd. v. Bell* [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,495 at 21,994; Long, *The Naked Commodity Option Contract as a Security*, 15 WM. & MARY L. REV. 211, 214 (1973).

128. 1974 *Senate Hearings*, *supra* note 122, at 508 (statement of Paul Franklin).

faculties which can result when jurisdictional authority overlaps, this witness testified:

Section 201 of the House bill, which deals with the jurisdiction of the Commission, does not end the confusion in both Federal and State law as to who should regulate the futures trading industry. While the House bill seems to make it clear that any potential new futures contract is to be regulated exclusively by the proposed Commission, even this provision could stand clarification. Some State courts have interpreted devices relating to the trading of futures as securities. This may have come about mainly out of desperation at the lack of any effective Federal regulations. The SEC interprets some aspects of futures trading as within the broad definition of a security under the Securities Act of 1933. The committee will be doing a great favor to the industry and the American public if it would change the jurisdictional provisions of section 201 to insure that if any transaction relates to a futures contract and is regulated by the Commission, these rules and regulations are preemptive of State regulations to the contrary and are exclusive of other Federal regulations.¹²⁹

Glenn Willet Clark, a professor of law who, since his testimony at the earlier House hearings, had completed his service as the superintendent of securities for the State of Iowa, also addressed the issue of exclusive jurisdiction. He insisted:

None of the proposed bills, in their present form, contemplate Federal preemption of the field. Perhaps it has not been brought to the attention of the Congress that traditional, long-existing, stable commodity trading institutions are now being subjected to a withering crossfire of disparate State regulation which, if unchecked by resolute Federal regulation, may force legitimate commodities dealers to cease activity in certain States, or, equally bad, to tailor their activities in all States to meet the eccentric requirements of a single State.¹³⁰

Thus, he chided the "well-meaning, but eccentric and ill-informed State attempts to regulate commodities markets under the guise of securities regulation. The States cannot now, in my judgment, begin to do so with any but ill effects."¹³¹ Professor Clark, whose service as a state securities commissioner had been "during the period in which the involvement of [state] securities regulators in the fringes of the commodities markets grew by leaps and bounds,"¹³² crisply advised the committee on the issue of exclusive jurisdiction. He asserted: "It is my judgment that the new Commission's authority with respect to orga-

129. *Id.* at 541 (statement of John Clagett).

130. *Id.* at 681 (statement of Glenn Willet Clark).

131. *Id.*

132. *Id.* at 682.

nized trading in contracts for future delivery should be plenary and exclusive, both as against other Federal agencies and against the States."¹³³

In response to this advice, Senator Talmadge, chairman of the committee, inquired whether Professor Clark "would preempt the States jurisdiction entirely?"¹³⁴ Professor Clark's reply of "very definitely"¹³⁵ prompted additional discussion, including the view expressed by Senator Clark that if preemption did not occur, "different State laws would just lead to total chaos."¹³⁶ Professor Clark, characterizing himself as a "veteran of the blue sky wars," reminded the committee of the problems experienced by the securities bar in "dealing simultaneously with the largely overlapping securities laws of 51 jurisdictions."¹³⁷ He implored the senators not to create a similar "nightmare" with respect to commodities.

Other witnesses expressed similar concern that states were using the definition of "security" to assert jurisdiction over commodities trading. The comments in one submission detailed state efforts in this regard:

Recognizing the growing interest in commodities on the part of the public, and particularly in certain unregulated commodities, . . . various existing regulatory agencies perceive the need for regulations to protect the public from fraud. In response to this need, the State of California recently passed a Commodity Law and various other states are considering regulation of commodities either through a commodities act or by defining commodities contracts as a security. Michigan has this area under active review. The Wisconsin Securities Act already defines a contract for future delivery of a commodity as a security, subjecting them to the anti-fraud and other provisions of the Act, but exempting them from registration requirements. The State of Arizona recently amended its Securities Act to define a commodity as a security, and the States of Texas and Arkansas have recently, either administratively or judicially, found certain types of contracts for future delivery of a commodity to be a security, subject to their state securities laws.¹³⁸

This witness warned: "Without passage of an Act such as is presently proposed, the entire commodity area would be left subject to much confusion, a commodity contract being variously designated and

133. *Id.* at 679.

134. *Id.* at 684.

135. *Id.* at 685.

136. *Id.*

137. *Id.*

138. *Id.* at 752 (statement of M. Martin Rom).

regulated as a security or commodity in different jurisdictions.”¹³⁹ Although he believed that the proposed legislation, by subjecting all commodities to regulation, would solve many of the problems stemming from “unregulated commodities,” this witness also emphasized that:

Further consideration must be given to regulating the variances between federal and state provisions in this area. It is vital that federal legislation preempt the states in making a determination that the various commodity contracts are, in fact, classified, regulated and traded as commodities and not as securities. State administrators would then be free to define their own regulations within these limitations.¹⁴⁰

ADJUDICATIVE PREEMPTION

In a letter to the Senate committee, Chairman Peter Rodino of the House Judiciary Committee expressed his concern regarding preemption. Referring to section 201(B) of H.R. 13113, Chairman Rodino advised that “[t]his double proviso could be construed to raise a question of federal preemption of the commodity futures industry and, therefore, unnecessarily raises a question of federal-State relationships.”¹⁴¹ The thrust of these comments, however, was not regulatory preemption, but rather adjudicative preemption. Chairman Rodino was concerned that the proviso could deprive state courts of their jurisdiction over commodity futures contracts “presently enforceable in State courts under recognized commercial law and contract principles.”¹⁴² Additionally, he feared that the failure to include “federal district courts” as an exception to the exclusive jurisdiction clause of that section would cause the constitutionally dubious result of exempting commission decisions from judicial review.¹⁴³

Section 201(B) aroused similar concern from others. One witness, representing the Department of Justice, characterized it as “[p]otentially the most troublesome provision of H.R. 13113.”¹⁴⁴ Like Chairman Rodino, this witness believed that:

If section 201(B) were read literally, State courts might be deprived of jurisdiction to enforce State contracts and commercial law relating to futures contracts since jurisdiction over those contracts is placed exclusively in the Commodity Exchange Commission. That this was not the intended effect of the bill is evidenced by the fact that no

139. *Id.*

140. *Id.*

141. *Id.* at 260.

142. *Id.*

143. *Id.*

144. *Id.* at 663 (statement of Keith Clearwaters).

substantive provisions in the nature of contract or commercial law are included in the bill. Clearly, the Commission was not intended to adjudicate disputes between commodities brokers and their customers over contract terms or similar matters.¹⁴⁵

To avoid such confusion, this witness recommended that the committee clarify the section 201(B) exclusive jurisdiction provision. He noted that:

Deletion of everything in section 201(B) beginning with the first proviso of that section would also eliminate any problem in this regard. Jurisdiction for violations of the Commodity Exchange Act would then be conferred on the Commission by the affirmative language of other provisions of the bill, while other adjudicatory authorities, including State and Federal courts, would not be deprived of jurisdiction to hear matters traditionally entrusted to them.¹⁴⁶

The chairman of the Senate committee concurred with these views. He similarly doubted that "the House had in mind depriving either Federal courts [of jurisdiction] in antitrust matters, or any other matter, and certainly not State courts."¹⁴⁷ He suggested that the witness work with the committee's staff to revise language in H.R. 13113 "to make it clear that we don't propose to deprive Federal courts of antitrust jurisdiction, or State courts' jurisdiction."¹⁴⁸

MANAGED ACCOUNTS

Other discussions focused on the controversy relating to the regulatory status of managed accounts. Both the commodity industry and regulatory officials concurred that an agreement between a customer and his commodity broker for the trading of commodity futures is not a security within the meaning of the Securities Act of 1933, so long as the broker executes trades only at the direction of his customer. Thus, they agreed that in such situations only the Commodity Exchange Authority would have regulatory authority with respect to the terms and conditions of the agreement between the customer and his broker. In managed accounts, however, a trader and a broker enter into agreements by which the trader confers discretion on his broker or any other person to trade his account. As one witness testified:

In this instance, the law is unclear whether the agreement and the trading pursuant thereto constitute a "security" within the meaning of the Securities Act of 1933. On this point there are conflicting federal court decisions and varying opinions among federal and state

145. *Id.* at 663-64.

146. *Id.* at 663.

147. *Id.* at 664.

148. *Id.*

regulatory personnel. . . . Since this Committee is attempting to refine the system of regulation in our industry, it is appropriate now to resolve, rather than to perpetuate, this difference of opinion concerning managed accounts.¹⁴⁹

Urging statutory clarification that the new commission would have exclusive regulatory jurisdiction to determine what constitutes a futures contract, this same witness noted that the ostensible objective of the pending legislation was an improved and comprehensive program for commodity futures regulation. He then queried whether: "Having created the regulatory program, and formed a commission with the expertise and manpower to implement that program, should not Congress vest in the new commission exclusive jurisdiction over all commodity trading accounts—managed and regular?"¹⁵⁰

PRO-STATE REGULATION TESTIMONY

Ironically, the strongest statement *in favor* of a state regulatory role was not submitted until after the formal Senate hearings had concluded. This statement addressed "the need and urgency to *decentralize the structure* of the commodity futures industry."¹⁵¹ The author argued that "this basic *structural reform* should provide for decentralization of the commodity exchange system so that *State supervision and control* of the system is clearly incorporated in the regulatory framework of this burgeoning industry."¹⁵² Admonishing Congress not to ignore any longer "the fact that State supervision and regulation is an absolute necessity," he favorably cited the "trend toward State supervision and regulation" which he perceived to be underway.¹⁵³ These comments, however, ignored what the proposed amendments sought to accomplish. For example, in his statement, the author noted:

One of the basic reasons for the need for decentralized control and State supervision of the commodities industry is the new growth community which has emerged . . . [and which] comprises millions of investors who have been provided with innovative investment vehicles and markets . . . in which returns and rewards have proved gratifying *but which currently are unregulated either at the Federal or State level.*¹⁵⁴

Considering that a major feature of the proposed amendments of the CEA was the bringing of *all* commodities under federal regulatory

149. *Id.* at 715 (statement of Harold Heinold).

150. *Id.*

151. *Id.* at 814 (statement of Arthur Economou).

152. *Id.*

153. *Id.*

154. *Id.* at 815.

authority, the situation which prompted the above comments—unregulated commodities—would no longer exist. Thus, it is doubtful that these remarks in support of “a dual Federal/State regulatory system” had any validity.

