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## AMBIGUITY AND EXCEPTIONS: DISSECTING CFTC V. MONEX CREDIT CO. AND THE COMMODITY EXCHANGE ACT TO EXPLAIN ACTUAL DELIVERY

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AMBIGUITY AND EXCEPTIONS: DISSECTING *CFTC v. MONEX CREDIT CO.* AND THE COMMODITY EXCHANGE ACT TO EXPLAIN ACTUAL DELIVERY

*By William Knotts\**

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## I. INTRODUCTION

“Leveraged trades” are transactions in which an investor borrows the capital to purchase or sell a commodity using the commodity itself as collateral.<sup>1</sup> These transactions are vital to the health of commodities markets as they relate directly to market participation and liquidity, both essential components.<sup>2</sup> A recent Ninth Circuit decision threatens these types of valuable transactions by adopting a narrow interpretation of a key exemption from the applicability of Commodity Exchange Act regulations.<sup>3</sup> This Article will argue a broader interpretation is more consistent with the purpose behind the Commodity Exchange Act, recent Commodity Futures Trading Commission interpretations, and will better serve commodities traders along with the markets themselves.

The fundamental purpose of the Commodity Exchange Act (CEA)<sup>4</sup> is to serve public interest by allowing markets that fall within its scope to self-regulate under the oversight of the Commodity Futures Trading Commission (CFTC). Through this oversight function, the CFTC seeks to protect market participants through the deterrence of fraud and price manipulation, while also incentivizing participation and innovation.<sup>5</sup> Historically, trades regarding the actual sale of precious metals fell outside of the scope of the Commodity Exchange Act.<sup>6</sup> However, in the past decade, this has changed.

The passing of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 expanded the scope of the CEA to retail commodity trades offered on leverage.<sup>7</sup> This meant that the enumerated acts of the CEA now applied to Monex, a California-based business specializing in leveraged retail commodity transactions. But did Monex’s trading conduct fall within an exception? Section 2(c)(2)(D)(ii)(III)(aa) of Dodd-Frank carves a limitation into the coverage of the CEA by exempting trades in which there is actual delivery of the traded commodity within twenty-eight days.<sup>8</sup>

Whether Monex’s trading practices fell within the CEA coverage of leveraged trading was the central question in *Commodity Futures Trading Commission v. Monex Credit Co.*<sup>9</sup> In addressing this question, the court wrongly decided this case which negatively impacted all leveraged, off-exchange retail commodity transactions going forward and directly impacted market participation and liquidity. Although the Dodd-Frank Act expanded the scope of the CEA to cover the type of leveraged-commodity trades carried out by Monex,

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1. *Leveraged Investing Strategies – Know the Risks Before Using These Advanced Investment Tools*, U.S. SEC. & EXCH. COMM’N (June 10, 2021), [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib\\_leveragedinvesting](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_leveragedinvesting).

2. See Bige Kahraman & Heather E. Tookes, *Trader Leverage and Liquidity*, 72 No. 4 J. FIN., Aug. 2017, at 1597.

3. CFTC v. Monex Credit Co., 931 F.3d 966, 975 (9th Cir. 2019).

4. 7 U.S.C. § 1.

5. 7 U.S.C. § 5.

6. See generally *Monex*, 931 F.3d at 971; 7 U.S.C. §§ 1 *et seq.*

7. See DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, 12 U.S.C. § 5301 (2010); *Monex*, 931 F.3d at 974.

8. 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa).

9. *Monex*, 931 F.3d at 975.

it also created an exception allowing legitimate trades to remain outside its scope.<sup>10</sup> The regulations allegedly violated would not apply if Monex made *actual delivery* of the traded commodities within twenty-eight days.<sup>11</sup> The Ninth Circuit held that Monex failed to make actual delivery and were thus bound to abide by the regulations set forth in the CEA.<sup>12</sup>

In this Article, the reasoning and holding of the Ninth Circuit will be analyzed regarding the appropriate interpretation of the phrase “actual delivery”. Part II provides a discussion of the facts and procedural history of the *Monex* case. To provide a background of the law, Part III covers its history, including the CFTC’s own prior interpretations of the past and present regulatory schemes, which expressly permitted the conduct that Monex is now being penalized for. Part IV then discusses the court’s holding that Monex failed to make actual delivery, while Part V analyzes the reasoning the court used to support their decision, as well as how it will likely affect similar claims in the future. Finally, Part VI concludes by arguing that the court reached the incorrect conclusion and that an alternative interpretation of the phrase would better achieve the goals of the CEA and comply with the drafter’s actual intentions by preventing fraudulent transactions without hampering legitimate off-exchange retail transactions.

## II. FACTS AND PROCEDURAL HISTORY

### A. *Summary of Facts*

Monex is a California-based company that focuses its business primarily on trading precious metals such as gold, silver, platinum, and palladium.<sup>13</sup> To facilitate these trades, Monex furnishes investors with multiple purchase options, but the case at bar only concerns Monex’s Atlas Program.<sup>14</sup> The Atlas program affords investors the ability to purchase these precious metals using “margin” or “leverage” accounts, meaning that they only pay a portion of the purchase price with Monex financing the remainder.<sup>15</sup> When an investor opens an Atlas account, they are allowed to take an “open” position in the precious metals market, meaning that they have entered into a trade that is not yet finalized; this type of transaction exposes the investor to market risk based on fluctuations in the value of the purchased commodity.<sup>16</sup> However, unlike transactions in futures, where the trades occur on a regulated trading exchange, Monex controls the platform, sets the price, acts as the counterparty to every transaction, and retains sole discretion to liquidate trading positions without notifying its customers.<sup>17</sup> Monex also retains the right to issue “margin calls” if the equity in

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10. 7 U.S.C. § 2(c)(2)(D)(ii)(III)(aa).

