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I. Introduction

Congress substantially amended the Commodity Exchange Act (the CEA)[1] in 1974[2] to provide additional protection to persons trading in commodity futures contracts, commodity options, and "leverage" transactions[3] and to place such transactions within the exclusive jurisdiction of the Commodity Futures Trading Commission (CFTC).[4] As the result, however, of continued abuses in commodity options and increased public trading[5] in exotic, new financial futures such as stock index[6] and Government National Mortgage Association (GNMA) futures contracts,[7] Congress twice recently has significantly amended the CEA to broaden those protections.[8] This Article reviews customer rights and remedies now available under the CEA. Specifically, part II of this Article explores the scope of transactions covered by the CEA,[9] part III addresses the antifraud provisions of the CEA,[10] and part IV discusses the standard of intent required to prove that fraud has been

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1. 7 U.S.C. §§ 1-22 (1982).

2. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389.

3. 7 U.S.C. §§ 1-22 (1982).

4. 7 U.S.C. § 2 (1982).

5. In 1972, 18.3 million commodity futures contracts were traded in tbe United States. By 1982 that volume had increased to 112.4 million contracts. 9 *Futures Industry Association Report* 6 (Feb. 1973); *see* Comptroller General, Report to the Congress, Commodity Futures Regulation—Current Status and Unresolved Problems 1 (July 15, 1982). "Last year, trading volume in financial futures soared to 42 million contracts from 29 million just a year earlier and 3.9 million five years before." N. Y. Times, Apr. 24, 1983, at 3, col. 1. In 1982 approximately 30 million financial futures contracts and 45 million agricultural commodity futures contracts (*e.g.*, soybeans and pork bellies) were traded, a decline in the latter from some 60 million contracts in 1980 and an increase in the former in that same year from some 15 million contracts. *Id.*

6. A stock index futures contract is a theoretical agreement to purchase a portfolio of stocks based on an index such as Value Line or the Dow Jones Industrial Average. Unlike an ordinary futures contract, actual delivery is not permitted with a stock index future contract. Markham & Gilberg, *Washington Watch: Stock Index Futures,* 6 Corp. L. Rev. 59, 61 (1983).

7. U.S. Treasury Department, Treasury/Federal Reserve Study of Treasury Futures Markets (May 1979). For an examination of the SEC's authority to regulate trading in GNMA certificates, see Board of Trade v. SEC, 677 F.2d 1137 (7th Cir.) (prohibiting trading of GNMA's pending action by the CFTC denying the authority of the SEC to regulate such trading), *vacated as moot,* 459 U.S. 1026 (1982).

8. *See* Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (1983) (codified as amended at 7 U.S.C. § 1 (1982)); Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865 (current version at 7 U.S.C. § 1 (1982)).

9. *See infra* notes 16-41 and accompanying text.

10. *See infra* notes 42-178 and accompanying text.

committed under CEA provisions.[11] Part V of this Article examines the secondary liability of brokerage firms and others for the fraudulent acts of its employees,[12] part VI discusses fiduciary liability under the CEA,[13] and part VII enumerates the various forums available for customer remedies.[14] This Article concludes in part VIII with suggestions for improving dispute resolution in the commodity industry.[15]

II. Transactions Subject to the CEA

A. *Commodity Futures Transactions*

A commodity futures contract is a legally binding commitment to purchase or sell a specified quantity of a commodity with delivery effected at a specified time in the future. The terms of a futures contract are standardized, with the exception of the price, which is determined by market forces.[16] Commodity futures contracts are traded on margin,[17] which allows substantial leverage that may compound gains or losses as the price of the commodity changes. If such fluctuations are adverse to the customer's positions, the customer will be required to post additional "variation" or "maintenance" margin payments at least roughly equal to the amount of loss caused to the investor by the adverse market move.[18] Margin calls must be met promptly, and if they are not so

11. *See infra* notes 179-204 and accompanying text.
12. *See infra* notes 205-19 and accompanying text.
13. *See infra* notes 220-36 and accompanying text.
14. *See infra* notes 237-54 and accompanying text.
15. *See infra* part VIII.
16. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 357-58 (1982). For example, a futures contract on silver traded on the Commodity Exchange, Inc. (COMEX) provides for delivery of 5000 ounces of silver at a stated time in the future and at a price negotiated by the parties upon execution of the contract. The *seller* of the futures contract undertakes an obligation to deliver 5000 ounces of silver, and is therefore said to have taken a "short" position (*i.e.*, he is "short" the silver). The *purchaser* of the contract, required to accept delivery of the silver, is referred to as taking a "long" position. Commodity Futures Trading Commission, Report to the Congress in Response to Section 21 of the Commodity Exchange Act, Pub. L. No. 96-276, ch. II, at 6, 96th Cong., 2d Sess. § 7, 94 Stat. 542 (1980) [hereinafter cited as CFTC Silver Report.
17. The margin on a commodity futures account, unlike its counterpart in the securities industry, does not represent an extension of credit, but is a "performance bond" or "earnest money" which serves as an assurance of the customer's good faith performance under the terms of the futures contract. Both the purchaser and seller of the futures contract are required to post margin payments. The amount of margin required is fixed as that amount deemed necessary to assure performance. The initial margin requirement generally represents a small percentage of the total value of the futures contract. CFTC Silver Report, *supra* note 16, ch. II, at 8.
18. P. Johnson, Commodities Regulation § 1.10, at 31, 32 (1982).

met, the broker has the right, and may be required by exchange rules,[19] to liquidate the customer's account. The risks of commodity futures trading are thus accentuated by the potential necessity for the customer to raise and commit sizable amounts of additional liquid funds, often in a very short period of time.

Trading risks are exacerbated further through imposition of "price limits" by contract markets, which restrict the extent to which the price of a particular commodity may drop ("limit down") or increase ("limit up") in the course of a trading day. Designed to maintain orderly trading in the market, these price limits may force an investor to maintain a loss position.[20]

Investors may engage in commodity futures trading solely for speculative purposes. A speculator taking a "long" position[21] in a particular commodity anticipates an increase in the price of that commodity prior to the delivery date. If the price rises he is able to sell the commodity at a market price higher than his purchase price and profit from the transaction. Conversely, if the price falls he will be obligated to sell the commodity at a price below the purchase price and will suffer a loss. Accordingly, the trader is speculating against the future price of the commodity.[22]

Trading commodity futures contracts also may be used to "hedge" business risks.[23] For example, an institution with a widely based stock portfolio or that is anticipating an overall drop in stock market values for a short term may, instead of selling the portfolio, hedge that market risk by entering into a stock index futures contract. This futures contract would reflect the overall drop in market prices and allow the institution to receive profits from the transaction that would offset, at least to some extent, losses in the institution's portfolio.[24]

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19. *See, e.g.,* Margin Rule H of the COMEX.

20. *See, e.g.,* Silver Trading Rule 5 of the COMEX. If a maximum price limit is reached (*i.e.,* a "limit up" or "limit down" market), a futures trader might be unable to liquidate a position (except possibly under a complicated "switching" arrangement), because maximum losses are "locked in" at the prevailing cash price for the commodity. The existence of a "locked limit" market may, therefore, force the trader to maintain a loss position and, if price limits continue over a number of days or become even more restrictive, increase the trader's losses.

21. A "long" position is the posture taken by the purchaser of the futures contract. *See supra* note 16.

22. *See* CFTC SILVER REPORT, *supra* note 16, ch. II, at 6; P. JOHNSON, *supra* note 18, § 1.14.

23. P. JOHNSON, *supra* note 18, § 1.12.

24. Markham & Gilberg, *supra* note 6, at 61. Only a very small percentage of all futures contracts result in the actual delivery of a physical commodity. *Id.* at 60 & n.5. In-

B. Commodity Options Transactions

A commodity option contract is a right for a limited period of time to purchase or sell a specified amount of a commodity or a commodity futures contract at a specified exercise or "striking" price.[25] The option right expires unless exercised by the purchaser. The writer of the option right pays a premium to the seller for the right. The option to buy is referred to as a call option, while the right to sell is commonly referred to as a put option.[26] Unlike commodity futures contracts, options offer the advantage of limiting the holder's liability to the amount of the premium paid while offering the opportunity to profit through a leveraged investment. The writer of an option, however, is liable to the full extent of any price changes. Therefore, the risk to the seller of a call option is comparable to that of a futures contract, although the option writer's losses are offset by the amount of the premium paid.[27]

Various forms of commodity options exist including "dealer" options which are backed by an inventory of the commodity, "naked" options which are not backed by anything other than the credit of the writer of the option, "London" options which are traded on the London markets, and, today, options traded on United States contract markets.[28] Commodity options trading historically has been a matter of concern under the CEA because of the many abuses that have arisen in connection with these instruments.[29] Those abuses were a precipitating factor in the enactment of the CEA and the creation of the CFTC in 1974,[30] when the CFTC was granted exclusive jurisdiction over commodity options.[31] The CFTC, however, was unable to stem a flood of "boiler room" operations, including one scandal concerning an escaped

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stead, the majority of commodity futures traders "liquidate" their contractual obligations by assuming an "offsetting" position. For example, a trader with a "long" position in a commodity may, rather than accepting delivery, enter into a "short" position in the same commodity for delivery in the same month. The trader would then hold both sides of the futures contract and extinguish the obligation. CFTC SILVER REPORT, *supra* note 16, ch. II, at 6.

25. P. JOHNSON, *supra* note 18, § 1.07, at 16.

26. *Id.*

27. *See generally* Markham & Gilberg, *Stock and Commodity Options—Two Regulatory Approaches and Their Conflicts*, 47 ALB. L. REV. 741, 756-59 (1983) (the authors discuss, *inter alia*, tbe mechanics of commodity option trading).

28. *Id.* at 757-59.

29. For a discussion of the nature and history of commodity options and their abuses, see P. JOHNSON, *supra* note 18, § 1.07; Lower, *The Regulation of Commodity Options*, 1978 DUKE L.J. 1095, 1098-99; Markham & Gilberg, *supra* note 27, at 747-56.

30. *See* H.R. REP. No. 975, 93d Cong., 2d Sess. 37 (1974).

31. 7 U.S.C. §§ 2, 6c (1982).

felon who operated a commodity firm on a nationwide basis.[32] As a result of those scandals, the CFTC[33] and later Congress[34] imposed a moratorium on all commodity options sales with the exception of certain "dealer" and commercial options and, more recently on a limited basis, commodity options traded on United States exchanges.[35]

C. *Leverage Transactions*

The CFTC also is given exclusive jurisdiction over so-called "leverage" transactions.[36] Leverage transactions generally contain a standardized agreement to purchase a specified quantity of a commodity such as gold or silver. The purchaser pays a portion of the purchase price at the outset and agrees to buy the commodity at a specified price with a delivery date at a specified time in the future. In addition to the initial payment, purchasers must pay a sales commission or markup along with maintenance, interest, and other finance charges connected with the seller's theoretical obligation to carry the commodity for the purchaser during the term of the contract. Actually, leverage merchants may not own the commodity but instead protect themselves through offsetting futures contracts or other means.[37]

The CFTC has imposed a moratorium on the expansion of trading in leverage contracts with one exception. A grandfather provision was adopted that allowed firms already engaged in leverage contract trading to continue.[38] The CFTC also, at one point, determined to regulate leverage contracts as futures contracts, which effectively would have banned their sale.[39] The CFTC later

32. *See* Kelley v. Carr, 442 F. Supp. 346 (W.D. Mich. 1977), *aff'd in part and rev'd in part*, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,025 (6th Cir. May 16, 1980); Markham & Gilberg, *supra* note 27, at 763-68; *see also* CFTC v. Crown Colony Commodity Options, Ltd., 434 F. Supp. 911 (S.D.N.Y. 1977); CFTC v. J.S. Love & Assoc. Options, Ltd., 422 F. Supp. 652 (S.D.N.Y. 1976); *In re* British Am. Commodity Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,526 (C.F.T.C. Dec. 2, 1977).

33. 17 C.F.R. § 32.11 (1984).

34. 7 U.S.C. § 6c (1982).

35. 17 C.F.R. § 33 (1984). *See generally* Markham & Gilberg, *supra* note 27, at 759-69.

36. 7 U.S.C. § 23 (1982).

37. *See* Matthews v. Monex Int'l, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,791 (C.F.T.C. Mar. 16, 1979).

38. *See* 17 C.F.R. § 31.1 (1984).

