

1-1-1982

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### Recommended Citation

Dunn, Raymond E. Jr. (1982) "Regulatory Jurisdiction Over Commodity Options: CFTC or SEC; Note," *Journal of Legislation*: Vol. 9: Iss. 1, Article 5.

Available at: <http://scholarship.law.nd.edu/jleg/vol9/iss1/5>

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# NOTES

## REGULATORY JURISDICTION OVER COMMODITY OPTIONS: CFTC OR SEC?

Commodity futures trading in the United States is regulated under the Commodity Exchange Act [CEA].<sup>1</sup> Congress amended the CEA by enactment of the Commodity Futures Trading Commission Act of 1974 [CFTCA].<sup>2</sup> Under the CFTCA, Congress created the Commodity Futures Trading Commission [CFTC] to administer the CEA.<sup>3</sup> The CFTCA granted the CFTC exclusive jurisdiction to regulate accounts, agreements, and transactions involving commodity futures contracts.<sup>4</sup> Appropriations for the CFTC will expire under existing law on September 30, 1982.<sup>5</sup> Congress is expected to reauthorize appropriations for the CFTC and amend the CEA in the spring and summer of 1982.<sup>6</sup>

Congress' most important task during CFTC reauthorization is to define clearly the scope of the CFTC's exclusive jurisdiction.<sup>7</sup> The crucial jurisdictional question is whether regulation of exchange-traded options on<sup>8</sup> physical<sup>9</sup> commodities<sup>10</sup> and exchange-traded options on

1. 7 U.S.C. § 1 *et. seq.* (1976 & Supp. II 1978) (originally enacted as the Grain Futures Act, Pub. L. No. 67-331, 42 Stat. 998 (1922), *as amended by* Commodity Exchange Act, ch. 545, 49 Stat. 1491 (1936), *as amended by* Act of February 19, 1968, Pub. L. No. 90-258, 82 Stat. 26 (1968), *as amended by* Act of July 23, 1968, Pub. L. No. 90-418, 82 Stat. 413 (1968), *as amended by* Commodity Futures Trading Commission Act of 1974 (CFTCA), Pub. L. No. 93-463, 88 Stat. 1389 (1974), *as amended by* Futures Trading Act of 1978 (FTA), Pub. L. No. 95-405, 92 Stat. 865 (1978)).
2. CFTCA, Pub. L. No. 93-463, 88 Stat. 1389 (1974) (codified at 7 U.S.C. § 1 *et. seq.* (1976) (amended 1978)).
3. CFTCA, § 101, 88 Stat. 1389 (1974) (amending CEA § 2(a)) (current version at 7 U.S.C. § 4a (1976 & Supp. II 1978)).
4. CFTCA, § 201(b), 88 Stat. 1389 (1974) (CEA § 2(a)(1)) (current version at 7 U.S.C. § 2 (Supp. II 1978)).

Section 2(a)(1) of the CEA provides, "that the commission shall have exclusive jurisdiction with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an 'option', . . . 'put', [or] 'call' . . .), and transactions involving contracts of sale of a commodity for future delivery. . . ." 7 U.S.C. § 2 (Supp. II 1978). For a discussion of "put" and "call" options, see notes 32-33 *infra*.

5. When the CFTC was created, appropriations were authorized only until September 30, 1978. CFTCA, Pub. L. No. 93-463, § 101(b), 89 Stat. 1389 (1974). The FTA renewed appropriations for another four years. Current authorization for appropriations expires on September 30, 1982. CEA § 12(d), 7 U.S.C. § 16(d) (1976), *as amended by* FTA, Pub. L. No. 95-405, 7 U.S.C.A. § 16(d) (1981).
6. Address by Robert Bor, Chief Counsel of the House Agriculture Committee, Fourth Annual Commodities Law Institute, Chicago, Illinois (Sept. 24, 1981). Mr. Bor's comments were made at a panel presentation on CFTC reauthorization.
7. See Addresses by Robert Bor, Chief Counsel of the House Agriculture Committee; Hon. Philip Johnson, Chairman of the CFTC; and Edmund Schroeder, of Barrett, Smith, Schapiro, Simon & Armstrong, New York, New York, Fourth Annual Commodities Law Institute, Chicago, Illinois (Sept. 24, 1981).
8. An option is said to be traded "on" an interest.
9. The term "physical" is used to denote the actual interest. Options on physical commodities

physical commodities which are also exempted securities<sup>11</sup> is within the CFTC's exclusive grant of jurisdiction.<sup>12</sup>

The CFTC has solicited comments on the desirability of expanding options trading to include exchange-trading of options on physical commodities.<sup>13</sup> Several security exchanges have applied to the Securities and Exchange Commission (SEC) for authorization which would allow them to trade options on physical commodities.<sup>14</sup> The SEC granted the Chicago Board of Options Exchange permission to trade options on Government National Mortgage Association pass-through certificates [GNMA's].<sup>15</sup> Subsequently, the Chicago Board of Trade filed suit to enjoin such trading permanently on the ground that exclusive jurisdiction to authorize option trading on physical commodities/exempted securities<sup>16</sup> rests with the CFTC.<sup>17</sup>

The arguments which the SEC and the CFTC made in *Board of Trade v. Securities and Exchange Commission*<sup>18</sup> flesh out the broader

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are to be distinguished from options on commodity futures contracts. See notes 47 & 48 *infra*.

10. Section 2(a)(1) of the CEA, 7 U.S.C. § 2 (Supp. II 1978) defines "commodities" as certain enumerated agricultural interests and "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." For the list of enumerated commodities, see note 35, *infra*.
11. Certain securities are exempted from the regulation under the Securities and Exchange Act of 1934 unless specifically included by a provision. Securities Exchange Act of 1934, § 3(a)(12), 15 U.S.C. § 78c(a)(12) (1976). United States Treasury bills, notes, bonds, and Government National Mortgage Association pass-through certificates (GNMA's) are examples of exempted securities.
12. Exempted securities upon which futures contracts are traded are "commodities" pursuant to § 2(a)(1) of the CEA. S. REP. NO. 850, 95th Cong., 2d Sess. 13-14 [hereinafter cited as 1978 Senate Report], reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2101-02. Exclusive jurisdiction to regulate accounts, agreements, and transactions involving futures contracts on exempted securities is vested in the CFTC and not in the SEC, Treasury Department, or Office of Management and Budget. *Id.* at 22-23, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2110-11.  
Futures contracts are presently traded on 90 day United States Treasury bills, one year United States Treasury bills, four year United States Treasury notes, four-to-six year Treasury notes, twenty year United States Treasury bonds, and thirty year GNMA modified pass-through certificates. See CHICAGO BOARD OF TRADE, COMMODITY TRADING MANUAL 239-56 (1980).
13. On June 29, 1981 the CFTC proposed a pilot program under which exchange-traded options would be traded on GNMA, gold, and sugar futures contracts. 46 Fed. Reg. 33293 (1981). The CFTC solicited comments on the desirability of expanding its pilot program to include options on physical commodities. *Id.*
14. Proposals to trade options on GNMA's have been made by the Chicago Board of Options Exchange [CBOE], 45 Fed. Reg. 32458-62 (May 16, 1980); and the New York Stock Exchange [NYSE], 45 Fed. Reg. 51016-25 (July 31, 1980). Proposals to trade options on Treasury securities have been made by the CBOE, 45 Fed. Reg. 79612-15 (Dec. 1, 1980); the NYSE, 46 Fed. Reg. 17939-43 (March 20, 1981); and the American Stock Exchange [AMEX], 46 Fed. Reg. 17936-38 (March 20, 1981).
15. 46 Fed. Reg. 15242, 15245 (March 4, 1981). GNMA's represent an interest in a pool of mortgages insured by the Farmer's Home Administration, the Federal Housing Administration, or the Veteran's Administration, or guaranteed by the Veteran's Administration. *Id.* at 15242, n.4. An option on a GNMA would give the purchaser the right to make or take delivery on a GNMA. *Id.* at 15242-45.
16. The term "commodity/exempted security" will be used to denote commodities which are also exempted securities.
17. Board of Trade v. Securities and Exchange Commission, No. 81-1660 (7th Cir., filed April 24, 1981). The CFTC filed an *amicus curiae* brief and the CBOE was brought in as intervenor.
18. *Id.*