11. *Id.*

12. *Monex*, 931 F.3d at 975.

13. *Id.* at 969.

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.* at 970.

the leveraged portion of their account falls below a certain amount, and this amount is subject to change at any time by Monex.<sup>18</sup>

Investors in the Atlas program have the option of taking either short or long positions in the market, meaning that they can either sell or buy depending on their speculated perception of the market's future behavior.<sup>19</sup> Investors are also allowed the option of risk mitigation strategies such as stop or limit orders which allow them to exit their position when the value of the commodity reaches a certain price.<sup>20</sup> Notwithstanding the options afforded to investors, approximately twenty-five percent of Atlas accounts that are operated on margin open and close within two weeks.<sup>21</sup>

The majority of the revenue generated by the Atlas Program comes from the price spread (the difference in the actual value of the asset and the quoted sale value), which is set by Monex; the remainder is generated via commission and fees drafted directly from the investor's account equity.<sup>22</sup> However, when customers signed the Atlas agreement, they gave assent to Monex to control the precious metals they were buying.<sup>23</sup> As a result, on its face, the customers appeared to never actually have physical control of the commodity.<sup>24</sup> Instead, Monex stored the metals in depositories and retained authority to control their handling.<sup>25</sup> However, Monex allowed customers to physically receive the commodity when (1) there was no margin, (2) the customer requested delivery, and (3) the customer had the metals shipped to themselves.<sup>26</sup> This structure is the same regardless of the position the investor has taken in the market.<sup>27</sup> For example, when a long position is liquidated at Monex's request, the metals remain in the depository, and the only proof that the metals changed ownership is in a book entry.<sup>28</sup>

### B. Procedural History

On September 6, 2017, the Commodity Futures Trading Commission filed a complaint in the United States District Court for the Northern District of Illinois, Eastern Division.<sup>29</sup> The complaint named Monex and two affiliates, collectively referred to as "Monex," as well as Louis and Michael Carabini, as "control persons" of Monex.<sup>30</sup> Its complaint alleged that, as early as 2011, Monex had defrauded customers, purposefully misrepresented the opportunities available to

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18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. Complaint for Injunctive and Equitable Relief and Penalties under the Commodity Exch. Act at 3, *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173 (C.D. Cal. 2018) (No. 17-cv-06416).

30. *Id.* at 4.

investors, and committed multiple violations of the Commodity Exchange Act.<sup>31</sup> The complaint alleged four violations, with Count I alleging violations for conducting off-exchange transactions in violation of section 4(a), Count II alleging fraud in violation of section 4b(a)(2)(a) and (c) of the CEA, Count III alleging fraud in violation of section 6(c)(1) of the CEA, and Count IV alleging a violation of section 4(d) for failure to register.<sup>32</sup> Subsequently, on October 3, 2017, Monex submitted a motion to transfer venue to the Central District of California, arguing that California was a more convenient forum because Monex conducted the vast majority of its business there.<sup>33</sup> Moreover, the majority of Monex's customers would be subject to the subpoena powers of the court in California.<sup>34</sup> The motion was ultimately granted, and the case was transferred to the United States District Court for the Central District of California.<sup>35</sup>

Following the case's transfer to a more convenient forum, each Defendant moved to dismiss the complaint pursuant to Federal Rule of Civil Procedure 12(b)(6).<sup>36</sup> The court subsequently dismissed counts I, II, and IV, reasoning that Monex's conduct was shielded by the actual delivery exception built into the Dodd-Frank Act.<sup>37</sup> Following the dismissal of these allegations, the court proceeded to dismiss count III because section 6(c)(1)<sup>38</sup> only prohibited conduct when both fraud and manipulation were present, which was not the case alleged in the CFTC's complaint.<sup>39</sup> As a result of all counts being dismissed, the court denied both the Plaintiff's motion for preliminary injunction and the Defendant's motion to exclude testimony as moot.<sup>40</sup> Following the dismissal of its complaint, the CFTC appealed the decision to the United States Court of Appeals for the Ninth Circuit.<sup>41</sup> The Court of Appeals in turn reversed and remanded.<sup>42</sup> On January 24, 2020, Monex petitioned the Supreme Court of the United States for a writ of *certiorari*, which it denied on June 29, 2020.<sup>43</sup>

On remand to the District Court, the individual Defendants, but not Monex, renewed their motions to dismiss the complaint.<sup>44</sup> The court granted the motion on counts II and III for failure to meet heightened pleading standards set forth in

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31. *Id.* at 1-3.

32. *Id.* at 23-29.

33. Def.'s Motion to Transfer Venue, *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173 (C.D. Cal. 2018) (No. 17-cv-06416).

34. *Id.* at 2.

35. Order Transferring Venue to Cent. Dist. of Cal., Santa Ana (S.) Div., *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173 (C.D. Cal. 2018) (No. 17-cv-06416).

36. *CFTC v. Monex Credit Co.*, 311 F. Supp. 3d 1173, 1176 (C.D. Cal. 2018).

37. *Id.* at 1183.

38. 7 U.S.C. § 6(C)(1).

39. *Monex*, 311 F. Supp. 3d at 1189.

40. *Id.* at 1177.

41. *CFTC v. Monex Credit Co.*, 931 F.3d 966, 969 (9th Cir. 2019).