39. Leverage contracts are not traded on futures contract markets. Congress authorized the CFTC, by amendment to the CEA in 1974, to determine whether leverage transactions should be regulated in the same manner as futures contracts, which are required to be traded on exchanges. *See* S. REP. No. 1131, 83d Cong., 2d Sess. 41 (1974). That determination was made by the CFTC in 1979. *See* Regulation of Leverage Transactions as Contracts

postponed the implementation of that decision,[40] however, and more recently Congress amended the CEA to require the CFTC to adopt a comprehensive regulatory scheme for such transactions, to remove the grandfather restriction, and to prevent the treatment of such transactions as futures contracts.[41]

III. Customer Right to Protection from Fraud Under the CEA

A principal protection for customers under the CEA is its antifraud prohibitions. One such provision, section 6b,[42] makes it unlawful for any person, in connection with the purchase or sale of futures contracts, "to cheat or defraud or attempt to cheat or defraud" any other person, to make or cause to be made any false statement or misrepresentation, or to "bucket"[43] a customer's order by failing to execute such order on a contract market. In addition, the CEA contains an express antifraud prohibition governing the activities of commodity pool operators and commodity trading advisors.[44] The CFTC also has adopted antifraud rules for futures contracts traded on foreign exchanges,[45] commodity options transactions,[46] and leverage transactions.[47] The following discussion outlines various fraud claims that have been made under the CEA and the corresponding CFTC attempts to develop those theories.

A. *Suitability*

The concept of "suitability" is traceable to securities exchange rules that required brokers to "know your customer"; a broker

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for Future Delivery, 44 Fed. Reg. 44,177 (1979); *see also In re* First Nat'l Monetary Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,707 (C.F.T.C. Apr. 29, 1983).

40. *See* Regulation of Leverage Transactions as Contracts for Future Delivery; Postponement of Effective Date, 44 Fed. Reg. 69,304 (1979).

41. *See* Futures Trading Act of 1982, H.R. Rep. No. 964, 97th Cong., 2d Sess. 50, 51; Horwitz & Markham, *Sunset on the Commodity Futures Trading Commission: Scene II,* 39 Bus. Law. 67, 86-97 (1983). Congress allowed the CFTC to prohibit leverage contracts in any commodity that was not already the subject of leverage trading on December 9, 1982, if the CFTC determined that such trading was contrary to public interest. Futures Trading Act of 1982, H.R. Rep. No. 964, *supra*, at 50. The CFTC has issued interim final rules to govern leverage transactions on commodities already the subject of trading. Regulation of Certain Leverage Transactions, 49 Fed. Reg. 5498 (1984).

42. 7 U.S.C. § 6b (1982).

43. *Id.*; *see infra* notes 176-77 and accompanying text.

44. 7 U.S.C. § 60 (1982).

45. 17 C.F.R. § 30.02 (1984).

46. *Id.* § 32.9.

47. *Id.* § 31.3 ; *see* Mitchell v. Premex, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,678 (C.F.T.C. Feb. 10, 1983).

must assure itself that its customers are able to meet their obligations.[48] This duty was later expanded to impose an obligation on securities brokers to refrain from making recommendations to customers that were not suitable in light of the customers' finances, needs, and objectives.[49] This expansion, however, of the "know your customer" rule has not been broadly applied. Its use is most frequently confined to "boiler room" operations that utilize high pressure telephone sales campaigns for speculative low price securities.[50]

At an early stage of its existence, the CFTC was faced with numerous "boiler room" sales operations. These operations generally involved the offer and sale of commodity options without any consideration of the suitability of those transactions for individual customers.[51] For example, in *CFTC v. Crown Colony Commodity Options, Ltd.*,[52] the district court held that the defendant had engaged in fraud by operating "a 'boiler room' operation calculated to sell as large a volume of options as possible to customers throughout the United States *without regard to the suitability* of the investment for customers . . . ."[53] The court noted that the defendants were "crass and callous" in their indifference to the needs of their customers.[54] Similarly, in *Kelley v. Carr*,[55] defendants also participated in a "boiler room" operation. The district court concluded that the defendants had made no attempt to counsel clients or to consider their financial position to determine whether customers could realistically afford to purchase the commodity options being offered.[56]

As a result of these types of abuses, the CFTC proposed a rule that would prohibit persons registered with the CFTC from recom-

48. *See, e.g.*, New York Stock Exchange Rule 405.

49. *See* 17 C.F.R. § 106-3 (1984); N. WOLFSON, R. PHILLIPS & T. RUSSO, REGULATION OF BROKERS, DEALERS AND SECURITIES MARKETS ¶ 2.08 (1977).

50. *See* N. WOLFSON, R. PHILLIPS & T. RUSSO, *supra* note 49, ¶ 2.08, at 2-36.

51. See Lower, *supra* note 29, at 1095, 1098-99; Schobel & Markham, *Commodity Options — A New Industry or Another Debacle?*, SEC. REG. & L. REP. (BNA) No. 347 (Special Supp.) (Apr. 7, 1976).

52. 434 F. Supp. 911 (S.D.N.Y. 1977).

53. *Id.* at 918 (emphasis added).

54. *Id.* at 919.

55. 442 F. Supp. 346 (W.D. Mich. 1977), *aff'd in pertinent part and rev'd in part on other grounds*, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,025 (6th Cir. May 16, 1980).

56. *Id.* For a discussion of these and other "boiler room" cases, see Schief & Markham, *The Nation's "Commodity Cops" — Efforts by the Commodity Futures Trading Commission to Enforce the Commodity Exchange Act*, 34 BUS. LAW. 19, 21-26 (1978).

mending a commodity transaction to a customer unless that customer was determined to be suitable for the transaction.[57] The CFTC subsequently concluded, however, that the adoption of such a rule merely would codify principles already implicit in the Act and unintentionally narrow the scope of existing standards.[58] Notwithstanding the CFTC's failure to adopt a suitability rule, various CFTC administrative law judges thereafter held that the CEA contemplated suitability violations.[59] The CFTC subsequently stated, however, that it rejected an administrative law judge's suggestion that there was a suitability requirement implicit in the CEA.[60] In another decision,[61] the CFTC expressly disavowed the decision of another administrative law judge who had stated that suitability is a basis for recovery under the CEA.[62] In addition, the Eighth Cir-

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57. The proposed rule stated that a registrant could not recommend a trade unless:

> (1) . . . the professional obtained from the customer, before the recommendation or trade, the essential facts about the customer's financial condition and trading objectives . . . ; and (2) . . . the professional had reason to believe, at the time of the recommendation or trade, that the position would be 'suitable' for the customer based on tbe information known to the professional. The suitability of a position would depend on whether the risk of loss involved was (a) one that the customer could safely assume in light of his financial condition and (b) consistent with the customer's trading objectives.

Proposed Standards of Conduct for Commodity Trading Professionals for the Protection of Customers, 42 Fed. Reg. 44,742, 44,743 (1977) (to be codified at 17 C.F.R. pt. 1, 166) (1977) [bereinafter cited as Proposed Standards of Conduct].

58. Adoption of Customer Protection Rules, 43 Fed. Reg. 31,886, 31,889 (1978).

59. For example, in Dwyer v. Murlas Bros. Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,520 (C.F.T.C. Nov. 21, 1977), a CFTC administrative law judge held that a widow who was solicited by a salesman at her husband's funeral and whose income was insufficient to meet her expenses was an unsuitable client for commodity futures transactions that were financed through the proceeds of her deceased husband's life insurance policy. *See also* Guzy v. Chartered Sys. Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,081 (C.F.T.C. July 14, 1980); Zoldessy v. Thomson & McKinnon Aucbincloss Kohlmeyer, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,798 (C.F.T.C. Mar. 19, 1979); Russo v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,513 (C.F.T.C. Nov. 4, 1977); *cf.* Rosenbaum v. E.F. Hutton & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,954 (C.F.T.C. Dec. 3, 1979).

60. Avis v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,379, at 25,830 n.4 (C.F.T.C. Apr. 13, 1982) (citations omitted). The CFTC's chief administrative law judge in a subsequent case concluded that the CFTC's decision in *Avis* "foreclosed any suggestion that suitability principles may be unplicit even in the antifraud provisions of the Act." Vaneck v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,697, at 26,733 (C.F.T.C. Mar. 30, 1983).

61. Jensen v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,062 (C.F.T.C. July 28, 1981).

62. *Id.* at 24,286. Subsequent decisions of CFTC administrative law judges have accordingly declined to find a right of action for suitability. *See, e.g.*, Kats v. Merrill Lynch Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,998

cuit held in *Myron v. Hauser*[63] that because the CFTC had not developed any suitability standard, the court could not find a violation of the CEA on the basis of a claim of suitability.[64] More recently a district court relying on *Myron* and the CFTC's earlier decisions,[65] held that no suitability requirement exists under the CEA.[66] Similarly, another district court held that there was no suitability standard under the CEA because of the difficulty that the CFTC had encountered in formulating meaningful standards of universal application.[67]

These decisions should not be construed, however, as a CFTC determination that customer suitability protection is not warranted. Rather, the CFTC has substituted specific disclosure requirements that advise the customers in simple boldface language of the risks they face in commodities trading. Thus, the CFTC imposes upon the customer, rather than the broker, the duty to assess trading risks in determining whether to accept a broker's recommendation.[68] For example, the CFTC recently approved a pilot program for exchanges that trade in commodity options. The specified disclosures that the program requires commodity brokers to make to customers contain a provision which states that commodity option trading is not suitable for everyone, and investors should consider their own situations to determine whether such trading is suitable for them.[69]

(C.F.T.C. Feb. 3, 1984); Hatami v. Smith Barney, Harris Upham & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,800 (C.F.T.C. June 30, 1983); Ryan v. Pearson, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,741 (C.F.T.C. May 27, 1983); Vaneck v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,697 (C.F.T.C. Mar. 30, 1983).

63. 673 F.2d 994 (8th Cir. 1982).

64. *Id.* at 1005-06; *see also* Sherry v. Diercks, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,221 (Wasb. Ct. App. May 26, 1981) (state court held tbat a suitability claim could not be made under the CEA or under state common law because the customer maintained a nondiscretionary commodity futures trading account). *But see* International Cattle Sys. v. Parsons, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,367 (D. Kan. Mar. 9, 1982) (district court denied summary judgment on suitability claims without analysis of whetber suitability exists under tbe CEA).

65. *See supra* notes 60 & 63 and accompanying text.

66. Hoetger & Co. v. Asencio, 558 F. Supp. 1361, 1364 (E.D. Mich. 1983).

67. Shearson Loeb Rhoades, Inc. v. Quinard, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,686 (C.D. Cal. Mar. 11, 1983); *accord* Applegate v. Dean Witter Reynolds, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,881 (S.D. Fla. Jan. 17, 1983).

68. *See* Adoption of Customer Protection Rules, 43 Fed. Reg. 31,886, 31,888 (1978).

69. This disclosure requirement states in part that:

BECAUSE OF THE VOLATILE NATURE OF THE COMMODITIES MARKETS THE PURCHASE AND GRANTING OF COMMODITY OPTIONS INVOLVE A HIGH DEGREE OF RISK. COMMODITY OPTION

The suitability issue also remains unresolved by the CFTC and in the courts. In a recent decision by the District of Columbia Court of Appeals, the court stated that the Commission had not actually rejected a suitability right of action in the *Jensen* and *Avis* cases. The CFTC, rather, had simply "reserved the question whether a suitability requirement is implicit in the Act."[70] Following the lead of the District of Columbia Court of Appeals, a CFTC administrative law judge concluded that there is a suitability right of action under the Act, rejecting the decisions in *Myron* and *Hoetger* and concluding that the *Jensen* and *Avis* cases did not undercut a right of suitability.[71]

B. Misrepresentations

The prohibitions against misleading and deceptive statements contained in section 4b and other provisions[72] of the CEA provide the principal CEA customer protection from high pressure "boiler room" commodity option solicitations. For example, in *CFTC v. J.S. Love & Associates Options Ltd.,*[73] the district court concluded that the promotional literature and the *New York Times* advertisement of an option firm was misleading because, while these materials promised large profits and limited risk, the advertisements failed to state that many of the firm's salespersons were inexperienced, the firm's charges for options were exorbitant, profitability claims were unsubstantiated in the advertisement, and commodity options trading "is often highly speculative and is usually engaged in by sophisticated investors."[74] Similarly, in *CFTC v. Crown Colony Commodity Options, Ltd.,*[75] the court held that the commodity options sales presentations at issue were fraudulent be-

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TRANSACTIONS ARE NOT SUITABLE FOR MANY MEMBERS OF THE PUBLIC. SUCH TRANSACTIONS SHOULD BE ENTERED INTO ONLY BY PERSONS WHO HAVE READ AND UNDERSTOOD THIS DISCLOSURE STATEMENT AND WHO UNDERSTAND THE NATURE AND EXTENT OF THEIR RIGHTS AND OBLIGATIONS AND OF THE RISKS INVOLVED IN THE OPTION TRANSACTIONS COVERED BY THIS DISCLOSURE STATEMENT.