Mark-Up

The Senate Committee on Agriculture and Forestry began its executive mark-up of the futures trading legislation on August 7, 1974, and completed its changes the following day. The exclusive jurisdiction provisions of section 201 agreed to by the committee read:

Provided, That the Commission shall have exclusive jurisdiction with respect to accounts, agreements . . . and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 5 of this Act and which, in accordance with section 4h of this Act, may not lawfully be executed or consummated otherwise than through a member of a contract market: And provided further, That, except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (ii) restrict the Securities and Exchange Commission and such other authorities from carrying out their duties and responsibilities in accordance with such laws.¹⁵⁵

By inserting the phrase “except as hereinabove provided,” the committee was simply trying to “clarify” the House bill. As explained in the report by the committee after this mark-up session:

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 *Committee* amendment retains the provision of the *House* bill but adds three clarifying amendments. The clarifying amendments make clear that (a) the Commission’s jurisdiction over futures contract markets or other exchanges is exclusive and includes the regulation of commodity accounts, commodity trading agreements, and commodity options; (b) the Commission’s jurisdiction, where applicable, supersedes State as well as Federal agencies; and (c) Federal and State courts retain their jurisdiction.¹⁵⁶

Senate Action

In presenting the committee’s recommendations to the Senate on

155. S. REP. NO. 1131, 93d Cong., 2d Sess. 54 (1974) (italics in original) (emphasis added).

156. *Id.* at 6.

September 9, 1974, Senator Talmadge reiterated that: "In establishing this Commission, it is the committee's intent to give it exclusive jurisdiction over those areas delineated in the act. This will assure that the affected entities—exchanges, traders, customers, et cetera—will not be subject to conflicting agency rulings."¹⁵⁷ However, Senator Talmadge seemed to contradict himself, and confuse others, when he added:

[I]t is not the intent of the committee to exempt persons in the futures trading industry from existing laws or regulations such as the anti-trust laws, nor for the Commodity Futures Trading Commission to usurp powers of other regulatory bodies such as those of the Federal Reserve in the area of banking or the Securities and Exchange Commission in the field of securities.¹⁵⁸

By itself, this last statement implied that regulatory jurisdiction at the federal level would be concurrent; thus, it was inconsistent with all previous discussions regarding preemption and exclusive jurisdiction. The most plausible explanation for, and reconciliation of, these statements has been advanced by the current CFTC Chairman who, in reviewing the 1974 CEA amendments shortly after their enactment, suggested: "The better reading would be that the Chairman, like his counterpart in the House, wished simply to assure his colleagues that the SEC and other agencies would retain their 'traditional' roles which had never included the regulation of futures trading on commodity markets."¹⁵⁹

An amendment subsequently offered by Senator Curtis seems consistent with this interpretation. At the time of these debates, section 4c of the CEA provided: "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."¹⁶⁰ Senator Curtis urged his colleagues to delete this section "[i]n order to assure that Federal preemption is complete."¹⁶¹ In his remarks, Senator Curtis expressed his understanding that:

[T]he 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

157. 120 CONG. REC. 30,459 (1974).

158. *Id.*

159. Johnson, *supra* note 1, at 16-17.

160. 120 CONG. REC. 30,464 (1974).

161. *Id.*

bill would *preempt the field completely*, so that if any substantive State law were contrary to or inconsistent with Federal law, the Federal law would govern.¹⁶²

Senator Talmadge, who had chaired the hearings on this legislation and presided over the mark-up session, concurred with Senator Curtis' assessment. He advised his colleagues: "I have studied the amendment of the distinguished Senator from Nebraska. I agree with its import. I urge the Senate to adopt it."¹⁶³ Consequently, section 4c was deleted.

Conference Committee

The Senate and House versions of H.R. 13113 went to a conference committee in September, 1974. The committee adopted the Senate amendments regarding the jurisdiction of the CFTC. As explained in the conference report:

Under the exclusive grant of jurisdiction to the Commission, the authority in the Commodity Exchange Act (and the regulations issued by the Commission) would preempt the field insofar as futures regulation is concerned. Therefore, if any substantive State law 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 Commission to regulate the futures trading industry, the *Conferees do not contemplate that there will be a need for any supplementary regulation by the States*.¹⁶⁴

Final Approval

The House approved H.R. 13113 on October 9, 1974, and the Senate followed suit the next day. Introductory remarks in both Houses again emphasized the preemptive effect H.R. 13113 would have relative to state regulatory authority over commodity trading. For example, Congressman Poage, who presented the conference report to the House, noted that:

[H.R. 13113] provides the first complete overhaul of the Commodity Exchange Act since its inception, and creates a *comprehensive* regulatory structure to oversee the trading of futures. The bill is a considered approach toward solving both immediate and readily perceivable problems besetting futures markets and the public interest, and *makes several major changes in the role of the Federal Government in regulating all futures trading enterprises*.¹⁶⁵

162. *Id.* (emphasis added).

163. *Id.*

164. H.R. REP. NO. 1383, 93d Cong., 2d Sess. 35-36, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5897 (emphasis added).

165. 120 CONG. REC. 34,736 (1974) (emphasis added).

Acknowledging that “[o]ne of the most difficult issues to be resolved in the Commodity Futures Trading Commission Act was the jurisdiction of the new Commission,” Congressman Poage characterized the jurisdiction of the commission as “*extensive and complete* relative to the trading of futures.”¹⁶⁶

It is also apparent from Congressman Poage’s references to section 412 of the Act that Congress anticipated a displacement of state regulatory activity. Congressman Poage expressed the view of his committee that:

This act is remedial legislation designed to correct certain abuses which Congress found to exist in areas that will now come within the jurisdiction of the CFTC. Congress was aware that there have been ongoing efforts by various State and Federal regulators to prevent some of these abuses. Accordingly, section 412 was included in the bill to make clear that all *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, particularly during the time between the adoption of this legislation and the full implementation of its provisions by the CFTC.*¹⁶⁷

Implicit in these comments is an acknowledgment that full implementation of the CEA amendments would result in the CFTC assuming functions formerly performed by the states. Congressman Poage was advising the states that only *pending* proceedings and *ongoing* investigations could continue. New matters, however, would be subject to exclusive, not concurrent, CFTC jurisdiction.

CFTC Act Extension

The CFTC Act was signed into law on October 24, 1974.¹⁶⁸ Although the Act was expected to become effective on April 21, 1975, delays in the appointment of CFTC commissioners prompted Congress to adopt a joint resolution, H.R.J. Res. 335, deferring the activation of certain provisions in the 1974 amendments.¹⁶⁹ In its report on H.R.J. Res. 335, the House Committee on Agriculture emphasized that, “No provision in the resolution . . . alters existing law with respect to the jurisdiction of other Federal or State regulatory efforts.”¹⁷⁰ Thus, the resolution was not intended to delay the preemptive effect of the 1974

166. *Id.* (emphasis added).

167. *Id.* at 34,737 (emphasis added).

168. *Id.* at 36,278 (1974).

169. H.R.J. Res. 335, 94th Cong., 1st Sess., reprinted in [1975] U.S. CODE CONG. & AD. NEWS (89 Stat.) 77.

170. H.R. REP. No. 122, 94th Cong., 1st Sess. 7 (1975).

amendments. The Senate report further clarified that the resolution would not defer the effective date of the exclusive jurisdiction conferred on the CFTC by the 1974 amendments. The report specified that, "Except as specifically provided therein, the resolution is not intended in any way to make substantive changes in the 1974 Act and the Commodity Exchange Act, as amended."¹⁷¹ The report also emphasized, however, that "the preemption of the regulation of commodity futures trading by the Commodity Futures Trading Commission Act of 1974 does not prevent the States from enforcing their criminal anti-fraud statutes."¹⁷²

III. PREEMPTION

The preemption doctrine¹⁷³ is a corollary of the supremacy clause of the Constitution.¹⁷⁴ Under it, courts may invalidate state legislation which infringes on areas Congress has expressly or impliedly reserved to itself. Since "[t]he purpose of Congress is the ultimate touchstone" in determining whether a state statute is invalid under the supremacy clause,¹⁷⁵ preemption analysis is essentially an attempt to divine congressional intent.¹⁷⁶ The courts have traditionally indicated a willingness to infer an intent to preempt state legislation even in the absence of clear congressional expression on the matter.¹⁷⁷ Such an inference has been likely where the federal regulatory scheme was so pervasive, or the need for uniformity so apparent, that it was tantamount to federal "occupation of the field."¹⁷⁸ Alternatively, the courts have

171. S. REP. NO. 73, 94th Cong., 1st Sess. 5, *reprinted in* [1975] U.S. CODE CONG. & AD. NEWS 143, 147.

172. *Id.*

173. *See generally* Note, *The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COLUM. L. REV. 623 (1975).

174. U.S. CONST. art. VI, cl. 2 provides:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

175. *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978) (quoting *Retail Clerks v. Schermerhorn*, 375 U.S. 96, 103 (1963)).

176. "The question whether federal law 'preempts' state action [is] largely one of statutory construction. . . ." L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 377 (1978).

177. In *Malone v. White Motor Corp.*, 435 U.S. 497 (1978), the Court acknowledged that, "Often Congress does not clearly state in its legislation whether it intends to pre-empt state laws," but noted that it would nevertheless find preemption if the state law "conflicts with federal law or would frustrate the federal scheme, or . . . the courts discern from the totality of circumstances that Congress sought to occupy the field to the exclusion of the States." *Id.* at 504.

178. *See, e.g.*, *Pennsylvania v. Nelson*, 350 U.S. 497 (1956); *Hines v. Davidowitz*, 312 U.S. 52 (1941).

found preemption if the congressional act touched a field where the federal interest was so dominant that it necessarily precluded enforcement of state laws on the same subject.¹⁷⁹ Finally, even if Congress has not completely foreclosed state legislation in a particular area, the courts have held state statutes void to the extent they actually conflict with a valid federal statute or would frustrate "the accomplishment and execution of the full purposes and objectives of Congress."¹⁸⁰

More recently, however, decisions of the Supreme Court involving preemption analysis have suggested a judicial disinclination to find preemption where congressional intent is uncertain. In *New York Department of Social Services v. Dublino*,¹⁸¹ the Court, quoting from an earlier decision, warned:

If Congress is authorized to act in a field, it should manifest its intention clearly. It will not be presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation of intention to do so. The exercise of federal supremacy is not lightly to be presumed.¹⁸²

Soon after *Dublino*, the Court, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*,¹⁸³ hinted at the probable objective of its seeming imposition of specific intent as a prerequisite to a finding of preemption. There, Justice Blackmun, referring to preemption analysis, expressed the Court's "conviction that the proper approach is to reconcile 'the operation of both statutory schemes with one another rather than holding one completely ousted.'"¹⁸⁴

Despite this evidence of a judicial proclivity to reject pervasiveness and potential conflict as preemptive grounds, other cases suggest that these doctrinal bases have survived and that the Court will still infer intent, even in the absence of clear congressional expression.¹⁸⁵ For

179. *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

180. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

181. 413 U.S. 405 (1973). *See also Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 132 (1978) ("This Court is generally reluctant to infer preemption . . .").

182. 413 U.S. at 413 (quoting *Schwartz v. Texas*, 344 U.S. 199, 202-03 (1952)).

183. 414 U.S. 117 (1973).

184. *Id.* at 127 (quoting *Silver v. New York Stock Exchange*, 373 U.S. 341, 357 (1963)).