42. *Id.*

43. *See CFTC v. Monex Credit Co.*, 931 F.3d 966 (9th Cir. 2019), *cert. denied*, (U.S. June. 29, 2020) (No. 19-933).

44. *CFTC v. Monex Credit Co.*, No. SAC 17-1868 JVS, 2020 WL 1625808, at \*1 (C.D. Cal. Sept. 29, 2021).

FRCP 9(b).<sup>45</sup> Following the dismissal of two of the four claims against Monex, the court granted the CFTC'S motion for injunctive relief.<sup>46</sup> This Article only explores with the Ninth Circuit's interpretation of "actual delivery" as used in the exception Monex claims to have exculpated them from the requirements of the CEA.

### III. BACKGROUND AND HISTORY OF THE LAW

Historically, as mentioned in the introduction, certain retail commodity trades such as those involving precious metals clearly did not fall within the scope of the CEA.<sup>47</sup> However, since the passing of the Dodd-Frank Act, courts, brokers, and the CFTC have litigated the topic on multiple occasions and have not always agreed with one another as to what is now covered under the Act. More pertinently, disagreement persists regarding what is still exempted under the actual delivery exception.<sup>48</sup>

#### A. Commodity Exchange Act

The predominant purpose for enacting the CEA was to protect consumers and the economy itself by deterring price manipulation, ensuring the integrity of all transactions, and protecting against fraud.<sup>49</sup> The CEA lays out the statutory framework under which the CFTC operates, giving the CFTC the authority to establish regulations that govern commodity futures.<sup>50</sup> Yet, from the enactment of the CEA in 1936 until the enactment of the Dodd-Frank Act in 2010, the CEA covered futures contracts, but it did not cover the sale of retail commodities that resulted in delivery such as the precious metal trades conducted by Monex.

However, in the aftermath of the "Great Recession," the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>51</sup> was passed, effectively overhauling much of the nation's financial regulation at the federal level. The portion of the Dodd-Frank Act relative to this Article added section 2(c)2(D),<sup>52</sup> known as the Retail Commodity Provision to the CEA.<sup>53</sup> This section extended the jurisdictional reach of the CFTC to retail commodities unless they met the "actual delivery" exception. However, even though the exception hinges on whether actual delivery is made, actual delivery is not defined in the statute.<sup>54</sup>

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45. FED. R. CIV. P. 9(b); CFTC v. Monex Credit Co., No. SAC 17-1868 JVS, 2020 WL 1625808, at \*1 (C.D. Cal. Sept. 29, 2021).

46. CFTC v. Monex Credit Co., No. SAC 8:17-cv-1868 JVS, 2020 WL 7786540, at \*1 (C.D. Cal. Sept. 29, 2021).

47. See generally 7 U.S.C. §§ 1 *et seq.*

48. Compare CFTC v. Hunter Wise Commodities, LLC, 749 F.3d 967 (11th Cir. 2014), with CFTC v. Noble Metals Int'l, Inc., 67 F.3d 766 (9th Cir. 1995), and CFTC v. S. Tr. Metals, Inc., 894 F.3d 1313 (11th Cir. 2018).

49. 7 U.S.C. § 5(b).

50. CFTC, <https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm> (last visited Feb. 26, 2023).

51. DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT, 12 U.S.C. § 5301 (2010).

52. 7 U.S.C. § 2(c)2(D).

53. CFTC v. Worth Group, Inc., No. 13-80796-CIV-RYSKAMP/HOPKINS, 2014 WL 11350233, at \*1, (S.D. Fla. Oct. 27, 2014).

54. *Id.*

This meant that, unless brokers could conduct their business within the bounds of the undefined and ambiguous actual delivery exception, they now had to comply with the multitude of additional regulations enumerated by the CEA and under the jurisdiction of the CFTC.<sup>55</sup>

### B. CFTC's Prior Interpretation of Actual Delivery

Prior to the instant case and *Hunter Wise*, the CFTC itself initially argued that depositing the metals in a depository and transferring title to the investor constituted conduct that fell well within the bounds of the actual delivery exception.<sup>56</sup> The district court in *CFTC v. Worth Group* explicitly noted that the CFTC initially stated that this conduct would exempt a defendant from the added regulations of the CEA, a fact that would be dispositive of the allegations for violations of CEA provisions.<sup>57</sup>

Then at the *Zelener Hearing*, which occurred before the enactment of Dodd-Frank, the CFTC's then-acting director of enforcement, Stephen Obie, acknowledged the validity of the actual delivery exception that existed under the Model Commodity Code.<sup>58</sup> Obie explicitly stated, in agreeance with Jim Marshall, chairman of the subcommittee on General Farm Commodities and Risk Management, that Monex's practice constituted actual delivery, was in compliance, and would not be affected by any proposed changes.<sup>59</sup>

Then, approximately six months after the *Zelener Hearing*, congress amended Dodd-Frank to include the actual delivery exception, codifying the legality of the conduct discussed during the hearing.<sup>60</sup> More specifically it effectuated the drafter's intent discussed at the *Zelener Hearing*, that Monex's conduct was legal as stated in the hearing and that the purpose of the regulation was to prohibit the operation of "bucket shops"<sup>61</sup> but not to interfere with those who made actual delivery.<sup>62</sup> Then, in 2013, after the enactment of Dodd-Frank, the CFTC published its interpretation of the term "actual delivery," along with examples of how it would interpret whether actual delivery had occurred.<sup>63</sup> One such example given by the CFTC includes physically delivering the commodity to a depository and transferring the title to the buyer.<sup>64</sup>

These examples combined with the previously mentioned, extensive discussions regarding the goal of the regulations relating to retail commodities

55. See generally 7 U.S.C. § 6(a).

56. *CFTC v. Worth Group, Inc.*, No. 13-80796-CIV-RYSKAMP/HOPKINS, 2014 WL 11350233, at \*1, \*3 (S.D. Fla. Oct. 27, 2014).