jurisdictional issues concerning exchange-traded options on physical commodities. In that case the CFTC, as *amicus curiae*, claims exclusive jurisdictional authority to regulate exchange-traded options on physical commodities including physical commodities/exempted securities.<sup>19</sup> The SEC disagrees arguing that the CFTC's exclusive jurisdiction does not extend to options on physical commodities.<sup>20</sup> It claims jurisdictional authority to regulate exchange-trading of options on commodities-exempted securities.<sup>21</sup> These claims and denials of regulatory jurisdiction mandate that Congress resolve this jurisdictional question.

In addition to CFTC reauthorization, Congress should decide whether the CFTC's regulatory jurisdiction includes exchange-traded options on all physical commodities.<sup>22</sup> This note provides a brief CEA jurisdictional history. It then analyzes the topic question in two steps: first, CFTC jurisdiction to regulate exchange-traded options on physical commodities; second, SEC arguments that regulation of exchange-

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19. Reply Brief of the Commodity Futures Trading Commission, *Amicus Curiae*, at 4, Board of Trade v. Securities and Exchange Commission, No. 81-1660 (7th Cir., filed April 24, 1981).
  20. Answering Brief for Respondent, at 3-4, Board of Trade v. Securities and Exchange Commission, No. 81-1660 (7th Cir., filed April 24, 1981).
  21. *Id.* at 15-49.
  22. Some might argue that options are actually futures contracts. Exclusive jurisdiction would, therefore, automatically attach because options on physical commodities would not only "involve futures contracts," they would be futures contracts. Futures contracts, however, are not options.

Futures contracts and options differ in two major ways. First, they differ in the incidents of ownership belonging to the purchaser. Options on a physical commodity are contracts of sale of a commodity for future delivery. Future delivery in an option, however, is conditional on the owner exercising his right to take delivery. The option purchaser has the right to make ("put" option) or take ("call" option) delivery of/on the underlying interest represented by the option at any time during ownership of the option. The futures owner must take delivery of the underlying interest if he owns the futures contract at expiration.

Second, the amount of money put at risk in purchasing a futures contract differs from the amount put at risk in purchasing an option contract. The purchaser of an option pays a fee "premium" for the right to make or take delivery on the underlying interest at a certain price (strike price) and up to a certain date (expiration). If the value of the underlying interest moves against him, he is under no obligation to make or take delivery or liquidate his contract by entering into an offset transaction. The option owner's risk is limited to the premium he paid for his right. The futures owner, however, deposits a percentage of the value of the futures contract upon purchase. This deposit is similar to a performance bond and serves to guarantee performance of his obligation under the contract. The futures owner must take delivery at the set price after expiration of his futures contract. If the value of the futures contract moves against him he must increase the amount of his performance bond. The futures owner is at risk for many times the value of his original deposit. If the owner does not want to take delivery, he must liquidate his ownership through an offset transaction (selling the futures contract to offset the purchase). See CHICAGO BOARD OF TRADE, COMMODITY TRADING MANUAL 10-11 (1980).

Congress did not intend to equate options and futures. Section 2(a)(1) specifically refers to "options" in one part of the exclusive jurisdiction sentence, and to "contracts of sale of a commodity for future delivery" in another part of the same sentence. CEA § 2(a)(1), 7 U.S.C. § 2 (Supp. II 1978). The Senate report to the Futures Trading Act of 1978 stated: "As to the newly-regulated commodities, section 201 of the CFTCA amended section 2(a)(1) of the Act to grant to the Commission exclusive jurisdiction over options involving commodity futures contracts. The juxtaposing of the terms "options" and "commodity futures contracts" indicates that they are not one and the same. Finally, the purpose of the CEA is to regulate futures trading, though certain activities which involve futures trading are also included within the exclusive jurisdiction of the CEA (i.e., commodity options). *Id.* at 10, reprinted in U.S. CODE CONG. & AD. NEWS 2087, 2098. To define options as futures contracts merely because they possess similar characteristics is absurd.

traded options on physical commodities/exempted securities is within its jurisdiction and not the CFTC's. Finally, this note proposes an amendment to § 2(a)(1) of the CEA which would define the CFTC's jurisdiction in accordance with the conclusions reached herein.

## CEA JURISDICTIONAL HISTORY

### Types of Commodities Regulated

Federal regulation of commodity-futures trading began with the Grain Futures Act [GFA] in 1922.<sup>23</sup> Congress placed futures contracts traded on certain grains within the GFA's regulatory jurisdiction.<sup>24</sup> In 1936 Congress renamed the GFA the Commodity Exchange Act [CEA].<sup>25</sup> That legislation extended the CEA's regulatory jurisdiction to include additional commodity futures.<sup>26</sup> Congress in 1968 amended the CEA to bring livestock, livestock products, and frozen concentrated orange juice futures under jurisdiction of the CEA.<sup>27</sup>

The CFTCA substantially broadened the regulatory jurisdiction of the CEA.<sup>28</sup> The CFTCA expanded the definition of commodities regulated under the CEA to include not only agricultural goods but also all services, rights, and interests in which commodity futures contracts are or would be dealt in.<sup>29</sup> In the Futures Trading Act of 1978 [FTA],<sup>30</sup>

23. Pub. L. No. 67-331, 42 Stat. 998 (1922) (current version at 7 U.S.C. § 1, *et seq.* (1976 & Supp. II 1978)). Under the Act, grain exchanges were required to be federally licensed in order to conduct lawful futures trading. The exchanges themselves were made responsible for preventing price manipulation by their members. The federal government's only effective check on trading abuses was the power to revoke or suspend an exchange's license. Federal regulation under the Grain Futures Act of 1922 was based on the commerce clause. The Act's constitutionality was upheld in *Board of Trade v. Olsen*, 262 U.S. 1 (1923).