185. *See, e.g., Jones v. Rath Packing Co.*, 430 U.S. 519 (1977) (the Court found that a federal statute regulating the weight labels on bacon and flour preempted stricter state statutes whose enforcement would have frustrated the congressional purpose to use uniform package weights to facilitate comparison by consumers); *Burbank v. Lockheed Air Terminal*, 411 U.S. 624 (1973) (the Court invalidated a city noise control ordinance which prohibited jet aircraft from taking off at a private airport during nighttime hours; the Court found that enforcement of this ordinance would hinder centralized control of takeoff and landing times and necessarily curtail, to a substantial degree, the flexibility of federal agencies in controlling air traffic flow under a comprehensive scheme of federal regulation of the industry). *Cf. Philadelphia v. New Jersey*, 437 U.S. 617, 620-21 n.4 (1978), where the Court refused to find preemption where it could find no "clear and manifest purpose of Congress" to preempt the entire field of interstate waste management or

purposes of the CEA, however, establishing such an inference may be an unnecessary tautological exercise. Even under the stricter standard of *Dublino*, it is apparent that Congress has "clearly" manifested its intention to supersede state regulation of commodities trading.

As reviewed above, preemption was a central issue in the proceedings which culminated in the 1974 amendments to the CEA. Numerous witnesses testified extensively as to the efforts of the states to use their securities laws to regulate, in varying fashion, commodities trading. Members of Congress expressed concern that confusion in futures markets could result from these conflicting laws. They concurred with witnesses as to the importance of securing uniform regulation of commodities trading and imposing comprehensive federal authority over a field which had direct implications for the well-being of the national economy. It was against this background of informed and thorough deliberation as to the preemptive scope of the proposed legislation that the 1974 amendments emerged.

In its final form, section 2(a)(1) of the CEA explicitly vested "exclusive jurisdiction" in the CFTC over all transactions involving or related to commodity futures contracts. Section 4c, which had expressly preserved state regulatory authority, was deleted "to assure that preemption is complete."¹⁸⁶ Section 5a(12) was inserted to require all commodity exchanges to secure prior CFTC review and approval of all trading rules and regulations adopted by the various boards of trade to govern futures transactions.¹⁸⁷ These amendments established independent evidence of congressional intent to displace any state regulatory role.¹⁸⁸ In addition, they wholly and unequivocally eliminated

transportation and where Congress had expressly provided in the Waste Disposal Act that states retain a primary role in collection and disposal of waste. The Supreme Court has acknowledged that there is no clear and consistent approach to preemption analysis. In *Hines v. Davidowitz*, 312 U.S. 52 (1941), Justice Black observed that no one formula "provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, there can be no one crystal clear distinctly marked formula." *Id.* at 67. This admission has not made it any easier for lower courts to apply the multifarious preemption pronouncements of the Court. One frustrated court concluded that "this area is imbued with result-oriented decisions which tend to comport with the philosophical leanings of the Supreme Court." *Great Western United Corp. v. Kidwell*, 439 F. Supp. 420, 435 (N.D. Tex. 1977), *rev'd sub nom. Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979).

186. See text accompanying notes 160-63 *supra*.

187. Pub. L. No. 93-463, § 5a(12), 88 Stat. 1389, 1401-02 (1974) (current version at 7 U.S.C. § 7a(12) (Supp. IV 1980)).

188. See also Russo & Lyon, *The Exclusive Jurisdiction of the Commodity Futures Trading Commission*, 6 HOFSTRA L. REV. 57, 69 (1977) [hereinafter cited as Russo & Lyon] where the authors, applying preemption analysis, similarly conclude that Congress intended pervasive federal regulation. Cf. Note, *The Pre-emption Doctrine and the Commodity Futures Trading Commission Act: In Favor of State Law*, 11 IND. L. REV. 467 (1978) [hereinafter cited as *Preemption Note*] (suggesting that the CFTC Act has not totally preempted state regulation of commodities trading).

each of the bases the Supreme Court had relied on in *Rice v. Board of Trade* to hold that the CEA did not preempt state regulation of commodities trading.¹⁸⁹

*Judicial Application of Preemption Doctrine to 1974
Amendments: 1974-1978*

Despite its seeming inevitability, no definitive judicial statement on preemption and the CEA emerged from any cases decided between 1974 and 1978 that considered the amended jurisdictional provisions of the CEA. Some courts avoided a comprehensive treatment of the preemption issue by relying on the "hold-over" provisions of section 412.¹⁹⁰ Others simply held in favor of preemption but did not indicate in any significant detail the factors leading to their decision. For example, in *State v. Monex International, Ltd.*,¹⁹¹ a state court held that "it is clear" that the newly created CFTC has exclusive jurisdiction to regulate an exchange's margin account sales of silver coins.¹⁹² However, the opinion contained virtually no analysis of the reasons prompting this conclusion. Similarly, the Supreme Court of Texas, relying on *Monex*, held that the jurisdiction of the CFTC with respect to London options was exclusive.¹⁹³ Although, on this basis, the court dismissed as moot a suit brought by the state to enjoin the defendant's sale of such options, it too failed to elaborate on the reasons behind its holding.¹⁹⁴

In *International Trading, Ltd. v. Bell*,¹⁹⁵ the Supreme Court of Arkansas attempted a comparatively more thorough evaluation of preemption under the amended version of the CEA. The Arkansas Securities Commission, relying on the Arkansas Securities Act, had brought an action to prohibit the defendant from engaging in fraudulent practices in connection with the sale of London options. After reviewing some of the previously discussed cases and the legislative history of the CEA, the court dismissed the suit. It found that the state law could not be enforced because the CEA had preempted the field of commodities regulation. A significant aspect of the court's decision was its rejection of the argument advanced by the Arkansas Securities

189. See text accompanying notes 73-81 *supra*.

190. See, e.g., *State v. Coin Wholesalers, Inc.*, 311 Minn. 346, 250 N.W.2d 583 (1976); *People v. Monex Int'l, Ltd.*, 86 Misc. 2d 320, 380 N.Y.S.2d 504 (1975).

191. 527 S.W.2d 804 (Tex. Civ. App. 1975).

192. *Id.* at 806.

193. *Clayton Brokerage Co. v. Mouer*, 531 S.W.2d 805 (Tex. 1975) (per curiam).

194. *Id.* at 806.

195. [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,495.

Commissioner that enforcement of the state regulatory scheme should be permitted when the state act is not in actual conflict with the federal act. Relying on section 2(a)(1) of the CEA, the court noted that "Where, . . . as here, 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."¹⁹⁶ The court added that preemption occurs even if a state law is not actually an obstacle to federal enforcement since "the potential for obstacles is just as important as their existence."¹⁹⁷ Unable to characterize as unfounded the congressional determination that commodity trading demanded exclusive federal regulation, the court suggested that the state, consistent with the CEA, rely not on its securities laws but on the general fraud provisions of its criminal code to protect its citizens from fraud.¹⁹⁸

Position of CFTC on Question of Preemption

The CFTC consistently reinforced and encouraged these early decisions, holding that the CEA, as amended, displaced state regulatory authority in the field of commodities trading. This is itself significant. In *Skidmore v. Swift & Co.*,¹⁹⁹ the Supreme Court observed that:

[T]he rulings, interpretations and opinions of the Administrator [of an administrative agency], while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.²⁰⁰

Thus, it is notable that a spokesman for the CFTC carefully explained the position of his agency:

[B]eyond any reasonable dispute . . . the Act totally preempts any state licensing or registration provisions. Further, we think 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

196. *Id.* at 21,996. The decision here refutes the position advanced in *Preemption Note*, *supra* note 188, at 486-87.

197. *Id.* (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1946)).

198. *Id.*

199. 323 U.S. 134 (1944).

200. *Id.* at 140.

would be preempted under the Supremacy clause of Article VI of the Constitution.²⁰¹

The CFTC, however, never suggested that the states were without any authority to protect their citizens against the fraud sometimes associated with commodity transactions unlawful under the CEA. In seeming concurrence with the advice of the Arkansas Supreme Court, the CFTC specified that it did "not believe that the states are preempted from prosecuting fraud under state laws of general application. The important concept is that the fraud statute must be of general application and is not part of some narrower state regulatory scheme."²⁰²

This, of course, precluded the states from applying their securities laws to commodity transactions. Under this view, the only permissible enforcement measures were those which would "induce compliance with the federal regulatory scheme."²⁰³ Although, according to this interpretation, the states were precluded from applying their own securities laws to commodity transactions, they were permitted to enforce their general fraud statutes and enjoin violations of the CEA by bringing suit under the doctrine of *parens patriae*.²⁰⁴ The objective of the CFTC was simply to maintain regulatory uniformity under standards established by the CEA and interpreted by the CFTC. Indeed, to facilitate consistent and cooperative enforcement efforts, the CFTC established a committee to act as a liaison between the CFTC and state officials in matters of mutual concern.²⁰⁵

Despite these efforts by the CFTC to delimit an appropriate regulatory sphere for the states, various securities commissioners bridled at the suggestion that they rely on *parens patriae* suits and enforcement of general antifraud statutes to protect their citizens from fraud associated with commodities trading. They argued that such measures were unproductive as well as time and resource consuming, and insisted that

201. Remarks of CFTC Vice-Chairman John Rainbolt, reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,075 at 20,706-07 [hereinafter cited as Rainbolt]; see also CFTC Interpretative Letter No. 76-19 [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,213; CFTC Interpretative Letter No. 76-20 [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,214.

202. Rainbolt, *supra* note 201, at 20,707; see also *The States' Two-Fold Commodities Enforcement Role: State Parens Patriae Suits to Uphold the Commodity Exchange Act and State Prosecutions Under General Criminal Antifraud Statutes*, CFTC, Office of General Counsel Release, reprinted in [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,218 [hereinafter cited as *Parens Patriae Suits*].

203. Rainbolt, *supra* note 201, at 20,707.

204. *Parens patriae* is a concept of standing which, in some instances, permits state attorneys general or other officials to bring actions in federal court on behalf of state residents. See *Parens Patriae Suits*, *supra* note 202, at 21,187-91.

205. See 41 Fed. Reg. 13,393 (1976); see also Russo & Lyon, *supra* note 188, at 71 n.56.

effective trader protection would not be possible without permission to prosecute under the more specific requirements of state securities laws.²⁰⁶ Dissatisfied with the position of the CFTC, and rebuffed by their own courts in their efforts to bring enforcement actions under state laws, these officials resolved that the extent of state regulatory authority would become a primary issue in the 1978 hearings on congressional reauthorization of the CFTC.