57. *Id.*

58. *Hearing to Review Implications of the CFTC v. Zelener Case: Hearing Before the Subcomm. on General Farm Commodities and Risk Mgmt. of the H. Comm. on Agric.*, 111th Cong. 5 (2009) (Statement of Stephen Obie, Acting Director of Enforcement Division, CFTC) [hereinafter *Zelener Hearing*].

59. *Id.*

60. H.R. Rep. No. 111-370 (Dec. 10, 2004).

61. *What is a bucket shop?*, Capitol.com, <https://capital.com/bucket-shop-definition> (last visited April 3, 2023) (defining a bucket shop as "an establishment that takes bets on asset prices, but does not arrange for their purchase or delivery to clients.").

62. *Zelener Hearing*, *supra* note 58, at 23.

63. 78 Fed. Reg. 52426-01 (example 2).

64. *Id.*



strongly point to one conclusion: the CFTC, until recently, only intended the expansion of its regulatory powers under Dodd-Frank to aid in fraud prevention and not to restrict the actions of those conducting lawful, off-market transactions by making actual delivery of commodities.

### C. *Prior Judicial Interpretation*

In the past, courts have attempted to interpret the meaning of actual delivery and have, in multiple decisions, struggled to agree with previously decided conclusions as to when the exception applies.<sup>65</sup> Initially, in *Noble Metals*, the Ninth Circuit held that delivery could not be satisfied by “simple device of a transfer of title.”<sup>66</sup> In this case, the CFTC initiated the suit alleging that the dealer was in violation of multiple sections of the CEA because the contracts that it referred to as “cash forward contracts” were actually futures contracts and therefore subject to CEA regulation.<sup>67</sup> The court reached the conclusion that the transfer of title is not enough for actual delivery by analyzing Noble’s conduct.<sup>68</sup> The court found Noble simply retained title to the commodity, and when they did transfer it to the investor, he would simply sell to a third party, who would in turn sell it back to Noble.<sup>69</sup> As a result, the metals never changed hands, nor did the investor ever have the ability to physically possess the metals.<sup>70</sup> The court used this analysis to conclude that without the possibility of the buyer possessing the metals, delivery was never even anticipated.<sup>71</sup>

Again in 2014, after the enactment of Dodd-Frank and the codification of the statutory term “actual delivery,” another circuit court attempted to clarify the meaning intended by the legislature.<sup>72</sup> In *Hunter Wise*, the court reached the same conclusion as it had in *Noble Metals*,<sup>73</sup> but this time for a different reason.<sup>74</sup> The *Hunter Wise* court introduced and adopted the dictionary definitions of the words “actual” and “delivery.”<sup>75</sup> Using these definitions they reached the conclusion that Hunter Wise’s purported delivery could not have been “actual” because they did not own enough metal to fulfill the contracts by delivering the metals.<sup>76</sup> As a result, Hunter Wise was subject to the CEA’s regulations and the CFTC’s jurisdiction.<sup>77</sup>

Again, in the 2018 case of *Southern Trust Metals*, the CFTC received favorable judgment against a company purporting to allow customers to enter

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65. See generally CFTC v. Hunter Wise Commodities, LLC, 749 F.3d 967 (11th Cir. 2014); CFTC v. Noble Metals Int’l, Inc., 67 F.3d 766, 773 (9th Cir. 1995); CFTC v. S. Tr. Metals, Inc., 894 F.3d 1313 (11th Cir. 2018).

66. *Noble Metals*, 67 F.3d at 773.

67. *Id.*

68. *Id.*

69. *Id.* at 769.

70. *Id.*

71. *Id.* at 773.

72. CFTC v. Hunter Wise Commodities, LLC, 749 F.3d 967, 978 (11th Cir. 2014).

73. *Noble Metals*, 67 F.3d at 773.

74. *Hunter Wise*, 749 F.3d at 978-80.

75. *Id.* at 978-79.

76. *Id.* at 979-80.

77. *Id.*

leveraged trades for retail commodities.<sup>78</sup> Here, Southern Trust represented to its customers that it would allow them to enter leveraged trades, store the metals for the buyer, and allow the buyer to obtain possession via delivery or pickup once their balances were fully paid.<sup>79</sup> However, Southern Trust never entered contracts for the actual metals; they entered into contracts with separate brokers for metal derivatives.<sup>80</sup> Further, the contracts that Southern Trust entered into with the third-party broker clearly stated that they were for metal derivatives, not the actual metals, and that Southern Trust had no legal right to ever receive delivery of the physical metals from which the contracts derived their value.<sup>81</sup> Yet, Southern Trust charged its customers storage fees for metals they never possessed and never had to store.<sup>82</sup> The Defendants again argued that they were sheltered under the actual delivery exception because they could arrange for metals to be delivered to their customers.<sup>83</sup> But because the evidence showed not only that Southern Trust never even owned the metals and that they only traded in derivatives markets instead of physical metals, the court found that they could not possibly have intended to deliver.<sup>84</sup> As a result of this overwhelming evidence, the court held that the actual delivery exception did not apply.<sup>85</sup>