The Federal Government initiated its attempt to regulate commodity futures trading in the Futures Trading Act of 1921, Pub. L. No. 67-66, 42 Stat. 187 (superseded by the Grain Futures Act, Pub. L. No. 67-331, 42 Stat. 998 (1922) (current version codified at 7 U.S.C. § 1, *et seq.* (1976 & Supp. II 1978))). This Act was based on the Federal Government's taxing power and sought to place a prohibitory tax on non-exchange or non-trade futures and options transactions. The Act was declared unconstitutional because its purpose was construed not to be the raising of revenue. *Hill v. Wallace*, 259 U.S. 44, 66 (1922). The tax on options was also declared unconstitutional in *Trusler v. Crooks*, 269 U.S. 475, 482 (1926).

24. Grain Futures Act, Pub. L. No. 67-331, § 2, 42 Stat. 998 (1922) (current version at CEA § 2(a)(1), 7 U.S.C. § 2 (Supp. II 1978)). The enumerated grains were corn, oats, barley, flax, and sorghum. *Id.*

25. Commodity Exchange Act, ch. 545, § 1, 49 Stat. 1491 (1936) (current version at 7 U.S.C. § 1 (1976 & Supp. II 1978)).

26. Commodity Exchange Act, ch. 545, § 3(a), 49 Stat. 1491 (1936) (current version at 7 U.S.C. § 2 (Supp. II 1978)).

27. Act of February 19, 1968, Pub. L. No. 90-258, § 1(a), 82 Stat. 26 (1968) (pertaining to livestock, and livestock products); Act of July 23, 1968, Pub. L. No. 90-418, 82 Stat. 413 (1968) (pertaining to frozen concentrated orange juice) (both of these statutes amended CEA § 2(a), current version at 7 U.S.C. § 2 (Supp. II 1978)).

28. CFTCA, Pub. L. No. 93-463, § 201, 89 Stat. 1389 (1974) (amending CEA § 2(a), codified at 7 U.S.C. § 2 (1976) (amended 1978)). "The expansion in the scope of the CEA and the creation of the Commission were designed to accomplish two basic goals: (1) to provide a uniform regulatory structure covering all futures trading in both the regulated and previously unregulated commodities, and (2) 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 might prove to be of value." *1978 Senate Report* at 10, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2109-11.

29. *Id.*

Congress reaffirmed the CFTC's exclusive jurisdiction established under the CFTCA.<sup>31</sup>

### Regulation of Commodity Options

In the CEA of 1936 Congress enacted a total ban on put<sup>32</sup> and call<sup>33</sup> options for all commodities.<sup>34</sup> The CFTCA retained this ban for specifically enumerated commodities,<sup>35</sup> but provided for option trading on non-enumerated commodities where such trading did not contravene CFTC rule, regulation, or order.<sup>36</sup> Under the CFTCA Congress extended CFTC exclusive jurisdiction to include commodity-option transactions involving non-enumerated commodities.<sup>37</sup>

The Ninety-fifth Congress, reacting to unscrupulous practices in commodity-option dealings,<sup>38</sup> prohibited in the FTA any commodity-option transaction involving any non-enumerated commodity unless in conformance with a congressionally approved plan.<sup>39</sup> It exempted trade options<sup>40</sup> and dealer options<sup>41</sup> on physical commodities from this

30. FTA, Pub. L. No. 95-405, 92 Stat. 865 (1978) (codified at 7 U.S.C. § 2 *et seq.* (Supp. II 1978)).

31. 7 U.S.C. § 2 (Supp. II 1978).

32. A "put" is a type of option. The put option on an interest gives the purchaser the right to sell that underlying interest up to a certain date for a certain price. The seller of a put option obliges himself to take delivery of the interest at a given price when the put owner exercises his right.

33. The "call" is also a type of option. The purchaser of a call option has the right to take delivery on that interest up to a certain date at a fixed price. The seller of a call option on an interest must deliver that interest for the fixed price when the call owner exercises his right to take delivery.

34. Commodity Exchange Act, ch. 545, § 4c, 49 Stat. 1491 (1936) (current version at 7 U.S.C. § 6c(a) (1976 & Supp. II 1978)).

35. CFTCA, Pub. L. No. 93-463, §§ 402(a) & (b), 88 Stat. 1389 (1974) (current version at CEA § 2(a)(1), 7 U.S.C. § 2 (Supp. II 1978)). The enumerated commodities under the act are wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, 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, soybeans, soybean meal, peanuts, livestock, livestock products, and frozen concentrated orange juice. CEA § 2(a)(1), 7 U.S.C. § 2 (Supp. II 1978).

36. CFTCA, Pub. L. No. 93-463, § 402(c), 88 Stat. 1389 (1974) (current version CEA § 4c(b), 7 U.S.C. § 6c(b) (Supp. II 1978)).

37. The Senate report to the FTA states that the CFTCA amended § 2(a)(1) of the Act to grant the CFTC exclusive jurisdiction over options involving commodity futures contracts. *1978 Senate Report, supra* note 12, at 59, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2147.

38. Sections 4c(c) and 4c(d) of the CEA were enacted in 1978 to stop fraudulent and deceptive practices relating to off-exchange traded commodity options. *1978 Senate Report, supra* note 12, at 14, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2012. The most serious problem involved sham operations where dealers offered or sold options on commodity futures contracts traded on London futures exchanges. *Id.* at 43, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2131 (letter of CFTC chairman William Bagley to Senator Talmadge). By enacting § 4c(d) Congress limited dealer options to those which involved physical commodities. The applicability of the "dealer exclusion" to only options on physical commodities was requested by the CFTC to stop dealers from lawfully offering and selling "London options." *Id.*

39. The plan was to be submitted to Congress documenting the CFTC's ability to "regulate successfully such transactions" including a copy of the rules and regulations. It became valid thirty continuous session days after transmittal if neither House of Congress passed a resolution of disapproval. CEA § 4c(c), 7 U.S.C. § 6c(c) (Supp. II 1978). *E.g., 1978 Senate Report, supra* note 12, at 23, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2112.

40. A trade option is one where the purchaser is a "producer, processor, commercial user of, or

prohibition.<sup>42</sup> Congress called on the CFTC to proceed rapidly in adopting a plan to implement exchange-trading of commodity options.<sup>43</sup> As Congressman Keith G. Sebelius (R-Kan.)<sup>44</sup> explained, the conference committee members of the FTA hoped that exchange trading of commodity options would drive questionable dealers out of business.<sup>45</sup>

### JURISDICTION OVER COMMODITY OPTIONS

There are two types of commodity options:<sup>46</sup> options on physical commodities<sup>47</sup> and options on commodity-futures contracts.<sup>48</sup> It is clear that Congress authorized the CFTC to regulate exchange trading in at least one type of commodity option.<sup>49</sup> The CFTC's main jurisdictional rival, the SEC, admits that the CFTC should regulate exchange trading of commodity options on futures contracts.<sup>50</sup> CFTC jurisdiction to regulate options on physical commodities is less clear. The first part of the question this note explores is whether Congress intended the CFTC to regulate exchange-traded options on physical commodities.