17 C.F.R. § 33.7 (1984); *see also id.* §§ 1.55 (disclosure requirements for brokers), 4.21 (disclosure requirements for commodity pool operators), 4.31 (disclosure requirements for commodity trading advisors).

70. Schor v. CFTC, 2 COMM. FUT. L. REP. (CCH) ¶ 22,297, at 29,475 n.12 (D.C. Cir. Aug. 10, 1984).

71. Phacelli v. Conticommodity Servs., Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,345 (C.F.T.C. Sept. 12, 1984).

72. *See, e.g.*, 7 U.S.C. § 60 (1982); 17 C.F.R. §§ 30.02, 32.9 (1983).

73. 422 F. Supp. 652 (S.D.N.Y. 1976).

74. *Id.* at 655-56.

75. 434 F. Supp. 911 (S.D.N.Y. 1977).

cause they "conveyed the distinct impression that extraordinary short-term profits were all but certain to be realized by investors" and because the mechanics of commodity options trading were misrepresented.[76] Numerous other commodity options cases found fraud in promoters' failure to disclose the absence of a secondary market in commodity options,[77] commissions and other charges,[78] the fundamentals of options trading,[79] the lack of registration and experience of commodity options salespersons,[80] and pertinent risks.[81]

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76. *Id.* at 916-17.

77. Wong v. First London Commodity Options, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,834 (C.F.T.C. May 29, 1979).

78. Ettingshaus v. Chartered Sys. Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,897 (C.F.T.C. Sept. 19, 1979); Pickens v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,721 (C.F.T.C. Dec. 11, 1978); Morgan v. Crown Colony Commodity Options, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,622 (C.F.T.C. June 8, 1978); Wolfe v. First Dover Commodities, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,585 (C.F.T.C. Mar. 30, 1978).

79. Hearn v. Economic Sys. Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,802 (C.F.T.C. Apr. 9, 1979) (violations found but decision vacated because of bankruptcy proceedings); Conti v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,722 (C.F.T.C. Dec. 12, 1978); Pickens v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,721 (C.F.T.C. Dec. 11, 1978); Siebenthaler v. First Dover Commodities, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,707 (C.F.T.C. Nov. 14, 1978); Akmajian v. International Commodity Options, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,584 (C.F.T.C. Mar. 29, 1978); Coffman v. Economic Sys. Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,581 (C.F.T.C. Mar. 28, 1978); Flasman v. R.G. Wilson Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,572 (C.F.T.C. Mar. 13, 1978); Sandberg v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,547 (C.F.T.C. Jan. 20, 1978).

80. Woodman v. London Commodity Options, Ltd., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,021 (C.F.T.C. Feb. 29, 1980); Herzig v. British Am. Commodity Options Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,936 (C.F.T.C. Sept. 29, 1979); Bassilios v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,641 (C.F.T.C. July 5, 1978), *vacated in part on other grounds*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,749 (C.F.T.C. Jan. 24, 1979); Troll v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,626 (C.F.T.C. June 16), *vacated in part on other grounds*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,676 (C.F.T.C. Sept. 22, 1978); Sandberg v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,547 (C.F.T.C. Jan. 20, 1978); Russo v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,513 (C.F.T.C. Nov. 4, 1977).

81. Conti v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,722 (C.F.T.C. Dec. 12, 1978); Pickens v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,721 (C.F.T.C. Dec. 11, 1978); Siebenthaler v. First Dover Commodities, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,707 (C.F.T.C. Nov. 14, 1978); White v. R.G. Wilson Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,682 (C.F.T.C. July 26, 1978), *vacated in part on other grounds*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶

The CFTC also has warned that unwarranted profit predictions in connection with commodity options transactions are "inherently fraudulent" whether expressed in terms of opinion or fact.[82] The CFTC's Office of General Counsel similarly has stated that section 4b of the CEA prohibits any suggestion or claim of profit potential that does not fairly represent the possibility of loss and has proscribed any predictions or recommendations that are not explicitly labeled or do not have a reasonable basis in fact.[83] CFTC administrative law judges have concluded that section 4b is violated when a customer is promised that losses will be limited,[84]

20,776 (C.F.T.C., Mar. 12, 1979); Bassilios v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,641 (C.F.T.C. July 5, 1978), *vacated in part on other grounds*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,749 (C.F.T.C., Jan. 24, 1979); Troll v. Lloyd, Carr & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,626 (C.F.T.C. June 16), *vacated in part on other grounds*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,676 (C.F.T.C., Sept. 22, 1978); Banks v. CIC Int'l, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,621 (C.F.T.C. June 1, 1978); Akmajian v. International Commodity Options, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,584 (C.F.T.C. Mar. 29, 1978); Sokol v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,582 (C.F.T.C. Mar. 28, 1978); Coffman v. Economic Sys. Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,581 (C.F.T.C. Mar. 28, 1978); Albany Ins. Agency, Inc. v. Hofmann, Kavanaugh Commodity Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,545 (C.F.T.C. Jan. 12, 1978); Russo v. Gregory Commodity Options, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,513 (C.F.T.C. Nov. 4, 1977); Prochniak v. First Commodity Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,501 (C.F.T.C. Oct. 7, 1977), *review denied*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,736 (C.F.T.C., Jan. 5, 1979). For a boiler room case in the context of commodity futures contracts, see *In re* Earl K. Riley Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,679 (C.F.T.C. Feb. 28, 1983).

82. *In re* British Am. Commodity Options Corp., Nos. 76-15 and 77-3 (C.F.T.C. Dec. 2, 1977), *noted in* [1977-1980 Transfer Binder] COMM. FUT. L. REP. ¶ 20,526 (C.F.T.C. Dec. 2, 1977), *and in* Schief & Markham, *supra* note 56, at 25; *see also* Hauser v. Rosenthal & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,731 (C.F.T.C. Jan. 4, 1979); Coffman v. Economic Sys. Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,581 (C.F.T.C. Mar. 28, 1978).

83. CFTC Interpretative Letter No. 77-16 [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,498 (Oct. 18, 1977). This letter from the general counsel also stated:

> A purported compilation of a record of past performance, which is disseminated by any means, would also violate Section 4b(2) unless it is based upon actual trades executed in the market place and fairly represents results achieved for comparable periods as well as for the period specifically set forth. Proscribed as well are the use of unwarranted superlatives or inflammatory statements, which tend to encourage trading on an emotional, rather than a reasoned basis.

Id. at 22,065.

84. *See, e.g.*, Kupser v. Chartered Sys. Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,717 (C.F.T.C. May 6, 1983); Pettyjohn v. Traders Inv. Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) 21,667 ¶ (C.F.T.C. Feb. 16, 1983); *In re* Citadel Trading Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,238 (C.F.T.C. Aug. 31, 1981); Besbara v. Spath, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶

material information or the mechanics of futures trading are not disclosed,[85] claims of large profit and limited risk are made,[86] inducements are promised that give undue expectations of profit,[87]

20,616 (C.F.T.C. May 25, 1978); Carfield v. Comstock Inv. Management Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,607 (C.F.T.C. May 11, 1978); LeBallister v. Lincolnwood Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,538 (C.F.T.C. Dec. 21, 1977); Allison v. Bache Halsey Stuart, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,502 (C.F.T.C. Sept. 28, 1977). *See generally* Shaver v. Ansell, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,044 (C.F.T.C. Mar. 1, 1984); Ward v. Stanford Management Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,979 (C.F.T.C. Jan. 27, 1984).

85. *See, e.g.*, Doran v. Yorkstone Research, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,932 (C.F.T.C. Dec. 9, 1983), *petition for review denied*, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,213 (C.F.T.C. May 15, 1984); Newman v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,811 (C.F.T.C. July 19, 1983); Zavish v. International Precious Metals Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,775 (C.F.T.C. July 19, 1983); Mitchell v. Premex, Inc., [1982-1984 Transfer Binder] (CCH) ¶ 21,678 (C.F.T.C. Feb. 10, 1983); Troy v. Young, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,441 (C.F.T.C. July 14, 1982); Lechtreck v. Commodity Inv. Counselors, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,402 (C.F.T.C. Apr. 14, 1982); Polissar v. Nelson, Ghun & Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,288 (C.F.T.C. Aug. 5, 1981); Yameen v. Madda Trading Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,536 (C.F.T.C. Nov. 9, 1977); Allison v. Bache Halsey Stuart, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,502 (C.F.T.C. Sept. 28, 1977). *See generally* Kerr v. First Commodity Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,119 (8th Cir. May 9, 1984); Sullivan v. Highfield Commodities, Ltd., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,040 (C.F.T.C. Mar. 14, 1984); Cox v. Eastern Capital Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,009 (C.F.T.C. Feb. 16, 1984); Laub v. Braverman, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,000 (C.F.T.C. Feb. 3, 1984); Cole v. E.F. Hutton & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,995 (C.F.T.C. Jan. 31, 1984); Nesting v. Boston Trading Group, Inc., [1982-84 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,917 (C.F.T.C. Nov. 28, 1983); Rosenfeld v. Chartered Sys. Corp., [1982-84 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,730 (C.F.T.C. May 17, 1983); Hopkins v. Stanford Management Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,836 (C.F.T.C. Mar. 30, 1983).

86. Gary Oakland Enters. v. R.B. Thompson Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,757 (C.F.T.C. June 17, 1983); Pettyjohn v. Traders Inv. Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,667 (C.F.T.C. Feb. 16, 1983); Aurora Nova Corp. v. Domestic Oil Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,634 (C.F.T.C. Nov. 22, 1982); Carfield v. Comstock Inv. Management Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,607 (C.F.T.C. May 11, 1978); LeBallister v. Lincolnwood Commodities, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,538 (C.F.T.C. Dec. 21, 1977). *See generally In re* Hardwick and Wells Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,001 (C.F.T.C. Feb. 10, 1984); Amelin v. United States Inv. Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,948 (C.F.T.C. Dec. 27, 1983); Doran v. Yorkstone Research, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,932 (C.F.T.C. Dec. 9, 1983), *petition for review denied*, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,213 (C.F.T.C. May 15, 1984); Nesting v. Boston Trading Group, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,917 (C.F.T.C. Nov. 28, 1983).

87. Gary Oakland Enters. v. R.B. Thompson Assocs., [1982-1984 Transfer Binder]

or simulated trading records are used improperly.[88] Imprudent investment decisions, however, do not give rise to liability under the CEA,[89] nor is it a violation for a broker to dissuade a customer from making a trade that would have been profitable or to make reasonable price predictions.[90]

As a means of countering misrepresentations and assuring that customers are informed of the risks of trading, the CFTC has required a "Risk Disclosure Statement" be supplied to customers before they trade. This document sets forth, in boldface type, the specific types of risk that may be incurred in commodities trading. For example, brokerage firms, referred to in the commodity futures industry as "futures commission merchants," are required to provide a statement to customers containing the following language:

> The risk of loss in trading commodity futures contracts can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. In considering whether to trade,

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COMM. FUT. L. REP. (CCH) ¶ 21,757 (C.F.T.C. June 17, 1983); Aurora Nova Corp. v. Domestic Oil Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,634 (C.F.T.C. Nov. 22, 1982); *In re* Citadel Trading Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,238 (C.F.T.C. Aug. 31, 1981); Beshara v. Spath, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,616 (C.F.T.C. May 25, 1978). *See generally* Shaver v. Ansell, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,044 (C.F.T.C. Mar. 1, 1984); Laub v. Braverman, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,000 (C.F.T.C. Feb. 3, 1984); Adil v. Moorthy's Commodity Servs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,973 (C.F.T.C. Jan. 26, 1984).

88. Kerr v. First Commodity Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,119 (8th Cir. May 9, 1984); Cox v. Eastern Capital Corp., [1982-1984 Transfer Binder]; COMM. FUT. L. REP. (CCH) ¶ 22,009 (C.F.T.C. Feb. 16, 1984); Ward v. Stanford Management Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,979 (C.F.T.C. Jan. 27, 1984); Lehman v. Madda Trading Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,117 (C.F.T.C. Sept. 11, 1980); Sztaba v. First Commodity Corp., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,789 (C.F.T.C. Mar. 12, 1979).

89. *See* Harcourt v. Conticommodity Servs., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,619 (C.F.T.C. Nov. 1982); *see also* Van Alen v. Dominick & Dominick, Inc., 441 F. Supp. 389, 400 (S.D.N.Y. 1976), *aff'd*, 560 F.2d 547 (2d Cir. 1977) (a market "recommendation that goes awry does not make out a [fraud] claim" under the federal securities laws).