While the aforementioned cases resulted in finding that the exception in which the defendants sought refuge did not apply to them, a court in 2014 barred the CFTC from prosecuting certain violations by finding the actual delivery exception applied.<sup>86</sup> In *Worth*, the CFTC instituted an action for multiple violations of the CEA.<sup>87</sup> The CFTC claimed Worth defrauded its customers, failed to register with the CFTC, and conducted illegal off-exchange transactions.<sup>88</sup> Following the initial filing of their complaint the CFTC sought to amend their complaint to defeat Worth's defense that the actual delivery exception shielded them from all allegations of fraud except for the section 6(c)(1) violations, but their motion was denied.<sup>89</sup> The court held that due to the fact that the CFTC had explicitly stated in earlier pleadings that Worth's conduct satisfied the requirements of the exception and that the definition of actual delivery was not in dispute, allowing them an amendment that would obviate those previous statements was violative of the defendant's due process rights.<sup>90</sup> The court further supported this decision by noting that Worth's conduct was in compliance with the guidance and advice of the CFTC and was confirmed by the

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78. *CFTC v. S. Tr. Metals, Inc.*, 894 F.3d 1313, 1319 (11th Cir. 2018).

79. *Id.* at 1319.

80. *Id.* at 1320.

81. *Id.*

82. *Id.*

83. *Id.* at 1324.

84. *Id.*

85. *Id.* at 1324-25.

86. *CFTC v. Worth Group, Inc.*, No. 13-80796, 2014 WL 11350233, at \*3 (S.D. Fla. Oct. 27, 2014).

87. Complaint for Injunctive and Equitable Relief and Penalties Under the Commodity Exch. Act., *CFTC v. Worth Group, Inc.*, No. 9:13-cv-80796, 2013 WL 10914848 (S.D. Fla. Aug. 13, 2013).

88. *Id.*

89. *Worth Group, Inc.*, No. 13-80796, 2014 WL 11350233, at \*3.

90. *Id.*

monitor to satisfy the exception.<sup>91</sup> The combination of these facts led to the court's denial of the CFTC's motion to amend which stemmed from the unfairness that would result from penalizing Worth when they directly complied with the CFTC's explicit guidance.<sup>92</sup>

#### IV. INSTANT CASE

Judge Siler, Circuit Court Judge for the Ninth Circuit Court of Appeals delivered the opinion for the court in *Monex*.<sup>93</sup> Its analysis of the claim, the Commodity Exchange Act, and The Dodd-Frank Act, led to the conclusion that "actual delivery" in the context of the exception relied upon by Monex, required a meaningful degree of possession of control by the customer.<sup>94</sup> This conclusion by the court resulted in the reversal of the lower court's decision.<sup>95</sup> The court also analyzed and reached conclusions regarding the other counts alleged by the CFTC.<sup>96</sup> However, this Article is only concerned with the discussion of the "actual delivery exception."

As noted above, Monex's defense that the registration and regulation requirements of the CEA did not apply to them because of the actual delivery exception, generated the crux of the court's focus.<sup>97</sup> Monex claimed that its business practices were exempted by the "actual delivery" exception.<sup>98</sup> However, while the court agreed that the contention in this case was decided by the proper construction of the two-word phrase, it concluded that the exception did not apply to Monex's behavior relating to the Atlas program.<sup>99</sup>

The court began by referring to §2(c)2(D)(ii)(III)(aa) of the CEA, which contains the exception that Monex claimed barred the CFTC's claim.<sup>100</sup> Then, after reasoning that the statute did not adequately define "actual delivery," the court turned to the statute's proper interpretation.<sup>101</sup> It began by referring to Black's Law Dictionary, which defines delivery as "the formal act of voluntarily transferring something," and the word actual as "existing in fact."<sup>102</sup> The court supported the use of these definitions by referring to *Hunter Wise*<sup>103</sup>, where the Eleventh Circuit first used them.<sup>104</sup> Viewing the phrase through the lens of the Eleventh Circuit, Monex argued that the only way actual delivery would fail to apply would be if the commodities in question did not exist, as was the case in *Hunter Wise*.<sup>105</sup> However, citing the same case, the court found that the actual

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91. *Id.* at 2.

92. *Id.* at 3.

93. CFTC v. Monex Credit Co., 931 F.3d 966, 969 (9th Cir. 2019).

94. *Id.*

95. *Id.* at 974.

96. *Id.* at 977.

97. *Id.* at 972.

98. *Id.* at 975.

99. *Id.*

100. *Id.* at 973.

101. *Id.*

102. *Id.* (quoting Black's Law Dictionary (9th ed. 2009)).

103. CFTC v. Hunter Wise Commodities, LLC, 749 F.3d 967, 979 (11th Cir. 2014).

104. *Monex*, 931 F.3d at 973.

105. *Id.* at 973-974.

delivery standard was not satisfied simply by the existence of the commodity, but that there must be real and immediate possession by the buyer.<sup>106</sup> The court supported its finding by elaborating that while existence was a prerequisite for delivery, mere existence itself does not satisfy actual delivery.<sup>107</sup>

The court further supported its interpretation by opining that the language of the statute inferred “some meaningful degree of possession or control by the customer.”<sup>108</sup> To bolster these contentions, the court cited multiple cases,<sup>109</sup> narrowing the historic interpretation of the two-worded phrase.<sup>110</sup> Relying on the cited cases, interpretation of congressional intent, and what they referred to as common sense, the court held that “actual delivery” requires the transfer of some degree of possession or control.<sup>111</sup> Nonetheless, Monex stood its ground and argued that allowing the buyer to have possession or control over the commodities that serve as the collateral for purposes of the leveraged trade would result in undermining the purpose and destroying the feasibility of margin accounts.<sup>112</sup> Even though Monex contested the accusations alleged by the CFTC, as a result of the appeal stemming from the lower court granting a motion to dismiss, the court disregarded the contentions and accepted the allegations in the complaint as true.<sup>113</sup> Following the court’s interpretation of the words “actual delivery,” it found that Monex’s practice of simply making “book entries” had not met the exception and therefore reversed the lower court’s dismissal of the CFTC’s claim.<sup>114</sup>