IV. LEGISLATIVE HISTORY OF 1978 AMENDMENTS

Investigation into Effectiveness of CFTC

THE WHITTEN REPORT

Two major federal investigations into the effectiveness of the CFTC were completed, and their findings released, just as the CFTC congressional reauthorization proceedings began. The Whitten Report had been prepared for use by a subcommittee of the House Committee on Appropriations.²⁰⁷ Among other things, it attempted "[t]o determine the effect of the 1974 Act on the States, and the relationship between CFTC and the States," and to evaluate the efforts of the CFTC to regulate the trading of commodity options.²⁰⁸

The Whitten Report accepted as "evident" that Congress "clearly intended" to grant the CFTC exclusive jurisdiction over commodity transactions.²⁰⁹ Nevertheless, it criticized the CFTC's "aggressive assertion" of this exclusive jurisdiction.²¹⁰ It believed this had not only seriously strained the relationship between the CFTC and the states but, more significantly, had effectively prevented "the enforcement resources of the securities agencies of the several States . . . from taking action in the field of commodity futures and commodity options."²¹¹

Although the Whitten Report was plainly sympathetic to views expressed by the SEC and state officials that concurrent state jurisdiction is necessary to augment the enforcement resources of the CFTC, it did not believe the states could assert any enforcement role without an amendment to the CEA. The report recognized that "[t]he exclusive Federal jurisdiction established by the CFTC Act obviously was designed to prevent a proliferation of commodity-related legislation by

206. See Russo & Lyon, *supra* note 188, at 71.

207. STAFF OF HOUSE COMM. ON APPROPRIATIONS, 95TH CONG., 2d SESS., INVESTIGATIVE STUDY ON THE COMMODITY FUTURES TRADING COMMISSION (Comm. Print 1978).

208. *Id.* at 3.

209. *Id.* at 130.

210. *Id.* at 129.

211. *Id.*

the States.”²¹² It also acknowledged that “[s]uch proliferation of widely disparate laws could be a serious burden on the industry and could negate the efforts of CFTC to maintain an orderly market.”²¹³ The only role the Whitten Report reasonably foresaw for state officials was in the limited area of fraud and consumer protection, and this only if “appropriate legislative language could be developed which would permit the States to enforce their laws if they are not inconsistent with the Commodity Exchange Act and subject to the supremacy clause of the Constitution.”²¹⁴

THE GAO STUDY

The study by the General Accounting Office (GAO) was more comprehensive than the Whitten Report.²¹⁵ It had been undertaken pursuant to the mandatory review provisions of section 8 of the CEA and in anticipation of the CFTC reauthorization proceedings. Although the GAO Study was critical of some aspects of the CFTC’s regulatory efforts—particularly in the area of options trading—it was emphatic in its conclusion that the CFTC should be reauthorized.²¹⁶

The conclusions of the GAO Study were strikingly similar to those of the Whitten Report. The GAO agreed that “[t]he 1974 act, in giving CFTC exclusive jurisdiction over commodity matters, effectively preempted the States and SEC from the field of commodity regulation, including the prosecution of fraudulent activity.”²¹⁷ Thus, although the GAO favored a general regulatory role for the states, it did not believe this would be possible without an amendment to the CEA. The GAO’s assessment that state enforcement authority was desirable was closely tied to its perception that commodity options trading had been ineffectively regulated by the independent actions of the CFTC. Like the Whitten Report, the GAO Study found that the CFTC had prematurely asserted its exclusive jurisdiction, thereby creating—due to the CFTC’s understaffing and limited experience—a regulatory gap “which has been exploited by fraudulent option dealers.”²¹⁸ Despite these perceived shortcomings, the GAO Study did not dispute the va-

212. *Id.* at 137.

213. *Id.*

214. *Id.*

215. *Regulation of the Commodity Futures Markets—What Needs to Be Done*, U.S. Gen. Accounting Office Doc. No. CED-78-110 (May 17, 1978) [hereinafter cited as GAO Study].

216. *Id.* at 15.

217. *Id.* at 186.

218. *Id.*

lidity of the CFTC's claim of exclusive jurisdiction. To the contrary, the authors of the study stressed that:

[We are] not challenging CFTC's interpretation of its exclusive jurisdiction . . . or questioning its authority to act as it has in asserting that jurisdiction. We believe, however, that in its early deliberations concerning whether to attempt to regulate options or to place a moratorium on their trading, CFTC should have given more consideration to the factor of exclusive jurisdiction and to its implications for effective enforcement of option regulations. We believe, also, that in view of the mounting evidence that its interim regulatory program was not providing the essential customer protections that had been promised, CFTC should have been more mindful of and responsive to the views of State and Federal regulatory officials *who had been effectively preempted from the field of commodity options* but who were, perhaps, better equipped and better staffed than CFTC to control the problem.²¹⁹

Consistent with this conclusion that state enforcement experience and resources were underutilized, the GAO urged Congress to amend the CEA "to permit any State securities commission or other State authority to investigate and prosecute options fraud and other forms of commodity-related fraud under State blue sky or other antifraud statutes."²²⁰

However, the GAO Study recognized that even with such an amendment, the states could enforce their antifraud statutes only to the extent that "such State agency or authority does not take action which conflicts with the Commodity Exchange Act or the rules and regulations thereunder."²²¹ Under this limitation, a state could never use its bucket-shop laws to prohibit the trading of stock index futures contracts approved by the CFTC pursuant to its powers under the CEA. Indeed, even the GAO Study implicitly sanctioned and deferred to the authority of the CFTC to approve trading in stock index futures. In discussing the role of the SEC relative to futures regulation, the GAO Study urged Congress to amend the CEA and transfer to the SEC "jurisdiction over futures contracts written on all securities subject to the registration requirements of the Securities Act of 1933, *including indexes of such securities*."²²² With respect to futures contracts written on securities exempt from registration requirements, the GAO Study suggested that the CEA be amended to permit the SEC "to bring an enforcement action under . . . the Securities Act of 1933, *subject to*

219. *Id.* at 188-89 (emphasis added).

220. *Id.* at 211.

221. *Id.*

222. *Id.* at 12 (emphasis added; footnote omitted).

CFTC's prior right to act."²²³

The manner in which the GAO Study advised this transfer of jurisdiction to the SEC is significant. Nowhere did the Study challenge the validity under the CEA of futures contracts based on stock indices. The appropriateness of such indices as instruments for futures trading was unquestioned. The concern of the GAO was jurisdictional—the issue was who should regulate stock index futures, not whether they were permitted under the CEA. Although the GAO Study would have resolved this concern in favor of the SEC, it admitted that until there was an amendment to the contrary, the CEA vested all regulatory authority over futures contracts, including those based on stock indices, in the CFTC alone. Further, despite the pronounced desire of the GAO to involve state expertise in the regulation of commodities trading, no mention was made of any presumed power of the states to thwart the trading of stock index futures—either through archaic bucket-shop laws or existing securities laws. Indeed, in discussing the specific prospects for such instruments, the GAO Study suggested that regulatory authority should vest not in the states, but in either the SEC or the SEC and CFTC jointly.²²⁴ As will be seen, Congress rejected even these alternatives and unequivocally affirmed the vesting of sole authority in the CFTC.

House Hearings

In February, 1978, the House Subcommittee on Conservation and Credit began hearings on H.R. 10285, "a bill to extend the Commodity Exchange Act, as amended, for four years." Battle lines over the issue of the CFTC's exclusive jurisdiction began to form quite early in these hearings. The vice-chairman of the CFTC, in his introductory statement to the subcommittee, urged passage of an amendment to the CEA "to provide a method to encourage states to enforce the Federal law and Commission regulations under it."²²⁵

In the view of the CFTC, the exclusive jurisdiction provisions of the CEA invalidated all state statutes, including bucket-shop laws, which directly or indirectly represented efforts by the states to regulate commodity trading. The amendment urged by the CFTC purported to codify only those enforcement tools already available to, but rarely

223. *Id.* (emphasis added).

224. *Id.* at 12-14.

225. *Extend Commodity Exchange Act: Hearings on H.R. 10285 Before the Subcommittee on Conservation & Credit of the House Committee on Agriculture, 95th Cong., 2d Sess. 62 (1978)* [hereinafter cited as *1978 House Hearings*] (statement of John Rainbolt).

used by, the states. It permitted the states to prosecute commodity-related fraud under consumer protection or criminal fraud statutes.²²⁶ Additionally, it sought to expressly authorize states to bring suits as *parens patriae* to enforce the provisions of the CEA and the related rules, regulations and orders approved by the CFTC.²²⁷ Enforcement actions, however, would not have been permitted under local securities laws or other regulatory-oriented legislation, including bucket-shop laws. As Commissioner Rainbolt noted in response to a question regarding preemption:

The idea behind the exclusive jurisdiction provisions of the Commission was to simplify and centralize regulation of the commodity market. You have always had a problem throughout history with State regulation of commodity markets. . . . This goes back quite a ways to when they declared futures contracts as illegal gambling contracts and could not be enforced because in many cases they did not contemplate delivery of the commodity.²²⁸

Since bucket-shop laws were enacted with commodity-related fraud specifically in mind, they assumed regulatory dimensions. Thus, they too would fall within the preemptive scope of the exclusive jurisdiction provisions of the CEA, regardless of the amendment suggested by the CFTC.

State Testimony

Extensive comments on the jurisdictional issue were also received from various state officials. The first such statement was from the Wisconsin Commissioner of Securities, who charged that the effect of the exclusive jurisdiction provision of the CEA had been "to hamstring the efforts of the various states effectively to prevent or curtail widespread fraud and abuses in the offer and sale of commodity options contracts, margin and leverage agreements . . . and other commodity-related investments."²²⁹ He noted that prior to the 1974 amendments, the bulk of state regulatory and prosecutorial activity centered on commodity-related investments such as commodity options and margin or leverage contracts and described how "numerous actions" had been brought as a result of this aggressive state posture. He contended, however, that the 1974 amendments had "seriously curtailed the ability of the states

226. *Id.* at 63. For the earlier view of the current CFTC Chairman disputing the CFTC position that civil consumer protection statutes can be invoked despite the exclusive jurisdiction provision of the CEA, see Johnson, *The Commodity Futures Trading Commission Reauthorization Process: A View from the Trenches*, 1 DET. C.L. REV. 1, 20 n.122 (1979).

227. 1978 *House Hearings*, *supra* note 225, at 63.

228. *Id.* at 80.

229. *Id.* at 123 (statement of Conrad Goodkind).

to prevent or prosecute fraudulent activities in connection with the sale of commodity-related investments.”²³⁰ The Wisconsin Commissioner also alleged—erroneously—that “no state securities administrator was aware that [exclusive jurisdiction] language was under consideration, and none testified at hearings in connection with the legislation.”²³¹ To prevent the “continuing loss of hundreds of millions of dollars annually in commodity-related frauds,” he proposed amending section 2(a)(1) of the CEA to “permit state and S.E.C. antifraud actions where commodities fraud would also constitute a fraud under federal or state securities laws.”²³²

When questioned by committee members, Commissioner Goodkind rejected the position of the CFTC that, regardless of the CFTC’s exclusive jurisdiction, states could bring effective enforcement actions against commodity-related fraud under either the doctrine of *parens patriae* or antifraud statutes of general jurisdiction under the general criminal code. As he explained:

The problems with proceeding under either of the two doctrines that the Commission has outlined are, first of all, as to *parens patriae*, it is a very tenuous doctrine. Not all the courts have recognized it and have only recognized it in limited circumstances. Suit can only be brought under that theory by the Attorneys General of the States, not by the regulators or by the enforcement agencies which are most familiar with financial crimes.