Certain commodities are also securities. United States treasury bonds, United States treasury bills, and GNMA's are commodities under the CEA because futures contracts are traded on them.<sup>51</sup> The

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- merchant handling, the commodity involved in the transaction, or the products or byproducts thereof." CEA § 4c(c), 7 U.S.C. § 6c(c) (Supp. II 1978); 17 C.F.R. § 32.4 (1981).
41. A permitted dealer option exists where the grantor was in the business on May 1, 1978 of granting options on physical commodities and was in the business of buying, selling, producing, or otherwise using that commodity, where the grantor is properly registered with the CFTC and meets certain regulatory requirements. CEA § 4c(d), 7 U.S.C. § 6c(d) (Supp. II 1978); 17 C.F.R. § 32.12 (1981).
  42. CEA §§ 4c(c) & (d), 7 U.S.C. §§ 6c(c) & (d) (Supp. II 1978).
  43. H.R. CONF. REP. NO. 1628, 95TH CONG., 2D SESS. 20, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2181.
  44. Congressman Keith G. Sebelius represented the 1st District of Kansas from 1969 to 1981. *See* JOINT COMMITTEE ON PRINTING OF THE UNITED STATES CONGRESS 96TH CONG., 1ST SESS., CONGRESSIONAL DIRECTORY 68-69 (1979). During the 95th Congress he was the second ranking Republican on the House Agriculture Committee and ranking minority member of the Livestock and Grains subcommittee. *See* JOINT COMMITTEE ON PRINTING OF THE UNITED STATES CONGRESS, 95TH CONG. 2D SESS., CONGRESSIONAL DIRECTORY 55 (1978).
  45. 124 CONG. REC. 11218, 11221 (daily ed. Sept. 29, 1978) (statement of Congressman Sebelius). The remarks were made during the floor explanation of the Conference Committee Report of the FTA.
  46. *E.g.*, British American Commodity Options Corp. v. Bagley, 552 F.2d 482, 484-85 (2d Cir. 1977), *cert. denied*, 434 U.S. 938 (1977) ("A 'commodity option' is a contractual right to buy, or sell, a commodity or commodity future."); Precious Metals Assoc. v. Commodity Futures Trading Commission, 620 F.2d 900, 907 (1st Cir. 1980).
  47. Such an option gives the owner the right to make or take delivery on the underlying physical commodity.
  48. Such an option gives the owner the right to make or take delivery on the underlying commodity futures contract.
  49. Congress directed the CFTC to proceed "expeditiously" in implementing exchange-trading of commodity options. H. CONF. REP. NO. 1628, 95TH CONG. 2D SESS. 20, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 2087, 2181. This directive would be meaningless if the CFTC did not have jurisdiction to authorize and regulate the exchange trading of at least one type of commodity option.
  50. Answering Brief for Respondent at 3-4, Board of Trade v. Securities and Exchange Commission, No. 81-1660 (7th Cir., filed April 24, 1981).
  51. Section 2(a)(1) defines the word "commodity" to include all "interests in which contracts for future delivery are presently or in the future dealt in." *See* note 12 *supra*.

Securities Exchange Act [SEA] defines these interests as securities<sup>52</sup> but exempts them from its provisions unless the provision is written to include exempted securities specifically.<sup>53</sup>

Exempted security transactions involving commodity futures are not subject to CFTC jurisdiction unless conducted on a board of trade.<sup>54</sup> Consequently, the CFTC's jurisdictional claim over commodities/exempted securities extends only to those transactions involving commodity futures contracts which are exchange-traded.

The CFTC claims jurisdiction over exchange-traded options on physical commodities/exempted securities pursuant to the CEA.<sup>55</sup> Conversely, the SEC claims regulatory jurisdiction based on the SEA.<sup>56</sup> The second question this note addresses is really an element of the first question. Did Congress intend the CFTC to regulate exchange-traded options on physical commodities, which are also exempted securities?

#### Exchange-Traded Options on Physical Commodities

The first inquiry is whether Congress intended the CFTC to regulate exchange-traded option transactions on physical commodities. The CFTCA granted the CFTC exclusive jurisdiction to regulate option transactions involving commodity futures contracts.<sup>57</sup> The key to interpreting the scope of the CFTC's exclusive jurisdiction is the word "involves". Framed in the language of the statute, the question is whether option transactions on exchange-traded physical commodities involve commodity futures contracts.<sup>58</sup> This question is examined by analysis of the congressional floor explanation of the jurisdiction which Congress intended for the CFTC, congressional reports to the CFTCA and the FTA, the CEA language, and relevant case law.

*Congressional Floor Explanation.* During the floor explanation of the conference committee's report on the CFTCA, the scope of the CFTC's jurisdiction was addressed by Congressman William R. Poage (D.-Tex.).<sup>59</sup> Congressman Poage, House manager of the CFTCA bill and then Chairman of the House Agriculture Committee, explained that the conference committee intended the CFTC to regulate trading

52. Securities Exchange Act of 1934 (SEA) § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976).

53. SEA § 3(a)(12), 15 U.S.C. § 78c(a)(12) (1976).

54. CEA § 2(a)(1), 7 U.S.C. § 2 (Supp. II 1978). For full treatment, see text accompanying notes 86-91 *infra*.

55. *Supra* note 19.

56. *Supra* note 21.

57. CEA § 2(a)(1), 7 U.S.C. § 2 (Supp. II 1978).

58. *Id.*

59. Congressman William Robert Poage represented the 11th District of Texas in the United States House of Representatives from 1937 until 1977. He was Chairman of the House Agriculture Committee (CEA House Oversight Committee) when the CFTCA was enacted. See JOINT COMMITTEE ON PRINTING OF THE UNITED STATES CONGRESS, 93D CONG. 2D SESS., CONGRESSIONAL DIRECTORY 179, 286, 356 (1974). He served as the senior House Manager for the Conference Committee bill which became the CFTCA. See H. CONF. REP. NO. 1383, 93d Cong., 2d Sess. 44, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5905.

of options on commodities and commodity futures.<sup>60</sup> Senator Herman E. Talmadge (D.-Ga.),<sup>61</sup> Senate manager and Chairman of the Senate Agriculture, Nutrition, and Forestry Committee, echoed Congressman Poage's explanation of the proposed law before the Senate in his explanation of the conference committee's bill.<sup>62</sup> In outlining the new Commission's jurisdiction, the congressional committee conferees who managed the bill which became the CFTCA thus specified both types of commodity options, options relating to commodities (physicals) and options relating to commodity futures.