90. *See* Bradley v. Clayton Brokerage Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,700 (C.F.T.C. Mar. 31, 1983); *see also* Biederman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,104 (C.F.T.C. Apr. 26, 1984); Wohlers v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,101 (C.F.T.C. Apr. 26, 1984); Zadik v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,036 (C.F.T.C. Feb. 16, 1984); Kenny v. Shearson/American Express, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,924 (C.F.T.C. Nov. 10, 1983); Kypriotakis v. International Precious Metals Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,893 (C.F.T.C. Oct. 21, 1983); Aslock v. Premex, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,602 (C.F.T.C. Oct. 8, 1982).

> you should be aware of the following:
>
> (1) You may sustain a total loss of the initial margin funds and any additional funds that you deposit with your broker to establish or maintain a position in the commodity futures market. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional marginal funds, on short notice, in order to maintain your position. . . .
>
> . . . .
>
> (5) The high degree of leverage that is often obtainable in futures trading because of the small margin requirements can work against you as well as for you. The use of leverage can lead to large losses as well as gains.[91]

Since the adoption of this provision, CFTC administrative law judges have been reluctant to find that risks of trading have been misrepresented to customers when the customer received a disclosure document before trading. In *Tapper v. Rosenthal & Co.*,[92] a CFTC hearing officer stated: "The disclosure statement made it abundantly clear, in bold-face type, that [complainant] could lose her entire investment. I reject [her] testimony that she was never told she could lose her investment."[93] Similarly, in *Thompson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[94] the administrative law judge noted that the "[c]omplainant signed a risk disclosure statement prior to any trades being made on the account, and that statement informed him that losses may be substantial." Consequently, complainant's contention that he would never have consented to trades recommended by his account executive had he realized the loss potential was rejected.[95] The CFTC also has concluded that when a required risk disclosure statement is not supplied, customers may not recover their trading losses if they are otherwise informed of the risks.[96] In a proceeding prior to the ef-

91. 17 C.F.R. § 1.55 (1984).

92. [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,400 (C.F.T.C. Mar. 5, 1982).

93. *Id.* at 25,915.

94. No. R 80-580-80-717 Slip Op. at 1 (C.F.T.C. Feb. 9, 1983).

95. *Id.* at 4. In Margolin v. First Commodity Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,432 (C.F.T.C. June 10, 1982), a CFTC hearing officer held that the CFTC had "sought to alert individuals to [the] danger [of trading commodity futures contracts] by establishing formal disclosure requirements which are designed to 'enlighten the prudent' and 'to discourage the foolhardy;' " therefore, the broker's "uninhibited optimism should have been offset in the complainant's mind by the clear warning to prospective customers set forth in the formal statement." *Id.* at 26,076 (footnotes omitted). The CFTC, however, subsequently found the hearing officer's opinion in *Margolin* to be unpersuasive. *Id.*; *see also* Rasheed v. Heinold Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,837 (C.F.T.C. Aug. 19, 1983).

96. Sher v. Dean Witter Reynolds, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,266 (C.F.T.C. June 13, 1984); *see also* Einhorn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,100 (C.F.T.C. Apr. 20, 1984);

fective date of the CFTC's risk disclosure statement requirements, a CFTC hearing officer held that no misrepresentation would be found, even though the broker had made assurances of "tremendous profits and very limited risk,"[97] because the broker had spe-

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Blome v. R.G. Dickinson & Co. [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21.916 (C.F.T.C. Nov. 18, 1983). *But see* Abeyta v. Bear, Stearns & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,350 (C.F.T.C. Feb. 10, 1982); *see also* Harris v. Davis H. Siegel, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,701 (C.F.T.C. Apr. 14, 1983); Mohr v. Gregory Commodity Options, Ltd., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,688 (C.F.T.C. Mar. 24, 1983); O'Shyne v. New Jersey Precious Metals, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,662 (C.F.T.C. Feb. 10, 1983); Al-Awar v. Rosenthal & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,680 (C.F.T.C. Dec. 27, 1982); Hardiman v. Nelson, Ghun & Assocs. [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,619 (C.F.T.C. Nov. 30, 1982); Shah v. David H. Siegel, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,485 (C.F.T.C. Sept. 28, 1982); Silverman v. Nelson, Ghun & Assocs. [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,484 (C.F.T.C. Sept. 28, 1982); Sher v. Dean Witter Reynolds, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,486 (C.F.T.C. Sept. 13, 1982); Meloche v. Fairchild, Arabatzis & Smith, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,419 (C.F.T.C. Mar. 26, 1982); Polissar v. Nelson, Ghun & Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,288 (C.F.T.C. Aug. 5, 1981); O'Brien v. Williston Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,180 (C.F.T.C. Mar. 24, 1981); Orr v. London Futures, Ltd., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,155 (C.F.T.C. Feb. 23, 1981); Reed v. Lincolnwood Communities, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,146 (C.F.T.C. Jan. 27, 1981). *But cf.* Blome v. R.G. Dickinson & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,916 (C.F.T.C. Nov. 18, 1983); Kupser v. Chartered Sys. Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,717 (C.F.T.C. May 6, 1983); DeCaro v. Rosenthal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,078 (C.F.T.C. Apr. 2, 1980); Greenberg v. Chartered Sys. Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,084 (C.F.T.C. Mar. 27, 1980).

97. Gorney v. Comvest, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,443, at 26,105 (C.F.T.C. June 24, 1982); *see also* Alter v. Shearson Loeb Rhoades, Inc., No. R 81-925-82-370 (C.F.T.C. July 7, 1983) (liability of defendant for misrepresentation overturned when a signed risk disclosure statement was offered with a motion for reconsideration); Ramoudt v. International Trading Group, Ltd., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,737 (C.F.T.C. June 8, 1983) (customer's oral acknowledgement that she had read the risk disclosure statement precluded a finding of misrepresentation); D'Antonio v. Bache Halsey Stuart Shields, Inc., No. R 80-1019-81-13 (C.F.T.C. Mar. 29, 1983) (signed risk disclosure statement demonstrates that complainants were adequately informed of the risk); Szymanski v. Cleary Trading Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,617, at 26,355 (C.F.T.C. Nov. 18, 1982) (complainant's allegations of nondisclosure of risks unsubstantiated where the risks were set out in documents signed by complainant); Thakarar v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,605, at 26,312-13 (C.F.T.C. Sept. 24, 1982) (because complainant was provided with risk disclosure statement, claim that risk of a tax straddle was not disclosed cannot be sustained); Hentschel v. Delphi Commodity, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,408, at 25,936 (C.F.T.C. June 15, 1982) ("The complainant's signature on the statement evidences that he was informed of the risk and chose to invest in full awareness thereof," and therefore, "[i]t is not necessary to resolve the question of who said what because the complainant received the written warning as to the risk of commodity futures trading and the danger of loss in such investment.");

cifically warned the complainant in writing before the account was opened that there was a high risk of loss trading commodity futures. Similarly, another CFTC decision indicates that any broker misrepresentations are cured through delivery of the disclosure statement.[98] In other decisions the CFTC has stated, however, that written disclosure statements will not provide immunity where oral misrepresentations are made that overcome the written disclosure.[99]

Koski v. Rosenthal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,207, at 24,975 (C.F.T.C. May 29, 1981) (broker provided customer with risk disclosure statement, and therefore no misrepresentation of risks was found). *See generally* Zobrist v. Coal-X, Inc., [1982-1983 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,163 (10th Cir. May 11, 1983) (knowledge of contents of risk disclosures in a private placement memorandum are imputed to a securities customer even though he did not read the memorandum and even though the broker falsely stated that there were no risks); Kats v. Merrill Lynch Commodites, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,998 (C.F.T.C. Feb. 3, 1984) (futures commission merchant did not violate CEA when customer was informed of the risks as evidenced by the customer's signing three different risk disclosure statements); ACLI Int'l Commodity Servs., Inc. v. Lindwall, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,115 (Minn. Ct. App. Apr. 23, 1984) (no fraud when customer executed a risk disclosure statement); *cf.* Hardill v. Williams, 2 COMM. FUT. L. REP. (CCH) ¶ 22,220 (C.F.T.C. May 31, 1984) (agent of futures commission merchant violated the CEA when he failed to disclose accurately the "option period").

98. Schwarz v. Drexel Burnham Lambert, Inc., No. 82-239 (C.F.T.C. Feb. 14, 1983) (any misrepresentation was cured by furnishing risk disclosure documents).

99. *See* Rasheed v. Heinold Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,837 (C.F.T.C. Aug. 19, 1983); *see also* Wegerer v. First Commodity Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,348 (10th Cir. Sept. 10, 1984); Gonzales v. National Monetary Fund, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,124 (C.F.T.C. May 10, 1984); Ward v. Stanford Management Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,979 (C.F.T.C. Jan. 27, 1984); Schmigel v. Kamin, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,954 (C.F.T.C. Jan. 4, 1984); Newman v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,811 (C.F.T.C. July 19, 1983); Swiers v. Rosenthal & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,817 (C.F.T.C. May 27, 1983); Sturcken v. Clayton Brokerage Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,727 (C.F.T.C. May 10, 1983); Notkin v. Paine, Webber, Jackson & Curtis, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,236 (C.F.T.C. Aug. 25, 1981); Walker v. Rosenthal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,168 (C.F.T.C. Mar. 25, 1981); Chicoine v. Rosenthal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,075 (C.F.T.C. July 2, 1980).

In Gittemeier v. Smith Barney, Harris Upham & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,929 (C.F.T.C. Nov. 30, 1983) an administrative law judge held that a CFTC risk disclosure statement was not a sufficient disclosure of the risks that could be incurred in a thin, infrequently traded contract market. *Cf.* Applegate v. Dean Witter Reynolds, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,881 (S.D. Fla. Jan. 17, 1983) (the district court held that a broker's claim of limited loss potential was contravened by the risk disclosure document signed by the customer); *see also* Farrell v. Money Int'l, Ltd., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,891 (C.F.T.C. Oct. 31, 1983).

C. Churning

Churning[100] is a form of cheating and defrauding and thus is a violation of section 4b(A) of the CEA.[101] Whether the volume of trading in a commodities account constitutes churning is dependent upon a consideration of the facts surrounding the transactions in that account.[102] Churning as a violation of the securities laws has been well documented in case law.[103] Two major elements must be present to establish churning in a securities account: (1) broker control over trading in the customer's account, and (2) trading that is excessive both in frequency and in volume in light of the customer's trading objective.[104]

Recognizing that motive and opportunity for churning in both commodities and securities are similar,[105] the CFTC, nonetheless,

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100. Churning consists of excessive trading by a broker of a customer's account to generate brokerage commissions rather than to benefit the customer. *See* 17 C.F.R. 240.15cl-7(a) (1984) (interpreting churning in the context of § 15(c)(1) of the Securities and Exchange Act of 1934).

101. *See* LaQuaglia v. Loeb Rhoades & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,392, at 25,888 (C.F.T.C. Mar. 12, 1982); *In re* Cayman Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,277, at 25,367 (C.F.T.C. Oct. 23, 1981).

102. In Hecht v. Harris, Upham & Co., 283 F. Supp. 417 (N.D. Cal. 1968), *modified on other grounds*, 430 F.2d 1202 (9th Cir. 1970) the court stated:

> Churning cannot be and need not be, established by any one precise rule or formula. The essential question of fact for determination is whether the volume and frequency of transactions, considered in the light of the nature of the account and the situation, needs and objectives of the customer, have been so "excessive" as to indicate a purpose of the broker to derive profit for himself while disregarding the interests of the customer.

Id. at 435.

103. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 809 n.18 (1983).

104. Follansbee v. Davis, Skaggs & Co., 681 F.2d 673 (9th Cir. 1982); Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980); Rolf v. Blyth Eastman Dillon & Co., 424 F. Supp. 1021, 1039-40 (S.D.N.Y. 1977) *aff'd in part and rev'd in part*, 570 F.2d 38 (2d Cir.), *cert. denied*, 439 U.S. 1039 (1978); *see also* McNeal v. Paine, Webber, Jackson & Curtis, Inc., 598 F.2d 888, 890 n.1 (5th Cir. 1979); Newburger, Loeb & Co. v. Gross, 563 F.2d 1057, 1069-70 (2d Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978); Carras v. Burns, 516 F.2d 251, 258 (4th Cir. 1975); Landry v. Hemphill, Noyes & Co., 473 F.2d 365, 368 n.1 (1st Cir.), *cert. denied*, 414 U.S. 1002 (1973); Hecht v. Harris, Upham & Co., 430 F.2d 1202, 1206-07 (9th Cir. 1970); Hudson, *Customer Protection in the Commodity Futures Market*, 58 B.U.L.R. 1, 18 (1978).