You have the same problem as to the antifraud statute of general jurisdiction which is that they can only be brought by the attorneys general. But in addition to that, you have a very serious proof problem in that the standard of proof under a criminal statute of general jurisdiction is intentional wrongdoing, whereas the standard of proof under the securities law and the commodities law is willful misconduct.

In the financial crimes area, it is very difficult, if not impossible, to establish intentional wrongdoing.²³³

Comments similarly critical of CFTC exclusive jurisdiction were received from the securities commissioners of Texas²³⁴ and Minnesota²³⁵ and from the Massachusetts Secretary of State.²³⁶ A letter received from the Texas official is notable simply because it admitted that, from a state perspective, a bucket-shop law is a form of commod-

230. *Id.* at 124-25.

231. *Id.* at 125.

232. *Id.* at 131-32.

233. *Id.* at 173.

234. *Id.* at 363-65 (letter from Richard Latham).

235. *Id.* at 383 (statement of John Larson).

236. *Id.* at 375 (statement of Paul Guzzi).

ity futures regulation preempted by the 1974 amendments.²³⁷ The testimony of Massachusetts Secretary of State Guzzi was more pointed. He advised the committee to "abolish the exclusive jurisdiction of the CFTC and the consequent preemption of state action against commodity-related fraud."²³⁸

The testimony of the securities commissioner of Minnesota was not as extreme as that of Secretary Guzzi. Yet, it similarly urged the curtailment of the CFTC's exclusive jurisdiction so as to permit the states to use their own securities antifraud provisions and personnel against fraud related to commodity investment contracts. When questioned by the committee, Commissioner Larson emphasized that the states were seeking only "an antifraud provision at the State level which is identical to what is contained in the CFTC Act which is also identical to what is contained in the Securities and Exchange Act."²³⁹ He noted that the states contemplated only a narrow role and were "not interested in getting into the area of regulating, that is, adopting rules, setting standards, determining what contracts can be sold, licensing the people, et cetera."²⁴⁰ Even Representative Glickman, perhaps the most vocal congressional critic of the CFTC's exclusive jurisdiction, concurred with this view, believing that a circumscribed role for the states was "appropriate."²⁴¹

Stock Index Futures

It is clear from the hearings that Congress was fully aware of the brewing controversy over stock index futures. Discussion of these instruments first arose in the context of whether the CFTC should retain exclusive jurisdiction over a futures contract regardless of the underlying commodity. In his testimony, SEC Chairman Harold Williams re-

237. The Texas Commissioner wrote that, prior to the 1974 CEA amendments, "Texas had never chosen to regulate commodity futures except to enact a bucket-shop law." *Id.* at 363 (letter from Richard Latham). This characterization of bucket-shop statutes as a form of commodities regulation is consistent with the view taken by the CFTC. See text accompanying notes 225-28 *supra*.

238. 1978 *House Hearings*, *supra* note 225, at 379. Secretary Guzzi also warned that the Commodity Options Fraud Task Force which he headed was considering recommending abolishing the CFTC. *Id.* at 381.

239. *Id.* at 439 (testimony of John Larson).

240. *Id.* Notwithstanding preemption, the position advanced by the Minnesota official would, by inference, preclude even an attempt by a state to apply bucket-shop statutes to prevent trading in stock index futures. If, as presented here, the states were not interested in setting standards or determining what contracts could be sold, they would, presumably, defer to CFTC decisions on such matters and not try to circumvent or undermine these decisions by evaluating them according to the standards of nineteenth-century legislation.

241. *Id.* at 440.

ferred to an application before the CFTC seeking contract market designation for a stock index futures contract. He cited as a major regulatory concern of the SEC the possibility that:

[A]s the number of futures contracts on securities continues to rise, the activity in the futures market may have a significant effect upon the market for the underlying securities, and *visa-versa*. Yet, *because there is jurisdiction in the CFTC over the futures market for these securities*, and there is jurisdiction in our Commission over the underlying markets in these same securities, the potential for conflicting or duplicative regulation is necessarily increased. . . .²⁴²

Accordingly, Commissioner Williams urged Congress to:

[A]mend the definition of the term "commodity" in Section 2 of the Commodity Exchange Act expressly to exclude any goods, articles, services, rights or interests which constitute or involve a "security" within the meaning of the federal securities laws. In addition, a new provision should be added to the Commodity Exchange Act making clear that it is the Securities and Exchange Commission, and not the CFTC, that is vested with jurisdiction over all accounts, agreements, and transactions involving contracts for the sale of a "security" for future delivery.²⁴³

Witnesses from the GAO, the Office of Management and Budget (OMB) and the Chicago Board Options Exchange echoed the views expressed by Chairman Williams and similarly recommended transferring to the SEC the CFTC's "current" authority over futures contracts based on securities.²⁴⁴

Many comments from committee members during these hearings involved futures contracts based on securities generally and stock index futures particularly. Representative Glickman, in response to testimony that the range of CFTC jurisdiction and authority included "cash markets related to the transfer of the commodities named in the Commodity Exchange Act, as well as any other commodity on which a futures contract exists,"²⁴⁵ expressed concern "about the incredible amount of capital that may be flowing out of the securities markets into futures markets."²⁴⁶ Noting that an application to commence trading in stock index futures was pending, he questioned whether "there are certain nontraditional commodity areas such as financial instruments that more properly belong within the jurisdiction of the Securities and Exchange Commission as opposed to the jurisdiction of [the

242. *Id.* at 189-90 (statement of Harold Williams) (emphasis added).

243. *Id.* at 209.

244. *Id.* at IV-VI.

245. *Id.* at 111 (statement of John Rainbolt).

246. *Id.* at 113 (statement of Rep. Dan Glickman).

CFTC]."²⁴⁷ It is significant that, like the authors of the GAO Study,²⁴⁸ Representative Glickman did not question the legitimacy of a futures contract based on securities stock indices. His only concern was vesting regulatory authority in the proper agency. This jurisdictional emphasis is implicit in his inquiry of witnesses:

Do you gentlemen believe that all futures trading is the same, or do you believe there is a fundamental difference between trading futures of a commodity or historical commodity, let us say under the Commodities Exchange Act, and trading futures on Treasury Bills and futures on Dow Jones indexes, and futures on things which really are not historical commodities at all? Is there a difference, and, if so, should those be separate in terms of regulatory functions? Should the SEC take over the regulation, at least with respect to the antifraud provisions of those things?²⁴⁹

The most extended consideration of stock index futures resulted from a direct question by the subcommittee's chairman as to the CFTC's position on a proposed futures contract based on the Dow Jones index.²⁵⁰ In response, the CFTC Chairman emphasized that a stock index futures contract is a hedging mechanism, and argued that "[t]he real question on Dow Jones is not the delivery of securities. It is a question of whether there is an economic purpose to hedging that arithmetical average."²⁵¹

CFTC Vice-Chairman Rainbolt elaborated on these comments and warned the subcommittee that if jurisdiction over securities futures contracts were transferred to the SEC, "you would probably not see . . . full development of the economic potential for commodity markets that might be available and that is free for development under the 1974 amendment giving CFTC exclusive jurisdiction over all futures trading."²⁵² Relative to the proposed stock index futures contract, he queried rhetorically:

In what environment will the Dow Jones futures be examined? Will it be examined in an environment, as the CFTC would apply, that would try to assess its fitness and suitability as a risk-shifting mechanism and a hedging mechanism for the economy or will it be evaluated as a security?

If it is evaluated as a security, there is a high degree of likelihood you will never see a Dow Jones future at all.²⁵³

247. *Id.* at 113-14.

248. *See* notes 222-24 *supra* and accompanying text.

249. 1978 *House Hearings*, *supra* note 225, at 176.

250. *Id.* at 610 (statement of Rep. Ed Jones).

251. *Id.* (statement of William Bagley).

252. *Id.* at 611 (statement of John Rainbolt).

253. *Id.* at 611-12.

Another representative of the CFTC described for the subcommittee the functional difference between securities and futures markets. He explained that the former "is simply a cash market where people buy a product and take title and delivery immediately."²⁵⁴ On the other hand:

The futures market is quite different from that. People contract for purchase or sale at a specific price for a given time in the future. The purpose is not to acquire title and take delivery of the product. The purpose is to offset the risk of a change in price during the time interval which is indicated in the contract.

If you try to cross these purposes and do not recognize the functional distinction, I think the whole matter will become hopelessly confused.²⁵⁵

The final reference to stock index futures was by the chairman of the subcommittee who asked whether, as proposed by the GAO, an interagency council—composed of representatives of the CFTC, SEC, Treasury and other departments—would assist the CFTC in regulating futures contracts in securities.²⁵⁶ The question suggested that formation of such a council was being considered as a reasonable alternative to a transfer of authority from the CFTC to the SEC.²⁵⁷ It also implied a recognition that the CFTC already had the exclusive authority to authorize and regulate futures contracts based on securities, including stock index futures.

Mark-Up

STOCK INDEX FUTURES SANCTIONED

In mark-up, the subcommittee rejected an amendment proposed by Representative Glickman that would have deleted from the CEA definition of commodity "any contract for future delivery of any security required to be registered under section 12 of the Securities Exchange Act of 1934."²⁵⁸ Significantly, Representative Glickman's proposal would still have specifically included within the definition of commodity "futures of any *index* of such securities or any aggregation or pool of different securities."²⁵⁹ He believed that a futures contract written on a specific security would actually be a variant of a stock option, an instrument already subject to the regulatory authority of the

254. *Id.* at 613 (statement of Read Dunn).

255. *Id.*

256. *Id.* at 613-14.

257. *Id.* at 614 (statement of William Bagley).

258. H.R. REP. No. 1181, 95th Cong., 2d Sess. 46 (1978).

259. *Id.* (emphasis added).

SEC.²⁶⁰ Nevertheless, he perceived that, despite their novelty, "futures on indexes or aggregates of securities may serve an economic purpose."²⁶¹ Thus, rather than frustrate the development of an economically useful hedging device, Representative Glickman simply wanted to encourage the CEA to proceed with caution in acting on applications for such futures contracts.²⁶²

The Committee on Agriculture appeared to heed Representative Glickman's concern. After mark-up, the full committee recommended that Congress amend the CEA and formalize the CFTC practice of soliciting the views of other federal agencies prior to designating contract markets for the trading of futures contracts based on financial instruments. This recommendation was a decisive rejection of the position advanced in the hearings by the SEC, the OMB, the GAO, and by state officials. Not only did it reaffirm the congressional view that futures contracts based on securities indices were legitimate trading instruments under the CEA, but it also made clear that regulatory authority should be based on the economic function of the transaction, not the underlying commodity. As the committee noted:

Congress was aware in 1974 that proposals for futures trading in financial instruments and Government securities were being developed by the futures industry. *Recognizing the risk-shifting and price-discovery functions of the futures markets*, regulation of futures contracts on financial instruments and Government securities under the Commodity Exchange Act was vested in the single expert agency that had been created to administer the Act—the Commodity Futures Trading Commission.²⁶³

Although mindful of the pending proposal for stock index futures, and of the position of the SEC favoring the transfer to it of jurisdiction over futures contracts written on financial instruments and other securities, the committee expressed its belief that:

[T]he Congressional judgment in 1974 to maintain the traditional horizontal regulatory approach to commodity futures trading under the Commodity Exchange Act is sound. The Committee is of the view that jurisdiction over futures markets should reside in an agency such as the Commission whose regulatory role requires an

260. *Id.* Apparently, the CFTC agrees with this position. In the House hearings, its representatives, although emphasizing that the futures field was ever expanding, asserted that despite the possible development of stock *index* futures, the CFTC was "not going to start a futures market in [specific stocks] or in any other listed stock. That is, in effect, a stock option. . . ." 1978 *House Hearings*, *supra* note 225, at 610 (statement of William Bagley).