*Senate Report to the FTA.* The Senate report on the bill which became the FTA summarized the CFTC's exclusive jurisdiction to include transactions "involving futures contracts and certain other commodity related activities."<sup>63</sup> One of these commodity related activities is commodity options.<sup>64</sup> The legislative histories of the CFTCA and the FTA repeatedly refer to the CFTC's exclusive jurisdiction over commodity options in the plural.<sup>65</sup> It would be contrary to a reasoned reading of the Senate report's language to interpret the words "commodity options" narrowly so as to include only one of the two types of commodity options in the CFTC's exclusive regulatory jurisdiction.

*Section 4c of the CEA.* Section 4c of the CEA provides rules for options involving non-enumerated commodities.<sup>66</sup> These rules apply to commodities generally,<sup>67</sup> any commodity option transaction involving any non-enumerated commodity,<sup>68</sup> and certain trade and dealer options on physical commodities.<sup>69</sup>

60. Congressman Poage reported that Congress intended the CFTC to regulate trading over options relating to *commodities* or *commodity futures*. He explained that trading in this area was regulated poorly if at all. Giving the CFTC jurisdiction over commodity options was intended to fill existing regulatory gaps. The intention was to avoid usurpation of jurisdiction already vested in the SEC. 120 Cong. Rec. 34736, 34737 (1974).

61. The Honorable Herman Eugene Talmadge represented the State of Georgia in the United States Senate from 1937 until 1981. He was Chairman of the Senate Committee on Agriculture, Nutrition and Forestry (CEA Senate Oversight Committee) when the CFTCA was enacted. See JOINT COMMITTEE ON PRINTING OF THE UNITED STATES CONGRESS, 93RD CONG., 2D SESS., CONGRESSIONAL DIRECTORY 44, 258, 343 (1974). He served as the senior Senate Manager for the Conference Committee bill which became the CFTCA. See H. CONF. REP. NO. 1383, 93d Cong. 2d Sess. 44, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5905.

62. 120 CONG. REC. 34995, 34997 (1974) (prepared statement of Senator Talmadge).

63. 1978 Senate Report, *supra* note 12, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2098.

64. *Id.*

65. S. REP. NO. 1131, 93d Cong., 2d Sess. 6, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5848; H. CONF. REP. NO. 1383, 93d Cong., 2d Sess. 35, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843, 5897; 1978 Senate Report, *supra* note 12, at 10, 23, 33, 34, 55, 59, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2098, 2111, 2121, 2122, 2143, 2147.

66. Commodity Exchange Act §§ 4c(b), 4c(c), 4c(d), 7 U.S.C. §§ 6c(b), 6c(c), 6c(d) (Supp. II 1978).

67. Commodity Exchange Act § 4c(b), 7 U.S.C. § 6c(b) (Supp. II 1978).

68. Commodity Exchange Act § 4c(c), 7 U.S.C. § 6c(c) (Supp. II 1978). For a discussion of the § 4c(c) plan required of the CFTC before options can be traded see note 39, *infra*, and accompanying text.

69. Commodity Exchange Act §§ 4c(c), 4c(d), 7 U.S.C. §§ 6c(c), 6c(d) (Supp. II 1978). For a discussion of the legislative history of §§ 4c(c) and 4c(d), see note 38, *infra*.

One should give special attention to the language in section 4c(c) of the CEA. Section 4c(c) provides that there may be no offer or transaction "of any commodity option transaction involving any commodity regulated under this chapter, but not specifically set forth in § 2" unless according to a CFTC-written congressionally approved plan.<sup>70</sup> Congress used broad strokes of language in writing this commodity option statute. Congress excluded trade and dealer options on physical commodities from the rules of section 4c(c).<sup>71</sup> It did not exclude exchange-traded options from section 4c(c)'s regulatory umbrella which applies to all such option transactions involving any CFTC regulated commodity. After a careful reading of section 4c, one can conclude that section 4c(c)'s options prohibition includes options on physical commodities.

*Case Law:* Case law provides that the jurisdiction of the CFTC includes exchange-traded options on physical commodities. In *Commodity Futures Trading Commission v. American Board of Trade*,<sup>72</sup> the defendant set up an exchange and marketplace for commodity-option transactions on physical commodities.<sup>73</sup> The CFTC sought to enjoin the defendant from dealing in exchange-traded options on physical commodities pursuant to sections 4c(b) and 4c(c) of the CEA.<sup>74</sup> The defendants conceded that they had engaged in commodity option transactions, that they were not registered, and that they had not applied for an exemption.<sup>75</sup> The defendants argued, however, that the CEA does not apply to options unless those options pertain to commodity-futures contracts. The court rejected the defendant's argument and held that the proscriptions of sections 4c(b) and 4c(c) were not confined to options on commodity futures. The court ruled that the CEA authorized the CFTC to regulate transaction in options on physical commodities.<sup>76</sup>

In summary, the CFTC should regulate exchange-traded options on physical commodities for four reasons. First, Congress expressed this intention in the CFTCA, FTA, and in legislative histories. Second,

70. Commodity Exchange Act § 4c(c), 7 U.S.C. § 6c(c) (Supp. II 1978).

71. Trade and dealer options on physical commodities are exempt, however, from § 4c(c)'s CFTC plan requirement. Commodity Exchange Act §§ 4c(c), 4c(d), 7 U.S.C. §§ 6c(c), 6c(d) (Supp. II 1978).

72. 473 F. Supp. 1177 (S.D.N.Y. 1979).

73. The commodities on which the defendants traded options were silver bullion, silver coins, gold bullion, platinum, copper, plywood, and certain foreign currencies. *Id.* at 1180.

74. *Id.* at 1177. Section 4c(b) of the CEA requires that transactions and agreements involving commodities must not be conducted contrary to any rule, regulation, or order of the CFTC. 7 U.S.C. § 6c(b) (Supp. II 1978). Section 4c(c) of the CEA prohibits commodity options transactions which involve any non-enumerated, regulated commodity until the CFTC submits a plan to Congress to regulate such transactions which is not disapproved. 7 U.S.C. § 6c(c) (Supp. II 1978). Pursuant to 17 C.F.R. § 32.11 (1981), the CFTC has suspended transactions in any commodity options which are not trade or certain dealer options.

75. *Commodity Futures Trading Commission v. American Board of Trade*, 473 F. Supp. 1177, 1181 (S.D.N.Y. 1979). Exemptions are available for trade options, 17 C.F.R. § 32.4 (1981), and dealer options on physical commodities, 17 C.F.R. § 32.12 (1981).