## V. ANALYSIS

When Monex sells a commodity, transfers title to the buyer, and physically delivers it to either the customer or to a depository subject to the sole control of the buyer, they are making actual delivery. The Ninth Circuit’s interpretation of actual delivery needlessly expands regulation beyond their own initial intent and requires the investor to have sole possession of a commodity, which without the use of leverage provided by the broker, they otherwise could not afford. Concededly, while some market regulation is warranted to protect investors, requiring “actual delivery” as the Ninth Circuit defines it is contrary to the purpose of this type of trading, and contradicts the CFTC’s own prior interpretations. In *Monex*, the Ninth Circuit formulated a definition of the phrase “actual delivery” to mean that the consumer must have some degree of actual possession of the traded commodity, even when the commodities are being traded on leverage.<sup>115</sup> However, this decision may simply shift the risk of

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106. *Id.* at 974.

107. *Id.*

108. *Id.*

109. *See Hunter Wise*, 749 F.3d at 979; *CFTC v. Noble Metals Int’l, Inc.*, 67 F.3d 766, 773 (9th Cir. 1995).

110. *Monex*, 931 F.3d at 974.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* at 977.

115. *Id.* at 974.

leverage trading from the investor to whoever is facilitating the trade and penalize the broker who has received multiple assurances their conduct complies with the exception. The following analysis suggests that this interpretation may neither be what legislators intended nor the most reasonable interpretation.

#### *A. Monex's Atlas Program*

Monex gives its customers the opportunity to enter into trades in excess of what they could otherwise afford by allowing them to trade on margin.<sup>116</sup> When they enter into trades, the metals are first delivered to a depository, then the buyer receives title to the metals in the form of a "Commodity Title Transfer Notice."<sup>117</sup> After title has been transferred, they also have the ability to receive verification of deposits as well as other information directly from the depository itself.<sup>118</sup> The transfer of title and ability to ascertain information directly from the depository itself without Monex acting as an intermediary is just one indication that the buyer has control over the metals. The buyer is also free to have the metals shipped to a place of their choice, at their disposition or allow them to remain in the depository for a storage fee.<sup>119</sup> Furthermore, once the consumer has decided to sell the metals that they have bought, they aren't required to sell them back to Monex; instead, the customers are permitted to deal or trade with whomever they wish.<sup>120</sup>

#### *B. The Purpose and Benefits of Trading on Margin*

The purpose of trading on margin, otherwise known as leveraged trading, is to allow an investor to enter into a larger transaction than they otherwise would be able to by essentially borrowing the money from the seller to finance the trade. However, while this does give potential investors the ability to increase profits by allowing them to increase the size of their trade, it is also inherently accompanied by the downside of increased market exposure. This is why leveraged trading is sometimes referred to as a "double-edged sword."<sup>121</sup> When dealing in physical metals bought on margin, the metal itself acts as collateral so that when the buyer defaults, the seller can recover the metals and sell them to recover their own investment.<sup>122</sup> While there is an increased risk when buying physical metals on margin, the same purpose and opportunity for reward exist. Yet in some cases, such purchases are illegal where the trades and practices do not conform to CEA regulations.<sup>123</sup> While it can be illegal for unregistered

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116. THE ATLAS ACCOUNT, MONEX, <https://www.monex.com/docs/atals-brochure.pdf> at 3.

117. *Id.* at 4.

118. *Id.*

119. *Id.*

120. *Id.*

121. Nick Lioudis, *Forex Leverage: A Double-Edged Sword*, INVESTOPEDIA (June 2, 2009), [https://www.investopedia.com/articles/forex/07/forex\\_leverage.asp](https://www.investopedia.com/articles/forex/07/forex_leverage.asp).

122. *Id.*

123. *The Risks of Buying Gold, Silver & Platinum*, U.S. COMMODITY FUTURES TRADING COMM'N., <https://www.cftc.gov/sites/default/files/idc/groups/public/@cpfraudawarenessandprotection/documents/file/cppreciousmetalsfraudbrochure.pdf>.

brokers to sell commodities on margin, they are allowed to legally do so if the buyer receives actual delivery within twenty-eight days.<sup>124</sup>

In addition to allowing investors to increase their market stake, margin trades contribute directly to market participation.<sup>125</sup> The availability of margin as a utensil for market participants has beneficial effects on market liquidity which correlate directly to the overall health of markets.<sup>126</sup> This positive effect has been recorded most directly in studies of equity markets; however, the similarities shared between commodity and equity markets for purposes of speculative trading increase the likelihood that margin may have the same effect on commodity market participation.

### *C. Defining Actual Delivery*

All of the litigation referenced by the court in an attempt to determine whether or not Monex may continue to practice its off-market trading has resulted from the ambiguity of the statute itself. Nowhere in the statute are the words *actual delivery* defined. As a result, the courts have had to rely on what they believed the legislators intended the phrase to mean as well as case law, in which each set of facts differs. However, the CFTC has given guidance throughout the years as to what it believes it meant as well as how it intended to apply the rules in order to further its goals.