261. H.R. REP. NO. 1181, 95th Cong., 2d Sess. 46 (1978). It was at the urging of Representative Glickman that language to this effect was included in the House Report. *Id.*

262. *Id.*

263. *Id.* at 13 (emphasis added).

economic expertise which focuses upon the risk-shifting and price-determining function that futures trading performs. Futures markets have not remained static and futures regulations have covered an increasing number of commodities as the benefits of futures trading [have] become more widely understood. The Committee does not believe that the public interest would be served by duplicating in one or more additional agencies regulatory authority over futures markets that presently exists in the Commodity Futures Trading Commission.²⁶⁴

Accordingly, noting that the CFTC has always solicited the views of federal agencies whose area of interest might be affected by the designation of a contract market for the trading of financial instrument futures,²⁶⁵ the committee advised that "H.R. 10285 retains and formalizes this practice in order to assure that communication between the Commission and these agencies will continue."²⁶⁶

Although it understood the fears expressed by the SEC that futures contracts based on equity or debt securities of a *single issuer* might be developed and might have an adverse impact on the cash market for the underlying securities, the committee stressed that it did "not believe that the same considerations necessarily would apply to any proposal for trading in a futures contract based upon an aggregate or pool of a number of different securities or an index involving such an aggregate."²⁶⁷ It believed that such indices "may reasonably be expected to serve a valid economic function."²⁶⁸ Consequently, citing reassurances from the CFTC that it would solicit SEC views before designating a contract market to trade futures involving securities, the committee simply encouraged the CFTC to proceed with caution and consideration for the proper functioning of the market for the underlying securities. At no time during its extended analysis did the committee express any doubts as to the validity of stock index futures. Its only concern was with jurisdiction over such futures, a concern which it clearly resolved in favor of the CFTC.

GENERAL STATE REGULATORY AUTHORITY: SUBSECTION 6d

The committee's approach toward the issue of state regulatory authority was similar to that which it took relative to the jurisdictional claims over securities based futures—the committee simply recommended codifying those powers which the CFTC had assured the com-

264. *Id.* (emphasis added).

265. See 1978 House Hearings, *supra* note 225, at 613-14 (statement of William Bagley).

266. H.R. REP. NO. 1181, 95th Cong., 2d Sess. 14 (1978).

267. *Id.*

268. *Id.*

mittee the states already possessed. In doing so, the committee refused to adopt an amendment suggested by Representative Baldus that would have authorized the states to investigate and prosecute in state courts violations of state laws *identical* to the provisions of the CEA.²⁶⁹ The committee expressed its concern that such a measure could result in conflicting interpretations among state courts and "cause confusion and disruption among the regulated persons."²⁷⁰

As an alternative, the committee proposed adding subsection 6d to the CEA. Subsection 6d(1) of the CEA provided that the states would have the authority to investigate and prosecute civil actions in federal district court for violations of the CEA, section 217 of the 1974 amendments, or rules and regulations promulgated by the CFTC.²⁷¹ The committee declared its intent that this subsection would empower the states to seek civil relief against those "who perpetrate fraudulent and other practices made *unlawful by the Federal law*."²⁷² It further qualified the authority of the states by prohibiting them from investigating or bringing suits "against a designated contract market, licensed Board of Trade or clearing organization."²⁷³ The committee wanted the power to enforce the CEA *with respect to organized exchanges* to remain solely in the CFTC.²⁷⁴ Indeed, the committee viewed the creation of these rights of action in the states only as a *supplement* to the CFTC's own enforcement activities.²⁷⁵

Subsection 6d(2) proposed to empower the states to enforce the CEA as *parens patriae* where a state could show that the violation of the CEA has harmed or is causing harm to the welfare of its citizens.²⁷⁶ In subsection 6d(3), the committee sought to clarify that, despite the exclusive jurisdiction provision of section 2(a)(1), "States may continue, as in the past, to enforce their own antifraud and other *criminal statutes of general application* in order to assure that the residents of the States are fully protected against improper activities in commodity-related transactions."²⁷⁷

269. *Id.* at 47.

270. *Id.* at 16.

271. *Id.* at 15.

272. *Id.*

273. *Id.*

274. *Id.* at 15-16.

275. *Id.* at 16.

276. *Id.*

277. *Id.* (emphasis added).

House Consideration

The House of Representatives considered these proposed amendments to the CEA in July, 1978. In his introductory remarks, Agriculture Chairman Foley advised Congress of the jurisdictional concerns expressed by the SEC relative to futures trading in financial instruments. He expressed the committee's conclusion, however, "that jurisdiction over futures markets should continue to reside in a single agency, such as the [CFTC], whose regulatory role requires an economic expertise which focuses upon the risk shifting and price determining function that futures trading performs."²⁷⁸

Perhaps persuaded by Representative Foley's proselytizing zeal, Representative Glickman arose and announced that he no longer resisted his committee's decision not to recommend allowing the SEC a regulatory role over contract futures based on securities. As he noted:

I strongly support the [CFTC] jurisdiction over futures on financial instruments as opposed to giving that jurisdiction to the Securities and Exchange Commission. I originally had supported the SEC retaining jurisdiction, but I have changed my mind, because I think there is a difference fundamentally and economically between futures and securities. I hope we will give that authority to the CFTC.²⁷⁹

In a subsequent session, Representative Glickman repeated this position but offered an amendment—which was subsequently adopted—"clarifying" that a purpose of the CFTC's communicating with affected agencies prior to designating a contract market for securities futures contracts is to consider "the relationship between the volume and nature of investment and trading in futures contracts under the jurisdiction of the Commission and in securities and/or financial instruments under the jurisdiction of such agencies."²⁸⁰

The entire issue of securities-based futures was thoroughly considered and deliberated in hearings, in mark-up sessions and during debate of the full House. Indeed, even Representative Glickman, in presenting his amendment, assured his colleagues that his committee had "discussed in depth the role of the CFTC and the SEC in the whole issue of futures on securities and futures on indexes."²⁸¹ It is significant, therefore, that despite such a thoughtful review, no member of Congress ever expressed any reservation as to the validity of the

278. 124 CONG. REC. 22,317 (1978).

279. *Id.* at 22,321.

280. *Id.* at 22,650.

281. *Id.*

CFTC approving trading in stock index futures. Such instruments seemed appropriate, if not inevitable, under authority of the expanded definition of commodity included in the amended CEA. Consequently, the House, in these proceedings, accepted stock index futures as a foregone conclusion. The issue no longer was whether there should be stock index futures, but who should regulate them. Having decided this question in favor of the CFTC, the House, in approving Representative Glickman's amendment, was simply urging the CFTC to consider the possible effect on capital markets as a factor in acting on specific proposals for futures based on financial instruments.

The other major jurisdictional issue considered by the House was what regulatory role, if any, should vest in the states. Representative Foley offered a "perfecting amendment" to proposed section 6d to "delete the necessity of demonstrating that the State is acting under the *parens patriae* doctrine."²⁸² Although the House accepted this amendment,²⁸³ it rejected the "Baldus amendment," which was reintroduced despite its defeat in committee. During the debate on the Baldus proposal to permit states to pass laws identical to the CEA and enforce them in state courts, many comments addressed the issue of whether any obstacles actually prevented states from bringing commodity-related actions in federal courts. Representative Glickman, speaking in support of the Baldus amendment, cited information supplied by the National Association of States' Attorneys General which indicated that "33 States in this country are either partially or fully restricted from ever going into Federal court on these types of matters."²⁸⁴ Representative English, however, who had authored section 6d as proposed by the Committee on Agriculture, was critical of these arguments in favor of a stronger state role. As he noted:

With regard to the issue pertaining to the State's opportunity to prosecute, much has been said about the fact that today the Federal law precluded the States from taking action in this area. However, up until 1974, when the CFTC was created, the States had a virtual blank check with regard to this matter. States were allowed to pass their own laws, to bring about their own prosecutions, and to effect their own enforcements of those State laws. However, the reason why we have a CFTC is due to the fact that most States had not done so. Therefore, the Federal Government stepped into the breach and filled the gap to bring about a uniform law under which the industry could live. This is the reason we have the CFTC.²⁸⁵

282. *Id.* at 22,861.

283. *Id.* at 22,862.

284. *Id.* at 22,863.

285. *Id.* at 22,864.

Other legislators expressed their support for Representative English's position. Some even urged that it was state law—not federal law—which was preventing states from bringing actions in federal courts. These representatives insisted that, instead of reenacting a state version of the CEA (as would have been necessary under the Baldus amendment), it would be much easier for these thirty-three states to amend their laws to remove any statutory limitation preventing the attorney general or other designated state official from entering federal court to enforce federal laws.²⁸⁶ Apparently agreeing that the Baldus proposal was not an effective means to secure uniform regulation of commodity trading, the House rejected the amendment, 141 in favor, 260 opposed.²⁸⁷ H.R. 10285 itself, however, was overwhelmingly approved by a vote of 401 to 6.²⁸⁸

Senate Hearings

As in the earlier House hearings, the predominant subject of interest in the Senate hearings on the reauthorization of the CFTC was the CFTC's exclusive jurisdiction. Securities officials of various states again argued in favor of amending the CEA to permit and encourage, in the area of commodities trading, state enforcement authority comparable to that already exercised by the states in the securities field. Industry representatives, however, were just as vigorous in denouncing such a proposal and in urging the continued preemption of a state regulatory role. Throughout these hearings, these officials emphasized the need for uniformity and warned of the confusion that could result from the imposition of varying and conflicting standards by different states. They expressed concern that state regulatory authority would burden interstate commerce and cited, as evidence, problems which had resulted from the stringent registration program imposed by the state of Wisconsin.²⁸⁹ One witness even asserted that it was the inadequacy of state regulatory enforcement measures which accounted for the commodity option scandals of the early 1970's and which necessitated vesting control in a strong central agency.²⁹⁰

286. *Id.* at 22,865.

287. *Id.* at 22,866-67.

288. *Id.* at 22,877-78.

289. *Reauthorization of the Commodity Futures Trading Commission: Hearings on S. 2391 Before the Subcommittee on Agricultural Research & General Legislation of the Senate Committee on Agriculture, Nutrition & Forestry*, 95th Cong., 2d Sess. 144 (1978) [hereinafter cited as 1978 *Senate Hearings*]. These hearings were held in response to the filing of S. 2391, a reauthorization bill for the CFTC filed by Senator Huddleston on January 19, 1978. See 124 CONG. REC. 34 (1978).