76. *Commodity Futures Trading Commission v. American Board of Trade*, 473 F. Supp. 1177, 1182 (S.D.N.Y. 1979).

case law supports this conclusion. Third, regulation of exchange-traded options on physical commodities in one body and regulation of other commodity options in the CFTC would lead to duplication of regulation, the precise result Congress sought to prevent by enacting the CFTCA.<sup>77</sup> Fourth, it is reasonable to place regulation of exchange-traded options on physical commodities in the same body that regulates futures on physical commodities; options and futures, though different,<sup>78</sup> provide the same risk-shifting function.<sup>79</sup>

### The SEC's Claim to Jurisdiction

The second issue for Congress concerns regulatory jurisdiction over exchange-traded options on physical commodities/exempted securities. The SEC argues that the SEA gives it authority to regulate these interests.<sup>80</sup> It asserts that two parts of section 2(a)(1) of the CEA serve to except exchange-traded options on physical commodities/exempted securities from the exclusive jurisdiction of the CFTC.<sup>81</sup> The portions of section 2(a)(1) of the CEA to which the SEC refers are the "except as hereinabove provided" clause and the amendment which the Treasury Department offered in 1974.<sup>82</sup>

*The "except as hereinabove provided" clause.* Section 2(a)(1) of the CEA provides in part "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."<sup>83</sup> To interpret this clause, one must ascertain the meaning of the phrase, "except as hereinabove provided." The House conference committee report to the bill which became the CFTCA provides a clear explanation. After referring to the jurisdiction of the SEC, the report states that the CFTC's jurisdiction under the CFTCA supersedes that of federal agencies where applicable.<sup>84</sup> Case law supports the House conference committee's intentions.<sup>85</sup>

77. The Senate Report to the FTA stated that one of the major goals in expanding the scope of the CEA was "to provide a uniform regulatory structure covering all futures trading in both regulated and previously unregulated commodities." *1978 Senate Report, supra* note 12, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2098.

78. *Supra*, note 22.

79. The second major reason for expansion of the CEA's jurisdiction and creation of the CFTC was to extend the economic benefits of futures trading to those areas of commerce where the risk-shifting and price-discovery functions might be beneficial. *1978 Senate Report, supra*, note 12, at 10, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2098.

80. See Answering Brief for Respondent at 15-49, *Board of Trade v. Securities and Exchange Commission*, No. 81-1660 (7th Cir., filed April 24, 1981).

81. *Id.*

82. 7 U.S.C. § 2 (Supp. II 1978).

83. *Id.*

84. H. CONF. REP. NO. 1383, 93d Cong., 2d Sess. 35, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 5894, 5897. The Senate and House managers of the Conference Committee bill which came to be the CFTCA indicated that the conferees sought to avoid the usurpation of the SEC's jurisdiction. The managers stated that regulation of options relating to commodities or commodity futures was poorly regulated if regulated at all. *Supra* notes 60, 62.

85. *E.g.*, *Securities and Exchange Commission v. American Commodity Exchange, Inc.*, 546

*The Treasury Amendment.* The Treasury Department was concerned that one could construe the regulatory jurisdiction of the CFTC as provided by the CFTCA to include the trading of currencies and financial instruments conducted by large financial institutions.<sup>86</sup> To prevent the CFTC from regulating such trading between large institutions, the Treasury Department requested that Congress limit the CFTC's regulatory jurisdiction.<sup>87</sup>

The Treasury Department's recommendation was enacted into section 2(a)(1) of the CEA in the CFTCA.<sup>88</sup> This clause provides that CFTC jurisdiction is not to extend to transactions in government securities, government mortgages, and mortgage purchase commitments except for exchange-traded transactions involving commodity futures contracts.<sup>89</sup> Because exchange-traded options on commodities/exempted securities do involve commodity futures contracts on these government obligations, the Treasury amendment to section 2(a)(1) does not foreclose the CFTC from exercising regulatory jurisdiction.<sup>90</sup> The legislative history of the CFTCA attests to this conclusion.<sup>91</sup>

*SEC Jurisdiction under the SEA.* The SEC claims jurisdictional authority over exchange-traded options on commodities/exempted securities pursuant to the SEA. The Commission's brief in *Board of Trade v. Securities and Exchange Commission*<sup>92</sup> sets out its argument.<sup>93</sup> It states that options on all securities are themselves securities according to section 3(a) of the SEA.<sup>94</sup> Since Congress authorized the SEC to regulate securities trading on national exchanges and to provide a marketplace for such securities trading,<sup>95</sup> the Commission concludes that it has regulatory jurisdiction over options on physical commodities/exempted securities.<sup>96</sup>

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F.2d 1361, 1367-69 (10th Cir. 1976); *Bartels v. International Commodities Corporation*, 435 F. Supp. 865, 868-69 (D. Conn. 1977).

There is a split in authority as to whether the CFTCA precludes SEC action on transactions occurring prior to the effective date of the 1974 Act. *Cf. Securities and Exchange Commission v. American Commodity Exchange, Inc.*, 546 F.2d 1361, 1367-69 (10th Cir. 1976) (SEC action precluded by enactment of CFTCA on transactions occurring after the effective date of the CFTCA); *Glazer v. National Commodity Research and Statistical Service, Inc.*, 547 F.2d 392, 392-93 (7th Cir. 1977) *aff'g* 388 F. Supp. 1341, 1344 (N.D. Ill. 1974) (SEC action precluded by enactment of the CFTCA on transactions occurring before and after the effective date of the CFTCA). The split in authority is mentioned in *Bartels v. International Commodities Corporation*, 435 F. Supp. 865, 869 (D. Conn. 1977).

86. S. REP. No. 1131, 93d Cong. 2d Sess. 49-51, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 5843, 5887-89.

87. *Id.*

88. 7 U.S.C. § 2 (Supp. II 1978).

89. *Id.*

90. *See* text accompanying notes 57-79 *supra*.

91. *Supra*, note 86.

92. No. 81-1660 (7th Cir., filed April 24, 1981).

93. *See* Answering Brief for Respondent at 15-28, *Id.*

94. *Id.* at 17; Section 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976), provides that "the term 'security' means any . . . right to subscribe to or purchase . . ." any enumerated security.

95. Securities Exchange Act of 1934 §§ 5, 6, 15 U.S.C. §§ 78e, 78f (1976).

96. *See* Answering Brief for Respondent at 21-27, *Board of Trade v. Securities Exchange Commission*, No. 81-1660 (7th Cir. filed April 24, 1981).

The SEC claims jurisdictional authority over both call and put options.<sup>97</sup> The key language on which the SEC relies defines a security as any right to purchase any enumerated security.<sup>98</sup> The statute does not clearly support the SEC's argument. A call option on a security does give the owner the right to purchase the underlying security. A put option, however, does not give the holder the right to purchase the underlying interest; it gives the holder the right to sell it. Consequently, section 3(a) falls short of including both interests within the definition of "securities" under the SEA and, therefore, does not provide for regulation of exchange-traded options on physical commodities/exempted securities on its face.