105. The CFTC stated that:

> (i) [C]ustomers trade through professionals whose remuneration usually depends on the volume of transactions in the customer's account, (ii) there is a temptation for the professional to cause an excessive number of transactions in order "to derive profit for himself while disregarding the interests of the customer," and (iii) the professional often occupies the dual role of advisor to the customer and agent for effecting trades.

Proposed Standards of Conduct, *supra* note 57, at 44,746 (footnote omitted).

has distinguished churning in a commodities account from churning in a securities account. Particularly, the Commission has rejected[106] the use of the "turnover rate"[107] as a statistical gauge for determining whether churning has occurred in the securities area. The CFTC stated that the "turnover rate", as applied in securities cases, is "inherently inappropriate for determining whether excessive trading has been established in futures churning cases."[108] A basic premise of securities trading is that once a securities professional acquires securities for a controlled account, the acquisition normally is followed by a holding period so the professional may determine whether his assessment of the securities' growth potential was accurate. Commodities futures contracts, however, are short term instruments that have a faster inherent "turnover rate" because of short expiration dates and the volatility of commodity prices. The CFTC concluded, therefore, that the length of time a futures contract is held is not "particularly revealing in determining whether a commodities account has been traded excessively."[109] Furthermore, the CFTC noted that the turnover rate's focus on the total cost of securities purchased over a period of time is inapplicable in commodities cases because a futures contract is executory in nature and the overwhelming majority of commodity customers trade futures contracts without any intention of making or taking delivery of the underlying commodity. Given this situation, the CFTC concluded that it would be inaccurate to consider the total dollar value of the commodity futures contracts purchased in the same manner as the "turnover rate" is considered in a securities account.[110]

In 1977 the CFTC proposed a regulation outlining the standards of conduct for commodity trading professionals.[111] The proposed standards contained a provision that expressly prohibited

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106. *See In re* Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,986 (C.F.T.C. Jan. 31, 1984).

107. The turnover rate is defined as " 'the relationship between the cost of purchases and the average investment, the latter representing the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number of calendar months under consideration.' " *Id.* at 28,246 n.76 (quoting *In re* R. H. Johnson & Co., 36 S.E.C. 467, 471 n.4 (1955), *aff'd,* 231 F.2d 523 (D.C. Cir.), *cert. denied,* 352 U.S. 844 (1956)).

108. *In re* Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,986, at 28,247 (C.F.T.C. Jan. 31, 1984).

109. *Id.*

110. *Id.*

111. Proposed Standards of Conduct, *supra* note 57.

the churning of commodities accounts.[112] The CFTC emphasized that this provision only made explicit what was implicitly required of commodity trading professionals under the various antifraud provisions of the Commodity Exchange Act and the CFTC's rules: that the churning of a customer's commodity futures account is a clear violation of section 4b of the CEA.[113]

The CFTC has noted that, although no precise guidelines can be drawn as to when churning occurs and each situation must be judged on its own facts,[114] the principal elements of the churning offense are: control of the account by the professional and excessive trading.[115] Control of an account is defined as the express authorization to the professional by the customer to trade or exercise "control in fact" over the account even though no grant of discretion has been made.[116] The CFTC outlined control in fact as

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112. Proposed § 166.3 stated:

> No Commision registrant, or representative thereof, who is vested with discretionary power or authority over a customer's account, or otherwise controls the account, may, directly or indirectly, effect for that account transactions in any commodity interest that are excessive in size or frequency in light of the nature of (a) the account and (b) the commodity interest involved.

Id. at 44,750. The CFTC noted that proposed § 166.3 was similar to rule 15cl-7(a) of the Securities and Exchange Commission. *Id.* at 44,745; *see* 17 C.F.R. § 240.15cl-7(a) (1984).

113. Proposed Standards of Conduct, *supra* note 57, at 44,743 (footnote omitted).

114. The CFTC listed certain factors that could be relevant in particular situations, with a caveat that such factors were not an exhaustive list:

> (i) *The turn-over rate.* This is the ratio of the total cost of purchases made for the account during a given period of time to the average month-end net equity in the account during the period. The amount of permissible turn-over will depend upon such factors as market conditions, the commodity interest [sic].
>
> (ii) *The nature of the account.* As indicated in (i) above, the stated objective of the customer is an important factor. A turn-over rate that is acceptable in the account of an individual who wishes to trade especially actively may be unacceptable in the account of an average trader.
>
> (iii) *"In-and-out" trading.* Since the establishment of market positions for periods of less than a day (such trades are commonly known as "day trades" or "in-and-out trades") can generate substantial commission revenues, this type of trading—although clearly not inherently improper—could be a factor in determining whether an account has been churned.
>
> (iv) *Ration* [sic] *of commissions to net equity.* The ration [sic] of the commissions generated by the account during a particular period to the average, month-end net equity in the account during the period is also a significant factor, particularly when it can be compared to the commission-equity ratio in other similar accounts maintained with the commodity professional.

Id. at 44,745. As noted *supra* notes 82-88 and accompanying text, the CFTC subsequently rejected the use of turnover rates in commodity futures churning analyses. *See In re* Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,986 (C.F.T.C. Jan. 31, 1984).

115. Proposed Standards of Conduct, *supra* note 57, at 44,745 (footnote omitted).

116. Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 433 (N.D. Cal. 1968). If a broker

existing:

> [W]here the professional—by reason of the trust and confidence placed in him by the customer, the customer's lack of sophistication in commodity trading, or some combination of these factors—significantly influences the trading in the account. The mere fact that the customer occasionally initiates his own trades or rejects the professional's advice would not preclude the existence of factual control, nor would the customer's sophistication in commodity trading.[117]

In 1978 the CFTC decided not to adopt the proposed churning rule on the basis of two factors. First, the CFTC believed the churning rule would merely codify principles that are implicit in the antifraud provisions of the CEA. Second, the Commission believed that "the benefits to be gained from codification [were] outweighed by the risk of unintentionally narrowing the scope of these provisions."[118]

As noted, an essential element in a churning claim is "broker control" over the commodities account. It is not necessary, however, for the account to be discretionary before churning can be found. Courts have found "broker control" in both discretionary and nondiscretionary accounts.[119] In the leading pronouncement of the CFTC on broker control, *Smith v. Siegel Trading Co.*,[120] the CFTC enunciated six factors that, although not exhaustive, were typified as "well recognized factors . . . probative of control and which at a minimum should be considered by the trier of fact" in determining whether churning has taken place:

> 1) a lack of customer sophistication
> 2) a lack of prior commodity trading experience on the part of the customer and a minimum of time devoted by him to his account
> 3) a high degree of trust and confidence reposed in the associated person by the customer

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overtrades a commodities account without having express or implied control over trading decisions, he is trading without customer authorization, not churning the account. *See* Hudson, *supra* note 104, at 20; *supra* notes 114-15 and accompanying text; *infra* notes 117-30.

117. Proposed Standards of Conduct, *supra* note 57, at 44,745 (footnote omitted).

118. *See* Adoption of Customer Protection Rules, 43 Fed. Reg. 31,886 (1978); *see also* Peloso, *Churning a Commodity Futures Account*, NEW YORK L.J. at 2, col. 2 (Sept. 23, 1982).

119. As one court noted:

> Although control by the representative over the account is essential to a finding of churning, such control need not amount to a formal vesting of discretion in that representative. A degree of control sufficient to warrant protection may be inferred from evidence that the customer invariably relied on the dealer's recommendations, especially when the customer is relatively naive and unsophisticated.

Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 433 (N.D. Cal. 1968).

120. [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,105 (C.F.T.C. Sept. 3, 1980).

4) a large percentage of transactions entered into by the customer based upon the recommendations of the associated person
5) the absence of prior customer approval for transactions entered into on his behalf
6) customer approval of recommended transactions where tbe approval is not based upon full, truthful and accurate information supplied by the associated person.[121]

Churning cases concerning nondiscretionary commodities accounts have hinged on a determination of whether the plaintiff had the capacity to determine his overall position or the total amount of real profit or loss occurring in his account.[122] The Ninth Circuit Court of Appeals recently held that "[t]he touchstone [for determining broker control] is whether or not the customer has sufficient intelligence and understanding to evaluate the broker's recommendations and to reject one when he thinks it unsuitable" and "[a]s long as the customer has the capacity to exercise the final right to say 'yes' or 'no', [sic] the customer controls the account."[123]

The judiciary and the CFTC have been loathe to adopt a precise empirical formula to determine when churning occurs in a commodities account. A court, however, invariably will review the length of the time period during which trading occurred, the amount lost by the customer, and the commissions earned by the

121. *Id.* at 24,454 & n.6; *see also* Friedman v. Dean Witter & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,307 (C.F.T.C. Nov. 13, 1981); *In re* Luizzi, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,833 (C.F.T.C. Jan. 27, 1981).

122. In Hecht v. Harris Upham & Co., 283 F. Supp. 417 (N.D. Cal. 1968), the court stated that a customer must be "sufficiently skilled" to be ahle to supervise his account. *Id.* at 434. The court held that "plaintiff's comprehension of the securities market was definitely limited, her comprehension of the commodities market was virtually nil and her comprehension of both was most superficial." *Id.* at 433.

In Knieriemen v. Bache Halsey Stuart Shields, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,363 (N.Y. Sup. Ct. Mar. 1, 1982), a state court upheld a finding of churning in a nondiscretionary account. Knieriemen, an unemployed merchant seaman who had once been employed as a stockbroker, invested approximately $100,000 from the proceeds of an insurance policy in a commodities account. The broker testified that he obtained Kneieriemen's consent before each trade in meetings at various bars. Knieriemen testified to a severe alcohol abuse problem and that he was intoxicated on "nearly every occasion" that he spoke to his broker. *Id.* at 25,709. The court stated:

> Even though the plaintiff's account was a non-discretionary one, the plaintiff adequately showed that the [broker] exercised control over trading in the account due to the plaintiff's continuous intoxication and that the plaintiff relied totally on the advice of [the broker] for the same reason.

Id. at 25,710. The *Knieriemen* court also found that churning does not require the same level of intent generally required for common-law fraud—noting that the hroker had abused the plaintiff's confidence and trust in order to create commissions. *Id.*

123. Follansbee v. Davis, Skaggs & Co., 681 F.2d 673, 677 (9th Cir. 1982).

broker. For example, churning was found when a broker engaged in over 500 transactions and generated $23,522.87 in commissions in a period of approximately eighteen months.[124] Churning also was found when the commissions of a broker equalled seventy-two percent of the amount deposited for a commodities account during a nine-week period in which the account was depleted from $2500 to $2.[125] A CFTC hearing officer has emphasized that "[a] very important factor in determining churning is the ratio of the size of the professional's profit in relation to the size of the customer's initial investment."[126] A 67.1% commission equity ratio and a 57% commission trading ratio were found to compel a finding of churning.[127] One administrative law judge has even stated "the entry of a single trade that is not for the benefit of the customer shall always be considered as churning."[128]

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124. *See* Knieriemen v. Bache Halsey Stuart Shields, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,363 (N.Y. Sup. Ct. Mar. 1, 1982).

125. *See* Martin v. Cayman Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,406, at 25,932 (C.F.T.C. May 26, 1982).

In Aronson v. Cayman Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,268 (C.F.T.C. Oct. 5, 1981), a CFTC hearing officer found that the account in question had been churned when the opening balance of $3500 had been depleted in two weeks by continuous day trading with the brokers receiving commissions totalling $3415. The hearing officer noted "[c]onsuming almost 100% of the principal investment in the form of commission income during only two weeks of trading is the type of statistic which by itself suggests that the account was being managed for the benefit of the brokers rather than that of the customer." *Id.* at 25,325.

126. Martin v. Cayman Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,406, at 25,932 (C.F.T.C. May 26, 1982).

127. Cox v. Eastern Capital Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,009, at 28,543 (C.F.T.C. Feb. 16, 1984). The CFTC hearing officer also noted other factors that were indicative of churning, namely: same day trading in a managed account (44 day trades in a six week period for the account in question) along with the absence of a legitimate trading strategy as demonstrated by the substantial open market position in T-Bonds and the liquidation and reestablishment of similar positions created a strong presumption of churning. *Id.* at 28,542-43.

128. Quigley v. Dean Witter Reynolds, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,330, at 25,597 (C.F.T.C. Jan. 22, 1982). A CFTC hearing officer in *In re* Cayman Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,277 (C.F.T.C. Oct. 23, 1981), found that, in a situation in which accounts were drained of equity with customers paying from 74% to 173% in commissions, the record of trading "amply satisfies the statistical measures for churning." *Id.* at 25,367; *see also* Schmigel v. Kamin, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,954 (C.F.T.C. Jan. 4, 1984); Cenizal v. Brown & Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,938 (C.F.T.C. Dec. 7, 1983). A district court in International Cattle Sys. v. Parsons, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,367 (D. Kan. Mar. 9, 1982), however, found that churning did not occur when customers specifically authorized each transaction and paid commissions of less than four percent of the absolute value of their trading profits and losses. *Id.* at 25,756; *see also* Greeley v. Lincolnwood Commodities Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,834 (C.F.T.C. Aug. 17, 1983); Tolliver v.