290. 1978 *Senate Hearings*, *supra* note 289, at 172 (statement of Robert Wilmouth).

As in the House hearings, there was virtual unanimity among participants in the Senate hearings that the 1974 amendments had preempted a state regulatory role. State securities officials, by their presence and in their testimony urging less restrictive amendments, demonstrated that they accepted that this had been the consequence of the earlier legislation. Similarly, no member of the Senate disputed the preemptive effect of the 1974 CEA amendments. The CFTC itself suggested that the resurgence of commodity-related trading abuses was partially attributable to preemption. Chairman Bagley testified that the CFTC's premature assertion of its exclusive jurisdiction had created a regulatory vacuum which the CFTC, during its start-up phase, was unable to fill because of inadequate funding, staffing and experience.²⁹¹

Other testimony at these hearings considered whether the regulatory authority of the CFTC should be shared with other federal agencies. The OMB, the Department of Treasury and the SEC submitted proposals which would have assigned regulatory jurisdiction on the basis of the underlying commodity on which a futures contract is written.²⁹² In response, the CFTC and industry officials described, at great length, the difference between trading in securities and trading in futures. These officials noted with particularity the role of securities trading as a means of raising investment capital, and contrasted the wholly distinct role of commodities trading as a hedging mechanism.²⁹³ As its recommendations would show, the Senate committee found this distinction persuasive and crucial.

Mark-Up

In its report on S. 2391, the Senate Committee on Agriculture, Nutrition and Forestry reviewed the history of the CEA. It concluded that the purpose of the 1974 amendments—which created the CFTC and expanded the scope of the CEA—was to accomplish two basic goals:

[T]o provide a uniform regulatory structure covering all futures trading in both the regulated and previously unregulated commodities and . . . to allow for the extension of the economic benefits of futures trading under this structure to those areas of commerce where the risk-shifting and price-discovery functions of futures markets

291. *Id.* at 17-18 (statement of William Bagley).

292. S. REP. NO. 850, 95th Cong., 2d Sess. 19-20, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2107-109.

293. *See, e.g.*, 1978 *Senate Hearings*, *supra* note 289, at 132-37 (statement and testimony of Leo Melamed); *id.* at 171-73 (statement of Robert Wilmouth); *id.* at 228-29 (statement of John Rainbolt).

might prove to be of value.²⁹⁴

Thus, the committee recognized that futures trading is functionally different from securities trading, whose primary purpose is capital development. It averred that, given the unique economic role of futures transactions, regulatory control over futures trading was not intended to be shared. Accordingly, the committee affirmed that:

The [CFTC] was created in order to assure that a single expert agency would have the responsibility for developing a coherent regulatory program encompassing futures trading and related activities. Therefore, Congress has vested in the Commission exclusive jurisdiction to build upon the foundation provided by the Commodity Exchange Act in erecting a sound and strong Federal regulatory policy governing futures trading.²⁹⁵

The Senate committee was generally laudatory in its evaluation of the performance of the CFTC. The one substantive concern it expressed was with the inability of the CFTC to control fraudulent trading in London options.²⁹⁶ Nevertheless, the committee supported action which the CFTC had taken—the promulgation of strict regulations—and cited other factors as responsible for the ineffectiveness of these regulations.

[These factors included] a year-long legal challenge to the Commission's regulations before they were ultimately sustained, judicial reluctance to close down businesses that were operating without registration by the Commission, and the Commission's limited resources to enforce the law in the face of pervasive fraudulent practices. Compounding this problem was the reluctance of the States, whose regulatory authority had been preempted by the 1974 amendments, to bring *parens patriae* actions under the Commodity Exchange Act or actions under their general antifraud statutes.²⁹⁷

The Senate report noted that the committee had, during its mark-up session, considered proposals by the OMB, the SEC and the Department of Treasury to remove from the exclusive jurisdiction of the CFTC certain aspects of futures trading. The committee, however, pointing out that “[t]he question of granting exclusive jurisdiction to the CFTC was extensively debated in 1974,”²⁹⁸ rejected these proposals to modify the grant of exclusive jurisdiction. In doing so, the committee expressed its support for the continued development of futures con-

294. S. REP. NO. 850, 95th Cong., 2d Sess. 10, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2098.

295. *Id.* at 13, U.S. CODE CONG. & AD. NEWS at 2101.

296. *Id.* at 14, U.S. CODE CONG. & AD. NEWS at 2102.

297. *Id.*

298. *Id.* at 21, U.S. CODE CONG. & AD. NEWS at 2109.

tracts, including stock index futures, which would be subject only to CFTC regulatory jurisdictions. As related by the Senate committee:

In amending the Commodity Exchange Act in 1974, Congress took the view that limiting commodities subject to the Act to a statutory list when commercial interest in trading futures in many other commodities was developing would be inappropriate. Accordingly, Congress determined that the definition of commodity, for purposes of the Act, would be the commodities on the pre-1974 list plus all other goods and articles (except onions), as well as all services, rights, and interests in which futures contracts are or would be traded.

In order to avoid duplication and confusion in the regulation of futures trading, the Commission created by the 1974 Act was given exclusive jurisdiction over all accounts, agreements (including options) and transactions involving futures contracts.

The action Congress took in 1974 reflects the congressional awareness that futures markets would not remain static. This action also sought to foster a climate in which the economic benefits of futures trading could be extended to other areas where such trading would be of value. Specifically, Congress was aware in 1974 that proposals for futures trading in financial instruments and Government securities were being developed.

The wisdom of these decisions is evident in rapid development and acceptance of futures markets in both GNMA mortgage-backed securities and United States Treasury bills.

These are not commodities in the traditional sense. However, the need and utility of futures markets in these commodities to hedge against inflation and market uncertainty, as well as aid in market arbitrage, is evident.

The changing nature of futures markets has stimulated the proposals of the SEC and the Department of the Treasury for increased jurisdiction by them in specific areas of futures trading. In each case, their proposals stem from their inherent interest in certain underlying "commodities"—SEC with equity securities and indexes thereof, and the Treasury with the potential expansion of Government security futures contracts.

The committee understands the basis of the Securities and Exchange Commission proposal and appreciates the interest of the Department of the Treasury in ensuring the integrity of markets for Government securities. However, the basic conclusion reached in 1974 that there should be a single regulatory agency responsible for futures trading is as valid now as it was then.

The committee has followed with interest the changing nature of futures markets. The nature of the underlying commodity is not an adequate basis to divide regulatory authority. Further, the fact that a futures contract market does not fit into the traditional mold where there are both hedging and price-discovery functions should not be the determining factor in whether the contract is to be regulated by the CFTC. *So long as the futures contract serves a legitimate function,*

*Congress has vested the Commodity Futures Trading Commission with jurisdiction.*²⁹⁹

As to the specific possibility that stock index futures might be developed, the committee simply expressed its intent that "the CFTC will actively solicit the views of other agencies when any application is made for a futures contract written on instruments under the jurisdiction" of other agencies.³⁰⁰

The committee also addressed the issue of the appropriate role of the states in the regulation of commodity trading. It noted that the proposed addition to the CEA of section 6d would permit the states to bring actions based on the CEA. Although this version provided the states more latitude in maintaining suits than had the more cumbersome device of *parens patriae* actions, it still would not have permitted the enforcement of local laws. Moreover, to further guard against the intrusion of local officials into the regulation of commodities trading, the committee proposed to make the federal courts the exclusive forum for section 6d actions.³⁰¹ It believed this was consistent with the CFTC's "exclusive jurisdiction and preemption of State regulatory activity enacted in 1974, and with the present decision to make Federal law the basis for all actions brought under this section."³⁰² The committee also expressed its intent that states could still proceed in state courts if other than injunctive relief were desired. However, it specified that actions in state courts could proceed only "on the basis of an alleged violation of any *general* civil or criminal antifraud statute."³⁰³

Finally, the committee noted that the purpose of section 6d's requirement that the states, before instituting actions, must receive the prior approval of the CFTC is to "assure that the body of decisional law developed under this section would be coherent and consistent with national policy."³⁰⁴ The committee believed that "State prosecutorial discretion would . . . be checked only to the degree that contemplated State prosecutions deviate from national policy established by the Commission."³⁰⁵

299. *Id.* at 21-22, U.S. CODE CONG. & AD. NEWS at 2109-10 (emphasis added).

300. *Id.* at 23, U.S. CODE CONG. & AD. NEWS at 2111.

301. *Id.* at 25, U.S. CODE CONG. & AD. NEWS at 2113.

302. *Id.*

303. *Id.* (emphasis added).

304. *Id.* at 26, U.S. CODE CONG. & AD. NEWS at 2114.

305. *Id.*

Senate Debate

S. 2391 was presented to the Senate on July 12, 1978.³⁰⁶ Debate was not as extensive as that in the House. The jurisdictional provisions of S. 2391 were among the first issues discussed. Senator Talmadge, who had played a major role in the development and passage of the 1974 amendments, expressed his support for continuing to vest exclusive jurisdiction in the CFTC.³⁰⁷ He rejected the position of other government agencies that the "agency that is responsible for regulating or issuing the commodity on which a futures contract is written is the one who should regulate that futures contract."³⁰⁸ He noted that:

While this approach may have appeal, it overlooks the basic fact that a futures contract is a futures contract regardless of what the underlying commodity may be. The regulation of futures contracts, likewise, is not dependent on the underlying commodity on which the futures contract is written.³⁰⁹

Although he acknowledged that the SEC and the Department of Treasury might "have justifiable concerns over some pending applications before the CFTC for futures contracts on indexes of equity securities,"³¹⁰ Senator Talmadge believed that such concerns could be resolved as part of the contract market designation process. As he explained, "we have not been presented any evidence that would indicate that the CFTC will not conduct full and open deliberations on these applications that would include the solicitation of advice and counsel from these two agencies."³¹¹

Senator Talmadge believed that until the shortcomings of the existing system were demonstrated, proposals that could ultimately result in costly and inefficient overregulation must be rejected.³¹² Senator Leahy affirmed Senator Talmadge's dismissal of proposals to allocate regulatory control over futures contracts on the basis of the underlying commodity. He asserted that during mark-up of S. 2391, such a proposal "was rejected, and rejected soundly, by all members of the committee, of all political ideologies, from all parts of the country."³¹³

The Senate also deliberated the enforcement powers which should

306. 124 CONG. REC. 20,353 (1978).

307. *Id.* at 20,361.