The SEC then turns to case law to support its argument that puts on securities, as well as calls, are securities themselves.<sup>99</sup> Each case which the SEC cited concerned whether a plaintiff could bring an anti-fraud action under section 10(b) and rule 10b-5 of the SEA.<sup>100</sup> The general rule is that a potential plaintiff must have purchased or sold securities to obtain standing to bring a § 10(b), rule 10b-5 action.<sup>101</sup> In *Blue Chip Stamps v. Manor Drug Stores*,<sup>102</sup> the Supreme Court of the United States said in dicta that it would recognize option holders of securities for purposes of obtaining standing to bring suit under rule 10b-5.<sup>103</sup>

97. *Id.* at 16-18. The SEC authorized the Chicago Board of Options Exchange to trade both put and call options on GNMA's. 46 Fed. Reg. 15242 (1981).

98. Treasury obligations and government related mortgage-backed certificates are securities under § 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (1976). Section 3(a)(10) also provides that any right to purchase any security is a security itself. Section 3(a)(13) of the 1934 Act, 15 U.S.C. § 78c(a)(13) (1976), provides that the term "purchase" includes any contract to buy or purchase. Since a call option on an exempted security is a contract giving the owner the right to purchase a security, the call option is itself a security.

A put option on an exempted security is a contract giving the owner the right to sell the underlying security. The seller of a put option has the contractual obligation to purchase the exempted security if the put owner exercises his right to sell. Neither the right conferred on the put owner, nor the obligation imposed on the put seller is included in the definition of a "security" under § 3(a)(10) of the 1934 Act. 15 U.S.C. § 78c(a)(10) (1976).

Additionally, the SEC notes that § 11(a)(1)(D) of the 1934 Act, 15 U.S.C. § 78k(a)(1)(D) (1976), equates put and call holders on equity securities with security holders. Answering Brief for Respondent at 18, Board of Trade v. Securities and Exchange Commission, No. 81-1660 (7th Cir., filed April 24, 1981). Exempted securities, however, are not equity securities.

99. Answering Brief for Respondent at 17, Board of Trade v. Securities and Exchange Commission, No. 81-1660 (7th Cir., filed April 24, 1981). To support its argument the SEC cites *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 750-51 (1975); *Mansbach v. Prescott, Ball, & Turben*, 598 F.2d 1017, 1026 n.40 (6th Cir. 1979); *Lutger v. Vanderbilt Bank*, 508 F.2d 1035, 1038 (5th Cir. 1975); and *Lloyd v. Industrial Bio-Test Laboratories, Inc.*, 454 F. Supp. 807, 810-11 (S.D.N.Y. 1978).

100. Section 10(b), 15 U.S.C. § 78j(b) (1976), proscribes use of any manipulative or deceptive device in connection with the sale or purchase of any registered or unregistered security. Rule 10b-5, 17 C.F.R. 240.10b-5 (1981), elaborates on manipulative or deceptive devices which are unlawful.

101. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 732, 731-55 (1975).

102. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 732 (1975).

103. *Id.* at 750-51. *Blue Chip Stamps* concerned whether an offeree could bring suit against the offeror for materially misleading statements in a prospectus. The precise question for the Court was whether an offeree of registered common stock could base an action on rule 10b-5 without having bought or sold the securities of the offeror. *Id.* at 727. The rule of *Blue Chip Stamps* is that a potential plaintiff must be a purchaser or seller of securities to maintain a private cause of action under Rule 10b-5. *Id.* at 731-55. The Court held that a mere offeree of common stock in a public offering was not a purchaser or seller of securities and, therefore, had no standing to bring suit. *Id.* at 725-55.

Picking up on this language, the Sixth Circuit in *Mansbach v. Prescott, Ball & Turben*,<sup>104</sup> cited *Blue Chip Stamps* for the proposition that exchange-traded options to purchase or sell stock were securities.<sup>105</sup> The Fifth Circuit, in *Lutgert v. Vanderbilt Bank*,<sup>106</sup> said that one's right to purchase common stock is a security.<sup>107</sup> Finally, the District Court for the Southern District of New York, in *Lloyd v. Industrial Bio-Test Laboratories, Inc.*,<sup>108</sup> citing *Blue Chip Stamps* and *Lutgert*, held that exchange-traded options purchased on common stock were securities within the meaning of section 10(b) and Rule 10b-5.<sup>109</sup>

The case law which the SEC cited is not on point. The securities in all of these cases were non-exempt securities. Additionally, none of the securities was also a commodity. The relevant issue in each case was whether the plaintiff had standing to bring a private cause of action under section 10(b) and rule 10b-5 of the SEA for fraud concerning common stock or exchange-traded options on common stock. In short, the case law relied on by the SEC does not imply a regulatory right in the SEC over exchange-traded options on physical commodities/exempted securities.<sup>110</sup>

104. 598 F.2d 1017 (6th Cir. 1979).

105. *Id.* at 1026 n.40. A potential plaintiff in rule 10b-5 actions must show scienter on the part of the defendant to use a manipulative or deceptive practice. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). In *Mansbach*, a seller of call options on registered common stock brought suit against a securities broker-dealer for recklessness in handling his account. The issue in *Mansbach* was whether recklessness would suffice as the requisite scienter. The court held that recklessness is a sufficiently culpable state of mind for liability under § 10(b) and rule 10b-5. *Mansbach*, 598 F.2d at 1023.

106. 508 F.2d 1035 (5th Cir. 1975).

107. *Id.* at 1038. The plaintiff in *Lutgert* was a purchaser of bank stock whose shareholders were given a pro-rata right to subscribe to stock in the Vanderbilt Bank. The plaintiff brought a class action suit against Vanderbilt alleging that he had lost his right to purchase its stock through fraud contrary to rule 10b-5 and rule 10b-17. *Lutgert* argued that his purchase of bank stock gave him a right to purchase Vanderbilt stock and that the right to purchase was itself a security. *Id.* at 1038. The court agreed but said that his purchase had not conferred such a right on him. The court held that dismissal was proper for plaintiff's failure to allege that he was a purchaser or seller of securities of the defendant corporation. *Id.* at 1038-39.

108. 454 F. Supp. 807 (S.D.N.Y. 1978).

109. *Id.* at 811. The plaintiff in *Lloyd* had purchased exchange-traded call options on a registered common stock. He brought a class action against the corporation which issued that stock for misrepresentation in its annual report and subsequent public statements and press announcements. The defendant corporation argued that options purchased on common stock were not securities and, therefore, the plaintiff had no standing to bring suit. *Id.* at 810. The court held that exchange-traded options on common stock were securities within the meaning of § 10(b) and rule 10b-5. *Id.* at 811.

110. It makes good sense to vest regulatory authority over options on physical commodities/securities in the CFTC. The cash market in Government securities and Government-related mortgage backed securities is regulated by the Federal Reserve Board and the Treasury Department not the SEC. SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 96TH CONG., 2D SESS., REPORT OF THE JOINT TREASURY-SEC-FEDERAL RESERVE STUDY OF THE GOVERNMENT-RELATED SECURITIES MARKETS, 177-81 (Comm. Print 1980).

Then SEC Chairman Harold Williams, in a letter stating the SEC's position, argued during the 1978 CFTC reauthorization that it would be beneficial to vest regulatory authority over futures and options on the same interest in the same regulatory authority. He stated that "both options and futures on securities would trade at a price derived from the price of the underlying security. Both could be used for hedging, or risk management purposes by holders of the underlying security." *Id.* at 52, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2140.