The CFTC, relying on *Siegel Trading*,[129] rejected an administrative law judge's conclusion that, as a general rule, churning may be found whenever trading in a controlled account generates commissions of fifty percent of a customer's investment over a period of six months or less.[130] The CFTC stated that the determination that trading was excessive can be made only after analyzing the specific objectives of the account.[131] The CFTC affirmed its belief that a finding of churning includes several factors, and the interrelationship between these factors should be carefully considered by the trier of fact in the context of each case.[132]

Murlas Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,752 (C.F.T.C. June 16, 1983); Vaneck v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,697 (C.F.T.C. Mar. 30, 1983); *cf.* Piskur v. International Precious Metals Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,664 (C.F.T.C. Nov. 4, 1982) (leverage transactions). For a discussion of damage claims for churning violations, see McGinn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,242 (8th Cir. June 22, 1984). *See generally* Hogstrom v. Brentman, 572 F. Supp. 692 (N.D. Ill. 1983); Douhet v. Peavey and Co., 2 COMM. FUT. L. REP. (CCH) ¶ 22,219 (C.F.T.C. June 4, 1984); Moore v. Andre Boesch Corp., 2 COMM. FUT. L. REP. (CCH) ¶22,204 (C.F.T.C. May 25, 1984); Gonzales v. National Monetary Fund, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶22,124 (C.F.T.C. May 10, 1984); Clayton v. Ace Am., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,120 (C.F.T.C. May 8, 1984); Trust & Inv. AG v. Stotler & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,122 (C.F.T.C. Apr. 26, 1984); Wohlers v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,101 (C.F.T.C. Apr. 26, 1984); McGowan v. Cinna, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,086 (C.F.T.C. Apr. 11, 1984); Berendt v. Strategic Fin. Servs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,077 (C.F.T.C. Apr. 9, 1984); Skinner v. Eastern Capital Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,055 (C.F.T.C. Mar. 20), *dismissed,* [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,107 (C.F.T.C. Apr. 26, 1984); Marcus v. Murlas Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,041 (C.F.T.C. Mar. 15, 1984); Boissonneau v. Dameron, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,016 (C.F.T.C. Feb. 22, 1984); Zadik v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,036 (C.F.T.C. Feb. 16, 1984); Cox v. Eastern Capital Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,009 (C.F.T.C. Feb. 16, 1984); *In re* Cayman Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,999 (C.F.T.C. Feb. 10), *vacated and remanded on other grounds,* [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,097 (C.F.T.C. Apr. 11, 1984); Cooper v. Conticommodity Servs, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,996 (C.F.T.C. Feb. 3, 1984); Schnigel v. Kamin, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,954 (C.F.T.C. Jan. 4, 1984); Centzal v. Brown & Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,938 (C.F.T.C. Dec. 7, 1983); Nesting v. Boston Trading Group, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,917 (C.F.T.C. Nov. 28, 1983).

129. *See supra* notes 120-21 and accompanying text.

130. *In re* Auster, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,274, at 25,343 n.4 (C.F.T.C. Oct. 4, 1981).

131. *Id.*

132. *Id.* For decisions concerning the appropriate measure of damages in churning

D. *Unauthorized Trading*

A trade in a nondiscretionary account without the customer's consent constitutes unauthorized trading. Unauthorized trading is a violation of section 4b of the CEA and CFTC Regulation 166.2.[133] This rule, prompted by frequent customer complaints of unauthorized trading by futures commission merchants,[134] prohibits future commission merchants, or associates from effecting transactions in nondiscretionary accounts unless the customer specifically authorizes the transaction and identifies the particular commodity and exact amount eligible for purchase or sale.[135] Upon adoption of the rule, the CFTC announced that because unauthorized trading had been held a violation of section 4b of the CEA, adopting the specific rule would have no substantive effect on existing law.[136]

The factual analysis of unauthorized trading cases includes a consideration of whether a confirmation was sent to the customer,[137] whether the customer objected to the confirmation,[138]

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cases, compare McGinn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,242 (8th Cir. June 22, 1984) with Lehman v. Madda Trading Co., CFTC Civ. No. R. 78-3-78-135 (C.F.T.C. Nov. 18, 1984) and Huff v. First Fin. Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,272 (C.F.T.C. June 28, 1984); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McKeehan, 570 S.W.2d 654 (Ct. App. Ky. 1978).

133. 17 C.F.R. § 166.2 (1984).

134. Proposed Standards of Conduct, *supra* note 57, at 44,746. The CFTC stated that complaints most commonly related to the following:

> (1) disputes as to whether a trade was in accordance with the customers' instructions as to price, quantity, etc.; (2) disputes as to whether a trade was authorized at all; and (3) disputes as to whether the customer had granted the [futures commission merchant] or other person discretionary authority to trade for his account.

Id.

135. *Id.* at 44,742. CFTC Regulation 166.2 "Authorization to Trade" states:

> No futures commission merchant, introducing broker or any of their associated persons may directly or indirectly effect a transaction in a commodity interest for the account of any customer unless before the transaction the customer, or person designated by the customer to control the account:
>
> (a) Specifically authorized the futures commission merchant, introducing hroker or any of their associated persons to effect the transaction (a transaction is "specifically authorized" if the customer or person designated by the customer to control the account specifies (1) the precise commodity interest to be purchased or sold and (2) the exact amount of the commodity interest to be purchased or sold); or
>
> (b) Authorized in writing the futures commission merchant, introducing broker or any of their associated persons to effect transactions in commodity interests for the account without the customer's specific authorization.

17 C.F.R. § 166.2 (1984).

136. Adoption of Customer Protection Rules, *supra* note 57, at 31,886, 31,888 & n.3.

137. Raskin v. Shearson Loeb Rhoades, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,459 (S.D.N.Y. Aug. 10, 1982); Bowen Supply, Inc. v. Ketchum, 2 COMM. FUT L. REP. (CCH) ¶ 22,237 (C.F.T.C. June 19, 1984); Frymier v. Murlas Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,043 (C.F.T.C. Mar. 9, 1984);

whether the customer ratified the unauthorized transaction,[139]

Hamann v. Conticommodity Servs., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,028 (C.F.T.C. Mar. 2, 1984); Rabstein v. Thompson-McKinnon Sec., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,017 (C.F.T.C. Feb. 27, 1984); Baker v. Stotler & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,994 (C.F.T.C. Jan. 31, 1984); Al-Awar v. Rosentbal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,430 (C.F.T.C. May 17, 1982); Bunzel v. Clayton Brokerage Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,080 (C.F.T.C. Mar. 30, 1980); Knall, Inc. v. Fairchild, Arabatzis & Smith, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,883 (C.F.T.C. Aug. 20, 1979); Siebenthaler v. First Dover Commodities, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,707 (C.F.T.C. Nov. 14, 1978); Keehner v. A.E. Staley Mfg. Co., 365 N.E.2d 275 (Ill. App. 1977); Brown v. Pressner Trading Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,136 (N.Y. City Sup. Ct. May 15, 1984).

138. Raskin v. Shearson Loeb Rhoades, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,459 (S.D.N.Y. Aug. 10, 1982); Stoller v. Siegel Trading Co., 2 COMM. FUT. L. REP. (CCH) ¶ 22,224 (C.F.T.C. June 6, 1984); Manoyian v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,223 (C.F.T.C. May 31, 1984); *In re* Fairchild, Arabatzis & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,106 (C.F.T.C. Apr. 27, 1984); Walton v. Heinold Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,078 (C.F.T.C. Apr. 9, 1984); Dealers Lift Truck Supply, Corp. v. Farmers Grain & Livestock Hedging Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,066 (C.F.T.C. Mar. 30, 1984); Rahal v. Paris Sec. Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,065 (C.F.T.C. Mar. 30, 1984); Goetze v. Chartered Sys. Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,058 (C.F.T.C. Mar. 29, 1984); Meridian Brick v. Murlas Commodities, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,042 (C.F.T.C. Mar. 8, 1984); Rabstein v. Thomson-McKinnon Sec., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,017 (C.F.T.C. Feb. 27, 1984); Cowen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,037 (C.F.T.C. Feb. 23, 1984); Baker v. Stotler & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,994 (C.F.T.C. Jan. 31, 1984); *In re* Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,986 (C.F.T.C. Jan. 31, 1984); Al-Awar v. Rosenthal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,430 (C.F.T.C. May 17, 1982); Siebenthaler v. First Dover Commodities, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,707 (C.F.T.C. Nov. 17, 1978); Schang v. London Futures, Ltd., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,613 (C.F.T.C. May 22, 1978).

For example, in Kats v. Cayman Assocs., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,205 (C.F.T.C. Apr. 10, 1981), the CFTC hearing officer found unauthorized trading to be present in an account of Kats, an Iowa farmer who demonstrated that his commodities trading account with Cayman Associates, Ltd. was solely for the purpose of hedging in connection with his feeder cattle business and no authorization had been given for speculative trades in pork bellies. When Kats received a confirmation that indicated trades had been placed in pork bellies, he called his broker to object and followed up the telephone call with a written complaint in accordance with the customer agreement that he had signed. The hearing officer awarded Kats the amount of the net loss on the unauthorized trades and the amount of commission charges plus interest.

139. Master Commodities, Inc. v. Texas Cattle Management Co., 586 F.2d 1352 (10th Cir. 1978); Lincoln Commodity Servs. v. Meade, 558 F.2d 469 (8th Cir. 1977); Herman v. T. & S. Commodities, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,250 (S.D.N.Y. June 29, 1984); Raskin v. Shearson Loeb Rhoades, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,459 (S.D.N.Y. Aug. 10, 1982); Blome v. R. G. Dickinson & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. ¶ 21,916 (C.F.T.C. Nov. 18, 1984); Manoyian v. Mer-

whether the transaction fell within the scope of the authorization,[140] whether the transaction was the result of a mistake,[141] and whether the failure to disclose risk precludes a holding of true authorization.[142] The preeminent case concerning ratification of unauthorized transactions is *Sherwood v. Madda Trading Co.*,[143] in

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rill Lynch, Pierce, Fenner & Smith, Inc., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,223 (C.F.T.C. May 31, 1984); Beer v. Smith Barney, Harris Upham & Co., Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,729 (C.F.T.C. May 17, 1984); Wohlers v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,101 (C.F.T.C. Apr. 26, 1984); Walton v. Heinold Commodities, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,078 (C.F.T.C. Apr. 9, 1984); Mills v. Smith Barney, Harris Upham & Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,082 (C.F.T.C. Apr. 5, 1984); Dealers Lift Truck Supply Corp. v. Farmers Grain & Livestock Hedging Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,066 (C.F.T.C. Mar. 30, 1984); Rahal v. Paris Sec. Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,065 (C.F.T.C. Mar. 30, 1984); Meridian Brick v. Murlas Commodities, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,042 (C.F.T.C. Mar. 8, 1984); Rabstein v. Thomson-McKinnon Sec., Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,017 (C.F.T.C. Feb. 27, 1984); Cowen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,037 (C.F.T.C. Feb. 23, 1984); Baker v. Stotler & Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,994 (C.F.T.C. Jan. 31, 1984); Blome v. R.G. Dickinson & Co., [1982-1984 Transfer Binder] (CCH) ¶ 21,916 (C.F.T.C. Nov. 18, 1983); Mendoza v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,918 (C.F.T.C. Nov. 14, 1983); Bradley v. Clayton Brokerage, Co. [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,700 (C.F.T.C. Mar. 31, 1983); Roberts v. Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,699 (C.F.T.C. Mar. 4, 1983); Harcourt v. Conticommodity Servs., Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,619 (C.F.T.C. Nov. 4, 1982); Caldwell v. Miller-Jesser, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,614 (C.F.T.C. Oct. 14, 1982); Millman v. International Precious Metals Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,663 (C.F.T.C. Sept. 27, 1982); Guttman v. Paine Webber Jackson & Curtis, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,434 (C.F.T.C. June 18, 1982); Al-Awar v. Rosenthal & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,430 (C.F.T.C. May 17, 1982); Watters v. Thomson-McKinnon Sec., Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,240 (C.F.T.C. Sept. 11, 1981); Bunzel v. Clayton Brokerage Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,080 (C.F.T.C. Mar. 30, 1980); Strite v. British Am. Commodity Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,903 (C.F.T.C. Sept. 21, 1979); Sieberthaler v. First Dover Commodities, Ltd., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,707 (C.F.T.C. Nov. 14, 1978).