308. *Id.*

309. *Id.*

310. *Id.*

311. *Id.*

312. *Id.*

313. *Id.*

be available to the states.³¹⁴ A motion by Senator Bellman to amend proposed section 6d was adopted which allowed the states to bring actions under the CEA without reference to the *parens patriae* doctrine and without first securing prior CFTC approval.³¹⁵ The amendment identified state securities officials as among those who, if authorized by state law, could bring actions under section 6d.³¹⁶ Despite its seeming liberality, this amendment did not vest any independent regulatory authority in the states; its purpose was simply to encourage state officials concerned with fraudulent trading activity to bring enforcement actions, but only in federal court and only under the CEA.³¹⁷ Senator Bellman did not intend his amendment to enable states to pursue measures deviating from policies enunciated by the CFTC. As he noted, it "is not meant to subject commodity traders to 50 different sets of laws as some traders have feared. It simply is meant to provide valuable assistance to enforcement agencies to prevent or punish fraudulent practices."³¹⁸

Conference Committee

In conference, the Senate accepted the House provisions requiring the CFTC to maintain communication with, and obtain the views of, other agencies which might be affected by CFTC designation of contract markets for the trading of futures based on financial instruments.³¹⁹ Even though the House and Senate were aware of concerns regarding proposed stock index futures, their only response was to insure that other agencies could contribute to, but in no way control, the CFTC decision as to whether trading in such futures should be approved.³²⁰ At no time during the House and Senate deliberations was

314. *Id.* at 20,382-88.

315. *Id.* at 20,384-85.

316. *Id.*

317. According to Senator Bellman, his amendment:

(1) Expands the statutory cause of action to include the right of the States to obtain damages in behalf of their residents or to obtain such further and other relief as the court may deem appropriate;

(2) Deletes the requirement in S. 2391 of prior Commission approval before the State may bring an action under this section and substitutes a requirement that the State must provide the Commission with a copy of its complaint;

(3) Specifically cites the State securities administrator as one of the State officials who, if otherwise authorized, could bring actions under this section (the ultimate delegation of prosecutorial authority will remain a matter of State law).

Id. at 20,385.

318. *Id.*

319. H.R. REP. NO. 1628, 95th Cong., 2d Sess. 17 (1978).

320. *Id.* Despite the provision in section 2(B)(i) requiring the CFTC to maintain such communications, it is clear that the CFTC is in no way obligated to defer to concerns expressed by these other agencies. The Act does not vest veto authority over CFTC decisions in any of these agen-

it ever suggested that futures contracts on securities indices were inappropriate trading instruments. Indeed, virtually all discussion focused only on the jurisdictional issue, an issue resolved in favor of the CFTC.

As to the question of state jurisdiction, the House and Senate conference also decided in favor of the CFTC, voting to adopt almost in entirety the Senate version of section 6d.³²¹ However, the version of section 6d which emerged from conference included the House provision entitling the CFTC to intervene as a matter of right in any action brought by a state under section 6d.³²² The conferees also modified a House proposal and included within section 6d a provision clarifying that "nothing contained in the new section on State jurisdiction shall prohibit an authorized State official from proceeding in State court on the basis of an alleged violation of any *general* civil or criminal antifraud statute of such State."³²³ Finally, relative to section 6d, the conferees melded Senate and House provisions exempting designated contract markets, floor brokers and boards of trade licensed by the CFTC from state civil actions. The conference adopted both House and Senate versions with necessary conforming changes.³²⁴

On September 28, 1978, the Senate agreed to the conference report on S. 2391.³²⁵ The House took similar action on September 29, 1978.³²⁶ On October 2, 1978, President Carter signed into law the Futures Trading Act of 1978, extending the life of the CFTC through September 30, 1982.³²⁷

V. CONCLUSION

The opponents of stock index futures have advanced arguments which are inconsistent with both the language and legislative history of the 1974 and 1978 amendments to the CEA. Congress fostered the development of nontraditional futures markets when it enlarged the definition of commodity to include not only traditional agricultural

cies. Further, under section 2(B)(iii), even if the CFTC ignores its communication responsibilities, section 2(B)(i) does not "create any rights, liabilities, or obligations upon which [private] actions may be brought." *Id.* Consequently, the CFTC may continue to designate contract markets just as it always has. For a contrary view by a former employee of the SEC, see Guttman, *The Futures Trading Act of 1978: The Reaffirmation of CFTC-SEC Coordinated Jurisdiction Over Security/Commodities*, 28 AM. U.L. REV. 1 (1978).

321. H.R. REP. NO. 1628, 95th Cong., 2d Sess. 22-24 (1978).

322. *Id.* at 23.

323. *Id.* at 24 (emphasis added).

324. *Id.* at 23.

325. 124 CONG. REC. 32,274 (1978).

326. *Id.* at 32,707.

327. See PUB. PAPERS OF JIMMY CARTER 1696-97 (Oct. 2, 1978). See also 14 WEEKLY COMP. OF PRES. DOC. 1696-97 (Oct. 2, 1978).

products but also “services, rights and interests.” As Congress then explained, the purpose of the expansive definition of commodity was to bring within the CEA regulatory scheme “all futures trading that might now exist or might develop in the future.”³²⁸

The authority to determine what futures trading “might develop in the future” was vested exclusively in the CFTC. Although this decision proved irksome to various state and federal officials, in 1978 Congress both reaffirmed and clarified its intent to preempt any competing regulatory role among the states or other federal agencies. In doing so, it specifically sanctioned and encouraged the development of stock index futures and, more significantly, it made explicit what was implicit in 1974—economic utility was to be the primary standard governing CFTC consideration of proposals for nontraditional futures contracts.

In 1978, Congress rejected proposals to enlarge the regulatory jurisdiction of other government units. Congressional sponsors of the CFTC reauthorization legislation insisted that such authority must continue to vest exclusively in the CFTC because futures markets require “an economic expertise which focuses upon the risk-shifting and price-determining function that futures trading performs.”³²⁹ They recognized that futures markets “have not remained static and futures regulations have covered an increasing number of commodities as the benefits of futures trading [have] become more widely understood.”³³⁰

Critics of these proposed stock index futures have ignored the economic purpose standard advanced by Congress. Instead, they have focused on the adequacy of the instrument’s delivery provision as determinative of its validity as a futures contract. This is ironic. Pending applications for stock index futures were extensively discussed during the 1978 reauthorization proceedings; yet, in its deliberations, Congress paid scant attention to the delivery controversy. It rejected criticism of such instruments and encouraged their development, believing they could “reasonably be expected to serve a valid economic function.”³³¹ Additionally, as a corollary of enlarging the definition of commodity to include tangibles and intangibles, Congress seemed to invite a much broader conception of delivery.

Even if it were not inconsistent with the congressional approach toward determining the legitimacy of futures contracts, the emphasis these critics place on delivery is still surprising. The presumption that

328. H.R. REP. NO. 975, 93d Cong., 2d Sess. 76 (1974).

329. H.R. REP. NO. 1181, 95th Cong., 2d Sess. 13 (1978).

330. *Id.*

331. *Id.* at 14.

delivery provisions, although customarily present, are a congressionally imposed requirement of a futures contract is increasingly suspect. Economists have concluded that such provisions are a peculiar American anachronism, which, depending on the commodity, can actually impede the economic function of the futures contract. Also reinforcing this skepticism regarding delivery provisions is the fact that less than three percent of all futures transactions ever result in delivery. Accordingly, in many instances, such provisions are merely perfunctory.

The suggestion that stock index futures would be illegal under state bucket-shop laws is but another example of the failure of these critics to grasp the extent and tenor of the 1974 and 1978 amendments to the CEA. Indeed, even without reference to these amendments, the bucket-shop statutes, standing alone, are of dubious relevance. Most of them were enacted prior to the development of regulated exchanges. They were designed to curb gambling on changes in futures market prices when, in fact, no futures transaction had been entered into on a contract market. However, since stock index futures would be traded on exchanges approved and regulated by the CFTC, they would be inappropriate subjects for local anti-gambling enforcement efforts.³³² Most states, by ceasing to enforce such laws coincidentally with the improved federal regulation of exchanges, appear to have recognized this. Additionally, because many bucket-shop laws require a showing of lack of intent to deliver the underlying commodity, they would not apply to stock index futures: as proposed, these futures would provide for a delivery mechanism.

Although, as suggested earlier, critics who are bound to a nineteenth-century conception of delivery might challenge the adequacy of these delivery provisions, the crucial consideration is whether bucket-shop statutes may be used as a conduit for expressing this dissatisfaction. Congress has vested solely in the CFTC both authority to determine whether to designate a contract market for a proposed future, and exclusive jurisdiction for the regulation of such markets after their designation. In 1978, state officials testified at the CFTC reauthorization proceedings and objected to the begrudgingly acknowledged preemptive scope of section 2(a)(1). Congress responded to these criticisms by refining, but essentially reaffirming, its 1974 decision to preclude state regulation of commodities trading.

332. One decision shortly after the enactment of the 1974 amendments held that bucket-shop laws did not apply to transactions executed on boards of trade even absent intent to make or take delivery. *Merrill Lynch, Pierce, Fenner & Smith v. Schriver*, 541 S.W.2d 799 (Tenn. Ct. App. 1976).

Throughout these proceedings, members of Congress emphasized the importance of maintaining uniform regulation of commodities markets under a single agency with an expertise in the economic underpinnings of futures trading. Specific proposals to carve out exceptions to the CFTC's exclusive jurisdiction were rejected by Congress. As they finally emerged, the 1978 amendments to the CEA embodied this congressional intent that the federal law provide the basis for all regulation of commodities trading. Accordingly, states are permitted to bring actions in federal court to enforce only the CEA and the regulations promulgated by the CFTC. Clearly, trading in futures contracts authorized by the CFTC would not provide the basis for such an enforcement action.

The only other alternative permitted the states under the CEA are enforcement actions in state courts for violation of *general* civil or criminal antifraud statutes. As was noted previously, however, bucket-shop laws are not general antifraud statutes. They were enacted specifically in response to gambling associated with commodities trading. Even state officials participating in the 1978 proceedings characterized these laws as "regulatory" and "commodities-related." Accordingly, section 6d of the CEA cannot be construed so as to authorize a state to prohibit under its bucket-shop laws trading in CFTC-approved stock index futures.

At least one federal district court already has found that the exclusive jurisdiction of the CEA preempts state bucket-shop laws and other anti-gambling legislation.³³³ As trading in futures based on financial instruments expands, other courts may be called upon not only to adjudicate the validity of nontraditional futures contracts approved by the CFTC, but also to explore in greater detail the preemptive scope of the CFTC's exclusive jurisdiction. In such analysis, it is important for the courts to savor the distinct flavor of the legislative history of the 1974 and 1978 amendments to the CEA. Commodities trading is an ancient practice and its value to the national economy has been affirmed by Congress. In the CEA amendments of the past decade, Congress has attempted to wrest from commodities trading concepts which are vestiges of nineteenth-century practices. Accordingly, it has urged both an administrative and legal approach to futures markets which is

333. *Paine, Webber, Jackson & Curtis, Inc. v. Conaway*, [1981] COMM. FUT. L. REP. (CCH) ¶ 21,200. Commendably, the court emphasized the national nature of commodity exchanges and characterized them as "an extremely vital component in our economic system." *Id.* at 24,956. The court concluded that enforcement of the Alabama bucket-shop law would *destroy* commodity trading in that state. *Id.*

grounded in an appreciation of the vital risk-shifting and price-discovery functions that such markets perform. Without such an appreciation, the expressed congressional desire to see the economic benefits of futures trading extended to nontraditional markets will be frustrated.

**NOTES
&
COMMENTS**