In summary, the SEC does not regulate trading in Government-related securities. The

Exercise of regulatory jurisdiction over options on exempted securities may contravene the SEA. Congress enacted section 9(b) of the SEA to prohibit the trading of options on a national securities exchange against the rules and regulations of the SEC.<sup>111</sup> By adopting section 9,<sup>112</sup> Congress sought to prevent the widespread manipulation and fraudulent practices which involved the concurrent trading of options and their underlying securities.<sup>113</sup> The SEC has written that § 9(b) vests it with plenary authority to regulate all aspects of option trading on exchanges.<sup>114</sup> Section 9(f) of the SEA, however, specifically states that section 9 does not apply to exempted securities.<sup>115</sup>

SEC approval of option trading on GNMA physicals for the Chicago Board of Options Exchange was based on section 19(b) rather than section 9(b).<sup>116</sup> Section 19(b)<sup>117</sup> is an enabling statute and is not, therefore, a substantive statute which adds to the regulatory authority of the SEC. Section 19 gives the SEC authority to approve rule changes for its self-regulatory organizations. Those rule changes, however, must be consistent with the substantive provisions of the SEA.<sup>118</sup> Thus, if section 9(b) provides the foundation for SEC regulation of exchange-traded options, the SEC has no authority to regulate exchange-traded options on exempted securities.

### CONCLUSION

Congress must clarify whether it intended the CFTC or the SEC to regulate exchange-traded options on all physical commodities. By so doing, Congress will prevent jurisdictional squabbling and regulatory uncertainty.

The wording of the CEA and the legislative history indicate that Congress intended CFTC jurisdiction to extend to these transactions.<sup>119</sup> Case law supports this conclusion.<sup>120</sup> Congress did not intend to carve a regulatory exception from the CFTC's jurisdiction for exchange-

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CFTC, however, regulates futures trading on Government securities which are commodities. Exercise of this regulatory authority by the CFTC brings it face to face with transactions involving commodities/exempted securities which use price-discovery techniques and are often motivated to hedge risks. Paying heed to former SEC Chairman Williams' advice, one must conclude that the CFTC would be the most efficient regulatory body because of its regulation of futures trading on commodities/exempted securities.

111. See H.R. REP. NO. 1383, 73d Cong., 2d Sess. 15 (1934), cited in 45 Fed. Reg. 21426, 21426 n.2 (1980).

112. Securities Exchange Act of 1934 § 9, 15 U.S.C. § 78i (1976).

113. See, e.g., "Senate Comm. on Banking and Currency, Stock Exchange Practices," S. REP. NO. 1455, 73d Cong., 2d Sess. (1934), cited in 45 Fed. Reg. 21426, 21426 n.2 (1980).

114. 45 Fed. Reg. 21426, 21426 n.2 (1980). This release (March 26, 1980) predated the original proposal by the Chicago Board of Options Exchange to trade options on GNMA's, 45 Fed. Reg. 32458 (May 16, 1980), by less than two months. It predated the SEC's approval of GNMA options pursuant to § 19(b), 46 Fed. Reg. 15242 (March 4, 1981), by less than one year.

115. 15 U.S.C. § 78i(f) (1976).

116. 46 Fed. Reg. 15242, 15242-45 (1981).

117. 15 U.S.C. § 78s(b)(1) (1976).

118. Securities Exchange Act of 1934 § 19(b)(3)(C), 15 U.S.C. § 78s(b)(3)(C) (1976).

119. See text accompanying notes 59-71 *supra*.

120. See text accompanying notes 72-76 *supra*.

traded options on physical commodities/exempted securities.<sup>121</sup> Also, the SEA does not provide for SEC regulation of exchange-traded options on exempted securities.<sup>122</sup> Case law does not serve to create an implied regulatory right over such trading.<sup>123</sup>

Therefore, the 1982 amendments should make clear that the CFTC is the proper regulatory body for exchange-traded options on physical commodities/exempted securities. Regulation by the CFTC is sensible because both futures and options are risk-shifting vehicles.<sup>124</sup> This regulatory result will avoid duplication of regulation over commodity options by the CFTC and the SEC.

The following proposal would provide the necessary clarification. Congress should amend section 2(a)(1) of the CEA so it includes, "Regulation over exchange-traded options on physical commodities (including commodities which are exempted securities pursuant to § 3(a)(12) of the Securities Exchange Act), which were not regulated by this section prior to 1974, is within the exclusive jurisdiction of the Commodity Futures Trading Commission, and such options are deemed to involve any commodity, and are subject to the statutory requirements set out in § 4c."<sup>125</sup>

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121. See text accompanying notes 83-91 *supra*.

122. See text accompanying notes 92-98 *supra*.

123. See text accompanying notes 99-110 *supra*.

124. See note 110 *supra*.

125. On December 7, 1981, the CFTC and the SEC, through their chairmen, entered into an agreement to settle their jurisdictional dispute [Johnson-Shad agreement]. United States Securities and Exchange Commission & United States Futures Commodities Trading Commission, No. 81-66 (Dec. 7, 1981) (press release). That agreement called for the SEC to regulate options on exempted securities and the CFTC to regulate options on physical commodities other than exempted securities. Options on foreign currencies would be jointly regulated. See, *id.*, Wall Street Journal, Dec. 7, 1981, at 4, cols. 1-2.

The CFTC does intend to implement exchange-trading over options on physical commodities other than exempted securities. 47 Fed. Reg. 1750 (1982). The CFTC, however, asked for comments on proposed rules that would exempt from the CEA transactions in options on exempted securities, where the transactions are conducted on a national securities exchange, registered with, and regulated by, the SEC. 47 Fed. Reg. 7677-78 (1982).

As of March 12, 1982, the Court of Appeals for the Seventh Circuit had not decided *Board of Trade v. Securities and Exchange Commission*, No. 81-1660 (filed April 24, 1981). On November 4, 1981, the court stayed until further order the SEC rule approving options-trading on GNMA's by the CBOE (The SEC had approved CBOE trading over options on GNMA's. 46 Fed. Reg. 15, 242 (1981)). That stay remained in effect as of March 12, 1982.

As this paper shows, SEC regulation of options on physical commodities/exempted securities is contrary to the SEA and the CEA. The Johnson-Shad agreement would permit the CFTC to regulate futures-trading over indexes of corporate or municipal securities, so long as settlement of these options is made by cash or other means not involving delivery of the underlying securities. United States Securities and Exchange Commission & United States Future Commodities Trading Commission, No. 81-66 (Dec. 7, 1981) (press release).

The CFTC cannot, however, bargain away its statutory authority to regulate exchange-traded options on physical commodities/exempted securities. Regulatory jurisdiction of the SEC and the CFTC is set forth in the SEA and the CEA. Amendments to these statutes must be made by Congress.

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