140. .Crump v. A.G. Edwards and Sons, Inc., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,232 (C.F.T.C. June 5, 1984); Snazuk v. Murlas Commodities, Inc., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,205 (C.F.T.C. May 29, 1984).

141. Gittemeier v. Smith Barney, Harris Upham & Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,929 (C.F.T.C. Nov. 30, 1983).

142. *In re* Fairchild, Arabatzis & Smith, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,106 (C.F.T.C. Apr. 27, 1984); Mendoza v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. ¶ 21,918 (C.F.T.C. Nov. 14, 1983).

143. [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,728 (C.F.T.C. Jan.

which the CFTC clarified the interrelated rights and duties that arise when a customer believes that unauthorized trades have been made in his account.[144] The complicated set of facts presented in *Sherwood* concerned several unauthorized trades in the plaintiff's commodity account made by a broker in the defendant's firm. The CFTC emphasized that a customer has an absolute right not to be liable for any trade not authorized by him. If an unauthorized trade occurs, the liability attaches to the futures commission merchant, not the customer.[145] The CFTC also emphasized that a futures commission merchant has a duty to inform the customer that he must complain about unauthorized trades.[146] The defendant's customer information statement contained the following notice: "Note: Please Report Any Differences Immediately."[147] The CFTC found that this "meager" statement imposed a duty upon the plaintiff to notify his original broker or the defendant brokerage firm of the errors, but advised that a more comprehensive statement would have been appropriate.[148] The CFTC found that the plaintiff had partially satisfied this duty through his daily at-

5, 1979).

144. *Id.* at 23,017.

145. *Id.* at 23,018.

146. The CFTC stated:

> [T]he futures commission merchant also must either inform the customer, or be demonstrably certain that the customer otherwise understands, that the customer's under a duty to make a complaint at the first reasonable opportunity should he discover unauthorized trading in his account. Any notification should be clear and unequivocal, assuring that the customer understands the import of his action or inaction. If the futures commission merchant fails to insure that its customer is on notice of this duty, the futures commission merchant must necessarily assume absolute liability for all trades ultimately found to have been executed without authorization. This notification in turn triggers the duty of the customer to complain or attempt to complain to his futures commission merchant immediately upon discovery of unauthorized trading. Should a customer, who has been informed that he must make a timely complaint of unauthorized trades, fail to notify or to attempt to notify the futures commission merchant of unauthorized transactions, the customer will have breached his duty to the futures commission merchant and thus must absorb himself any aggravated losses resulting from subsequent liquidation of the unauthorized positions . . . .

Id. at 23,018-19 (footnotes omitted).

147. *Id.* at 23,019.

148. The CFTC stated:

> It would have been better had Sherwood also been informed of his right to have unauthorized trades removed from his account upon timely and substantial complaint. This would have assured Sherwood's understanding of the consequence of his failure to object to the unauthorized trades. We wish to emphasize that a clear explanation to the customer of his rights and duties inures to the benefit of both the customer and the futures commission merchant.

Id. at 23,019 n.16.

tempts[149] to contact his original broker. The CFTC also held that the defendant's statement was "sufficiently ambiguous" so that the plaintiff should not have been expected to know that his failure to complain in timely fashion constituted permanent adoption of the unauthorized trades and, therefore, was insufficient to demonstrate ratification by the plaintiff.[150] The CFTC recognized that notifications indicating a customer duty to inform the responsible officer or agent of the futures commission merchant that an error has occurred, such as those found in customer agreements, trade confirmations and account statements, raise a presumption of understanding on the part of a customer. However, this presumption can be dispelled or rebutted if a customer can demonstrate that his broker's subsequent conduct obscured the customer's understanding of his rights and duties.[151]

The CFTC in *Sherwood* discussed the timing of notice of error stating that "instant repudiation by the customer is not absolutely necessary in order to dispel claims of ratification."[152] The CFTC further stated that:

> The fact that a customer and account executive either by explicit or implicit agreement await short-term market action which might cure any loss occurring as the result of unauthorized activity prior to actually fixing financial responsibility for the transaction in question does not, by itself, constitute ratification or affirmative adoption of a trade. Rather, it is more of a cooperative attempt to mitigate — and hopefully, eliminate — losses incurred in hopes that the ultimate question of responsibility might never need to be reached. However, absent some understanding between the parties, the customer risks being estopped from recovering a full measure of damages should his delay in protesting result in aggravated losses. . . . Indeed, should the delay be of an unreasonable length, a factfinder might be free to conclude, in conjunction with other circumstances, that the customer did actually intend by his silence to adopt unauthorized trades as his own, regardless of subsequent market actions.[153]

In cases decided after *Sherwood*, the CFTC continued to opt for the more "*ad hoc* and flexible principles of equitable estoppel"[154] when approaching a ratification question arising from unau-

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149. The original broker instructed the plaintiff to call him person-to-person collect whenever the plaintiff wished to contact him. After refusing the call, plaintiff would return the call via the firm's WATS line. *Id.* at 23,017 n.8. The plaintiff called the broker daily upon discovery of the unauthorized trades. The broker returned only one telephone call, which the plaintiff was not available to answer. *Id.* at 23,019.

150. *Id.* at 23,020.

151. *Id.* at 23,018 n.14.

152. *Id.* at 23,020 n.20.

153. *Id.*

154. *Id.* at 23,022.

The CFTC stated:

thorized trading.[155]

E. Other Customer Claims Under the CEA

Customer claims may be brought under sections of the CEA other than section 4b. For example, section 4 of the CEA[156] prohibits commodity futures contracts from being sold unless through a member of a contract market registered with the CFTC and such transactions must be effected on that exchange. The CFTC has brought numerous actions charging that various forms of "off-exchange" contracts were actually futures contracts and were re-

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> We will not permit a commission merchant to assert that a customer has ratified a trade made without customer authorization, such trade being patently fraudulent and illegal, absent a clear and unequivocal adoption of such a trade by the customer. However, neither will we permit recovery of damages where unfair conduct by a customer harms the financial interests of the broker. In sum, we wish to assure that all receive fair treatment in the marketplace.

155. In Anderholt v. Rosenthal & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,218 (C.F.T.C. June 26, 1981), a CFTC administrative law judge found tbat certain unauthorized trades were ratified and certain others were not. The determining consideration in *Anderholt* was whether the broker obscured the customer's understanding as to the nature of commodities trades. The administrative law judge found that the customers ratified certain unauthorized trades because they should have understood the text of the confirmations that were sent to them and objected to the unauthorized trades. The *Anderholt* judge stated:

> I find complainant's testimony believable . . . . However, under [*Sherwood v. Madda Trading Co.*] they are nevertheless bound by the statements, and must themselves "absorb" the losses resulting from the discrepancies. [Complainants] were not experienced commodity or stock traders, but they obviously are above average in business sophistication and capable of reading such statements. There is no claim that respondent obscured their understanding of the statements or misled them as to their meaning. It is, therefore, found that the unauthorized purchases of March options were ratified by complainants.

Id. at 25,076; *see also* Kochman v. Interest Rate Analysis, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,890 (C.F.T.C. Oct. 21, 1983); Apel v. E.F. Hutton & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,782 (C.F.T.C. Aug. 31, 1982).

In Brown v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 640 P.2d 453 (Mont. 1982), the court upheld a grant of summary judgment in favor of the defendant brokerage firm following allegations that the firm both improperly had withdrawn funds from plaintiffs' ready asset account to cover margin calls in their commodity account and improperly liquidated certain securities to cover a deficiency balance in another of plaintiffs' accounts. The commodity customer agreement contained the following provisions: (1) any securities or commodities carried in any of the customers' accounts are held as security by the broker for any liability of the customers; (2) the broker had the discretion to liquidate accounts to protect itself; and (3) the broker was authorized to transfer funds of the customers among accounts. The court in *Brown* found that this agreement was an adequate authorization to permit broker liquidation of a commodities account. *Id.* at 459; *see also* Greeley v. Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,834 (C.F.T.C. Aug. 17, 1983); Parver v. Patton, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,454 (C.F.T.C. Aug. 4, 1982).

156. 7 U.S.C. § 6 (1982).

quired to be traded on a contract market.[157] The CFTC has set forth a detailed description of a futures contract that must be traded on a contract market.[158] Characteristics of such a contract are, *inter alia*, standardization and the provision for future, rather than present, delivery.[159]

Customers frequently assert that a futures commission merchant either waited too long to liquidate futures contracts after margin calls were not met and thereby failed to mitigate damages, or that a futures commission merchant acted too quickly in liquidating an account for failure to meet margin calls promptly. The CFTC[160] and the courts,[161] however, have concluded that a futures

157. *See, e.g.*, Co Petro Marketing Group, Inc. v. CFTC, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,421 (9th Cir. June 28, 1982); CFTC v. Co Petro Marketing Group, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,420, at 26,013 (9th Cir. June 25, 1982); CFTC v. National Coal Exch., Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,424, at 26,054-55 (W.D. Tenn. Apr. 2, 1982); CFTC v. Commercial Petrolera Internacional S.A., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,222 (S.D.N.Y. June 26, 1981); *In re* Stovall, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,941 (C.F.T.C. Dec. 6, 1979); *see also*, NRT Metals v. Manhattan Metals, Ltd., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,931 (S.D.N.Y. Dec. 7, 1983).

158. *In re* Stovall, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,941 (C.F.T.C. Dec. 6, 1979). Damages were awarded on the sale of futures contracts illegally sold off an exchange in Kartheiser v. First Nat'l Monetary Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,831 (C.F.T.C. June 28, 1983), and in NRT Metals v. Manhatten Metals, Ltd., 576 F. Supp. 1046 (S.D.N.Y. 1983); Blalack v. First United States Coal Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,235 (C.F.T.C. May 31, 1984); Jackson v. American Gold Dealers Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,956 (C.F.T.C. Jan. 9, 1983); *cf.* Ahrams v. Oppenheimer Gov't Sec., Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,214 (7th Cir. May 30, 1984); Plymouth-Home Nat'l Bank v. Oppenheimer & Co., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,808 (N.D. Ill. June 24, 1983).

159. More specifically, these characteristics are: (1) The existence of "standardized contracts for the purchase or sale of commodities which provide for future, as opposed to immediate, delivery"; (2) transactions that are "directly or indirectly offered to the general public"; (3) transactions that are "generally secured by earnest money, or 'margins' "; (4) transactions that are "entered into primarily for the purpose of assuming or shifting the risk of change in value of commodities, rather than for transferring ownership of the actual commodities." *In re* Stovall, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,941, at 23,777 (C.F.T.C. Dec. 6, 1979).

160. Ball v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,184 (C.F.T.C. Apr. 2, 1982); Friedman v. Dean Witter & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,207 (C.F.T.C. Nov. 13, 1981); Baker v. Edward D. Jones & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,167 (C.F.T.C. Jan. 27, 1981); *see also* Sherman v. Sokoloff, [1982-1984 Transfer Binder] (CCH) ¶ 21,901 (S.D.N.Y. Sept. 12, 1983); Berenson v. Madda Trading Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,689 (D.D.C. Oct. 30, 1978); Weteh v. Monex Int'l, Ltd., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,980 (C.F.T.C. Jan. 30, 1984); Southerton v. Bache Halsey Stuart Sheilds, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,927 (C.F.T.C. Nov. 16, 1983); Tolliver v. Murlas Commodities, Inc.,

commission merchant should have broad authority in setting margin requirements for its customers, therefore, and they have generally deferred to the discretion of the broker. This deference is afforded the broker because margin is a fundamental protection of futures commission merchants who themselves are responsible to the exchanges when customers fail to meet margin calls.

A futures commission merchant is required by the CEA to segregate customer funds and can use those funds only for transactions of the customer.[162] The CFTC has held that a futures commission merchant violated such segregation requirements when it used customers' funds to pay for a trading loss in a customer account caused by broker error.[163] This holding is premised on the CFTC's decision that an unauthorized transaction is the position of the futures commission agent, not the customer.[164] Therefore, when a futures commission agent negligently reverses the customer's instructions, resulting in a loss for which the customer's account is debited, the futures commission agent wrongfully charges that customer for the futures commission agent's own transaction.[165]

Other customer claims are more difficult to establish. For example, the CFTC has concluded that violations of exchange rules do not permit an award of damages in reparations proceedings.[166]

[1982-1984 Transfer Binder] (CCH) ¶ 21,752 (C.F.T.C. June 16, 1983); Blunt, Ellis & Loewi, Inc. v. Ingram, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,385 (Iowa Sup. Ct. May 19, 1982). *But see* Baker v. Stotler & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,994 (C.F.T.C. Jan. 31, 1984).