Even before the enactment of Dodd-Frank, the CFTC previously alluded to what it meant to make delivery.<sup>127</sup> The commissioner of enforcement specifically stated that the exact conduct that Monex was practicing, delivering the commodities and transferring title, was not the type of conduct warranting the CFTC's concern at the time they were proposing legislation to further regulate retail commodities markets.<sup>128</sup> He stated concisely that they were only attempting to regulate leveraged transactions in which there was no expectation of delivery.<sup>129</sup> Further, in 2013, after Dodd-Frank was enacted, the CFTC explicitly noted that transferring title to the buyer and housing the metals in an independent depository was permitted as a way to comply with the actual delivery exception.<sup>130</sup> When the CFTC has given such longstanding and clear guidance on what type of conduct complies with actual delivery exception, it is reasonable to expect that a broker following that guidance and structuring their conduct accordingly would fall within that exception. Yet, even though Monex transferred title to the buyers who entered trades through the Atlas Program, deposited the metals in an insured depository, and allowed the buyer to collect once full payment was made, the CFTC still alleged that they failed to make actual delivery.<sup>131</sup>

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124. *Id.*

125. See Kahraman & Tookes, *supra* note 2 at 1597 for a study finding positive correlation between availability of margin and market liquidity in equity markets.

126. *Id.*

127. See Zelener Hearing, *supra* note 57, at 23.

128. *Id.*

129. *Id.*

130. 78 Fed. Reg. 52426-01.

131. *CFTC v. Monex Credit Co.*, 931 F.3d 966, 971 (9th Cir. 2019).

Using the CFTC's own guidance and prior interpretations of how to effectuate actual delivery leads to a more reasonable interpretation than that created by the Ninth Circuit. A more reasonable interpretation of actual delivery would be to require tender of the materials within 28 days to either a depository or the buyer themselves, thus allowing the buyer to obtain possession upon payment of the leveraged amount. This interpretation effectuates the intent expressed by the CFTC in 2009 while not increasing the risk incurred by the brokers themselves. Support for this interpretation lies in the differentiation between Monex's ownership and sale of actual metals compared to the conduct of the other brokers, which courts have found fail to comply with the actual delivery requirement.<sup>132</sup>

In *Noble*, the holding was warranted as the buyer of the metals never actually had the opportunity or ability to obtain the metals, and the *only* thing that happened was a book transfer of title.<sup>133</sup> The fact that the broker in *Noble* never actually had the metals they were selling demonstrates a scenario that clashes with the purpose of the CFTC's goals of regulating trades where delivery was never actually anticipated.<sup>134</sup> The conduct in *Noble* is the exact conduct that the CEA and CFTC seek to prevent. The differentiation between *Noble* and *Monex* is the anticipation or potential for delivery. While the buyers in *Noble* did not have the opportunity to obtain the metals, buyers in the Atlas Program could obtain them upon completion of payment and closing the open trade.

Next, in *Hunter Wise*, the court found that actual delivery was not possible because the firm did not actually own the metals that they were selling to their customers.<sup>135</sup> Without the existence of the metals that one is allegedly selling to its clients, actual delivery is in fact impossible. Therefore, just as in *Noble*, *Hunter Wise* never intended to provide the opportunity to the buyer to obtain possession of the metals, which again is consistent with the type of fraudulent trades the CFTC seeks to regulate. However, in the case at hand, Monex does own the metals it is selling. It can, and does, store the metals in depositories across the country in which the buyer can retrieve them if the buyer chooses to complete payment.

Defining actual delivery as tendering the metals to the buyer at either a depository or any other place of delivery in which they so desire allows legitimate brokers to continue to function while prohibiting the type of conduct discussed in these cases. The ability to tender the metals complies with the idea that to make actual delivery, the metals must both exist, and the buyer must have the opportunity to obtain them upon payment. This interpretation better allows the CFTC to prevent fraudulent sales in which the brokers do not actually have the metals or do not intend to ever present them to the buyer. Furthermore, this interpretation avoids the sharp deviation from the previous guidelines set by the CFTC themselves, which would prevent the deterioration of confidence that

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132. See *CFTC v. Hunter Wise Commodities, LLC*, 749 F.3d 967 (11th Cir. 2014); see also *CFTC v. Noble Metals Int'l, Inc.*, 67 F.3d 766 (9th Cir. 1995).

133. See *Noble Metals*, 67 F.3d at 769.

134. *Id.*

135. See *Hunter Wise*, 749 F.3d at 979-80.

brokers would receive by conducting their business in compliance with guidance provided by regulatory agencies that would likely result if the Ninth Circuit's interpretation becomes the new standard.

Under this alternate interpretation, Monex's conduct carried out during business transactions and trades related to the Atlas Program would comply with the actual delivery exception. As the then acting director of the CFTC stated, their intention was never to regulate trades in which the seller transferred title to the buyer and deposited the metals in a depository or alternatively delivered them. That is exactly what Monex did and has done since the inception of the Atlas Program in 2011. Therefore, it should not be required to register with the CFTC, abide by the regulations set out in the CEA, nor be subject to the litigation in the case at hand.

#### *D. Potential Consequences*

The Ninth Circuit's definition of actual delivery is much too narrow. If brokers such as Monex are required to relinquish all control of metals bought via sales financed by the broker themselves, then the risks posed to those brokers increases exponentially. The fact that the metal itself is the collateral for the money loaned to the buyer supports the idea that allowing the metals to be stored in an independent depository is more aligned with what the drafters of Dodd-Frank intended. Under the Ninth Circuit's interpretation of what constitutes actual delivery, brokers such as Monex would likely be less inclined to offer the volume of leveraged trades they currently do, due to the increased risk which would deprive participants of the ability to leverage their investments and decrease market access and liquidity. If the CFTC is allowed to change its interpretation based on one court decision, as they attempted to in *Worth*, it would create another element driving the decrease in these types of trades that could have a potentially drastic effect on the market. It could drastically deteriorate the confidence that complying with regulatory guidance would render a participant safe from prosecution. This effect likely would not be isolated to Monex alone. For instance, in October 2015, there were over 6.7 million off-exchange retail transactions in the United States alone.<sup>136</sup> As a result, there would likely be fewer brokers offering leverage options to buyers and investors, which in turn, would decrease market fluidity and deprive those investors of the opportunity to enter the market. Along with the possibility that some firms will choose not to participate in margin trading to evade conflict with the ambiguous government statutes, the increased regulation that comes along with this interpretation itself poses significant additional costs that may drive out smaller firms altogether resulting in fewer market participants and less market liquidity.<sup>137</sup>

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136. REPORT ON THE IOSCO SURVEY ON RETAIL OTC LEVERAGED PRODUCTS FINAL REPORT, THE BD. OF THE INT'L ORG. OF SEC. COMM'N. (2016), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD550.pdf> (last visited Feb. 26, 2023).

137. See Kahraman & Tookes, *supra* note 124; see also *Clarity on Commodities Trading*, KPMG (2016), <https://assets.kpmg/content/dam/kpmg/pdf/2016/04/ch-2016-clarity-on-commodities-trading-en.pdf>.



Another negative side effect of this narrow reading of the statute is the possible imposition of criminal charges against brokers who have unknowingly violated CEA regulations.<sup>138</sup> The CFTC, in the process of investigating violations of the CEA, may report any alleged violations to the Department of Justice in order to pursue criminal prosecution.<sup>139</sup> As a result of the ambiguity of the statutory exception, those who have unknowingly violated CEA provisions could then face criminal charges for violating laws that they were not aware were applicable. The confusion resulting from this ambiguity in the law would be amplified if the CFTC were to seek both civil and criminal recourse against a defendant as the statutes would be subject to two separate modalities of interpretation depending on whether the trial was civil, which would implicate a *Chevron* deference,<sup>140</sup> or criminal which would require application of the *Lenity*<sup>141</sup> Doctrine.<sup>142</sup> As a result of the two different standards or methods of determining the meaning of the regulations the possibility for differing outcomes exists. This is especially risky with a phrase that has been proven as ambiguous as the phrase in the case at bar, which is only muddled by the changing CFTC interpretations and litigation.

## VI. CONCLUSION

The Ninth Circuit's definition of actual delivery substantially fails to align with the goals of both the CEA and those who advocated for the inclusion of the exception in Dodd-Frank. Holding that "actual delivery" requires a degree of possession by the investor may provide investors with increased protection, but this interpretation places further restriction on market transactions by increasing the burden on facilitators such as Monex.

As Monex argued, actual delivery in the retail commodity market was never intended to mean that the investor *must* have possession and control, only that they had the opportunity to. When dealing with leveraged or margin trades in retail commodities, this exception should apply whenever the commodity being traded resides in a neutral depository, titled in the name of the buyer, and is equally accessible by either party upon either the payment of the leveraged amount by the investor or the liquidation of the trade by the facilitator. In fact, this is the definition that most explicitly complies with the 2009 and 2013 guidance of the CFTC. This is exactly what Monex was doing. Further, this interpretation allows such facilitators the ability to continue offering reasonable trading options such as margin accounts, thereby affording the investors the

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138. *Enforcement*, COMMODITY FUTURES TRADING COMM'N., <https://www.cftc.gov/LawRegulation/Enforcement/OfficeofDirectorEnforcement.html> (last visited Feb. 26, 2023).

139. *Id.*

140. Courts in civil matters will refer to an administrative agencies interpretation of a statute they implemented. *See Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

141. In criminal law, the rule of lenity requires courts to resolve statutory ambiguities in favor of the defendant. *See infra* note 142.

142. *The Rule of Lenity: A five-minute guide to navigating the intersection of administrative and criminal law*, THE FEDERALIST SOC'Y (May 1, 2017), <https://fedsoc.org/commentary/fedsoc-blog/the-rule-of-lenity-a-five-minute-guide-to-navigating-the-intersection-of-administrative-and-criminal-law>.

chance to assume the market risks in return for the potential to receive benefits that they otherwise could not obtain. Finally, this interpretation is the interpretation that both complies with the goals of the CEA and respects the idea that while some market regulation is warranted, excessive regulation can be harmful.

The second word in the name of the CFTC is *futures*, implicating the idea that the CFTC'S jurisdiction would be limited to the sale of futures contracts, and not the sales of all commodities. Even with the expansion of their jurisdiction, as a result of the enactment of Dodd-Frank, the CFTC still lacks jurisdiction over sales in which physical metals are bought or sold, when the buyer may obtain possession within 28 days.

When Monex enters a trade, gives title to the buyer, and allows the buyer to collect the metals upon full payment, it seems difficult to believe that actual delivery is not at least contemplated if not definitely occurring. This type of purported delivery seems to be in compliance with the actual delivery exception, most obviously because it is exactly what the CFTC has explicitly permitted for years. The CFTC should not be allowed to abruptly reverse its interpretation and decide what business models are subject to their regulations and punish them simply because those businesses facilitate transactions concerning retail commodities. The Atlas Program deals in the sale of actual, physical metals and not derivative or futures contracts over which the CFTC has jurisdiction or authority. Therefore, the Ninth Circuit incorrectly held that Monex was bound by the burdensome regulations of the CEA, as their conduct should have been found to constitute actual delivery.