161. *See, e.g.*, Shearson Hayden Stone, Inc. v. Leach, 583 F.2d 367 (7th Cir. 1978); Lincoln Commodity Servs. v. Meade, 558 F.2d 469 (8th Cir. 1977); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brooks, 548 F.2d 615 (5th Cir. 1977), *cert. denied*, 434 U.S. 855 (1978); Hornblower & Weeks-Hemphill, Noyes v. D & G Supply & Maintenance Co., 390 F. Supp. 715, 720 (N.D. Tex. 1975); Nichols & Co. v. Columbus Credit Corp., 204 Misc. 848, 126 N.Y.S.2d 715 (N.Y. Sup. Ct. 1953), *aff'd*, 284 A.D. 870, 134 N.Y.S.2d 590 (1954). *Compare* Flynn v. First Nat'l Monetary Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,396 (C.F.T.C. Mar. 9, 1982) *with* Iowa Grain v. Farmers Grain & Feed Co., 293 N.W.2d 22 (Iowa Sup. Ct. 1980).

162. *See* 7 U.S.C. § 6b (1982); 17 C.F.R. § 1.20 (1984).

163. Hunter v. Madda Trading Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,242 (C.F.T.C. Sept. 2, 1981); *see also* Weiskopf v. Trans-American Commodity Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,933 (C.F.T.C. Nov. 30, 1983); *cf.* Trust & Inv. AG v. Stotler & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,122 (C.F.T.C. Apr. 1984).

164. *See supra* note 125 and accompanying text.

165. Hunter v. Madda Trading Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,242, at 25,205 (C.F.T.C. Sept. 2, 1981).

166. Friedman v. Dean Witter & Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,307 (C.F.T.C. Nov. 13, 1981); Graves v. Shearson Hayden Stone, Inc., [1980-

Courts have reached a similar conclusion holding that no private right of action exists for violations of the internal policies or procedures of a brokerage firm.[167] Similarly, as a result of recent changes in the CEA,[168] the CFTC cannot award reparations against a person who is not registered with it, and, recently a district court held that there was no private right of action for the failure of a broker to register with the CFTC.[169]

1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,301 (C.F.T.C. Oct. 14, 1981).

167. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Goldman, 593 F.2d 129 (8th Cir. 1979); Carras v. Burns, 516 F.2d 251 (4th Cir. 1975); Sherman v. Sokoloff, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,901 (S.D.N.Y. Sept. 12, 1983); J.E. Hoetger & Co. v. Ascencio, 572 F. Supp. 814, 821 (E.D. Mich. 1983); Chapman v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,419 (D. Md. July 19, 1983); Shearson Loeb Rhoades, Inc. v. Quinard, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,686 (C.D. Cal. Mar. 11, 1983); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brooks, 404 F. Supp. 905 (N.D. Tex.), *aff'd*, 548 F.2d 615 (5th Cir. 1975); Einhorn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,100 (C.F.T.C. Apr. 20, 1984); *see* Jablon v. Dean Witter & Co., 614 F.2d 677 (9th Cir. 1980). Contract claims do not constitute a basis for recovery under the CEA. *See* Schraman v. Comvest, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,616 (C.F.T.C. Nov. 4, 1982); Ashlock v. Premex, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,602 (C.F.T.C. Oct. 8, 1982). *But see* O'Hare v. Premex, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,708 (C.F.T.C. Apr. 20, 1983).

168. *See* SENATE COMM. ON AGRICULTURE, NUTRITION AND FORESTRY, FUTURES TRADING ACT OF 1982, S. REP. No. 384, 97th Cong., 2d Sess. 48 (1982); H.R. REP. No. 565 (Pt. 1), 97th Cong., 2d Sess. 55-57 (1982). This amendment was made in the Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (1983). The CFTC, however, has determined that these changes are not to be applied retroactively. *See* Nelson v. Chilcott Commodities Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,934 (C.F.T.C. Dec. 12, 1983).

169. J.E. Hoetger & Co. v. Ascencio, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,684 (E.D. Mich. Mar. 22, 1983); *see also* Moody v. Bache & Co., 570 F.2d 523, 527 n.6 (5th Cir. 1978); Cresswell v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,859 (S.D.N.Y. Sept. 27, 1983); Hoymayer v. Dean Witter & Co., 459 F. Supp. 733, 738-739 (N.D. Cal. 1978); Ryan v. Pearson, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,741 (C.F.T.C. May 27, 1983). In Woodman v. London Commodity Options, Ltd., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,021 (C.F.T.C. Feb. 29, 1980), a CFTC administrative law judge ordered recission of a futures transaction because of a failure to disclose that an individual had complied with CFTC registration requirements. *See also* Maloley v. R.J. O'Brien & Assocs., 2 COMM. FUT. L. REP. (CCH) ¶ 22,366 (C.F.T.C. Sept. 24, 1984). Compare also, Rivers v. Rosenthal & Co., 634 F.2d 774 (5th Cir. 1980), *vacated*, 456 U.S. 968 (1982), in which the Supreme Court vacated a decision that had held there was no private right of action under the registration and other provisions of the CEA. That action was based on the Supreme Court's decision in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982), which held there was a private right of action under some provisions of the CEA. In Eastside Church of Christ v. National Plan, Inc., 391 F.2d 357, 362 (5th Cir.), *cert. denied*, 393 U.S. 913 (1968), the court of appeals held that the failure of a broker-dealer to register with the Securities and Exchange Commission permitted recovery on transactions effected by the broker-dealer for a customer. In *Hoetger*, however, the court noted that the securities laws provide that contracts entered into in violation of the provisions of the securities laws are "void," while

Section 4c of the CEA[170] prohibits "wash trading," "cross trading," "accommodation trading," "fictitious sales," and transactions that cause a false price to be reported.[171] In *CFTC* v. *Savage*[172], the Ninth Circuit noted that such transactions were viewed by Congress to be "pure, unadulterated fraud."[173] The court held that although scienter is necessary to establish a violation of section 4c, it cannot be avoided by "willfully or carelessly induced ignorance."[174]

Another transaction prohibited by section 4b of the CEA is referred to as "bucketing."[175] Generally, bucketing occurs when a broker does nothing with an order at all, simply betting that the market will move adversely to the customer and allow the broker to profit to the extent of the losses suffered by the customer.[176]

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the CEA has no comparable provision. J.E. Hoetger & Co. v. Ascencio, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,684 (E.D. Mich. Mar. 22, 1983). The *Hoetger* court also distinguished the *Curran* case because Congress had not considered whether there was a private right of action under the registration provisions of the CEA. *Id.* at 26,617. The Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (1983), now codifies private rights of action under the CEA. 7 U.S.C. § 25 (1982). Whether the codification would allow a right of action for registration violations is unclear. Presently recovery is allowed only for "actual" damages, and it may be difficult to show actual damages for mere failure to register. *See* International Cattle Sys. v. Parsons, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,367 (D. Kan. Mar. 9, 1982).

170. 7 U.S.C. § 6c (1982).

171. In CFTC v. Savage, 611 F.2d 270 (9th Cir. 1979), the Ninth Circuit noted that these terms had been defined by the Commodity Exchange Authority (the predecessor to the CFTC) as follows:

> (a) "Wash trading" as "entering into or purporting to enter into transactions, for the purpose of giving the appearance that purchase and sales are being or have been made but without actually taking a position in the market";
> (b) "Cross trading" as "indirectly bucketing a customer's order, or indirectly offsetting the buying order of one customer against the selling order of another customer, or wash trading by means of transactions with another floor hroker who is engaged in a similar type of trading"; and
> (c) "Accommodation trading" and "wash trading entered into by one broker to assist another broker to make cross trades, wash trades, ..."

Id. at 284 n.13 (quoting Commodity Exchange Authority, Memorandum on Definition of Certain Trade Practices Prohibited by the Commodity Exchange Act (May 25, 1966)).

172. 611 F.2d at 284.

173. *Id.* (citing 80 CONG. REC. 7905 (1936) (remarks of Sen. Smith)).

174. 611 F.2d at 284. The court also noted that wash trades were viewed by the Commodity Exchange Authority as including "the *intent* not to make genuine, bona fide trading transactions in stocks or commodities." *Id.* (quoting *In re* Jean Goldwurm, 7 Agric. Dec. 265, 274 (1984)) (emphasis in original); *see supra* note 170 and accompanying text.

175. 7 U.S.C. § 6b (1982).

176. *See* Behl v. Stanford Management Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,935 (C.F.T.C. Dec. 7, 1983); *In re* Siegel Trading Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,452 (C.F.T.C. July 26, 1977). Bucketing has been referred to as the "first and fastest felony" under the CEA. Johnson, *The First and Fastest Felony: Trading Futures off the Exchanges*, 35 BUS. LAW. 711, 711 (1980).

Bucketing (in the form of "cross trading") also occurs when a broker fails to execute a customer's order and instead offsets the order against the matching order of another customer. Bucketing is a particularly pernicious practice because it allows a broker to favor some customers by switching their orders to the detriment of others. In instances where the broker does not execute the order at all, he is simply betting against the customer. This offense is compounded when the broker had advised the customer that the market would move in a given direction and persuaded the customer to enter into the transaction based upon the broker's prediction. The broker bucketing the order, in such instances, is hoping that his own advice is erroneous. Bucketing is dangerous also because the success or failure of the transaction becomes dependent upon the ability and willingness of the broker to pay the customer any realized profits.

Manipulation of commodity futures prices is also prohibited by the CEA.[177] Claims of manipulation, however, require a complex analysis of the commodity market to determine whether manipulation actually has occurred. In addition, plaintiffs have the difficult burden of showing that the alleged manipulator acted with the intent to manipulate prices.[178]

IV. Scienter Requirements Under the CEA

A determination of the standard of intent necessary to prove that fraud has been committed is a recurring concern under the CEA. Portions of section 4b contain an express willfulness requirement. The Seventh Circuit has held that willfulness is present if the defendant acts intentionally, "irrespective of evil motive or reliance on erroneous advice," or if the defendant acts with "careless disregard."[179] The Second Circuit has taken a similar approach,

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177. 7 U.S.C. § 13b (1982).

178. *See* Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); G.H. Miller & Co. v. United States, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 359 U.S. 907 (1959); Great W. Food Distribs., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); Strobl v. New York Mercantile Exch., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,050 (S.D.N.Y. Mar. 20, 1984); *In re* Collins, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,008 (C.F.T.C. Feb. 3, 1984); *In re* Collins, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,960 (C.F.T.C. Jan. 10, 1984); *In re* Cox, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,767 (C.F.T.C. Jan. 3, 1983); *In re* Indiana Farm Bureau Coop. Assoc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (C.F.T.C. Dec. 17, 1982).

179. Goodman v. Benson, 286 F.2d 896, 900 (7th Cir. 1961); *accord* Silverman v. CFTC, 549 F.2d 28, 31 (7th Cir. 1977); *see also In re* Williams, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,560 (C.F.T.C. Feb. 13, 1978).

holding that a defendant need not have "an evil motive or an affirmative intent to injure his customer" or a subjective intent to cheat or defraud; all that is required is a knowing, intentional act.[180] Other circuits have demanded at least a recklessness standard before finding scienter. The Ninth Circuit held that scienter to establish a violation of section 4b is present when one acts in "careless disregard of whether his acts amount to cheating, filing false reports, etc."[181] Similarly, the Tenth Circuit held that conduct must be purposeful or intentionally deceptive to violate section 4b and that mere negligence, mistake or inadvertance is not sufficient to establish liability.[182] The CFTC, however, has taken a broader view. In *Gordon v. Shearson Hayden Stone, Inc.*,[183] the CFTC rejected any scienter requirement under section 4b, holding that unintentional or negligent violations of any part of the CEA would be sufficient to establish a violation. Although this decision was later affirmed by the Ninth Circuit in an unpublished opinion, the court affirmed on the basis that scienter was present in that

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180. Haltmier v. CFTC, 554 F.2d 556, 562 (2d Cir. 1977); *see also* McIlroy v. Dittmer, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,076 (8th Cir. Apr. 11, 1984). *See generally* Markham & Meltzer, *Secondary Liability Under the Commodity Exchange Act*—Respondeat Superior, *Aiding and Abetting, Supervision, and Scienter*, 27 EMORY L.J. 1115, 1165-70 (1978) (discussion of scienter in commodities fraud); *cf.* Minpeco S.A. v. Conticommodity Servs., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,625 (S.D.N.Y. Nov. 24, 1982); Gordon v. Hunt, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,626 (S.D.N.Y. Nov. 21, 1982).

181. CFTC v. Savage, 611 F.2d 270, 283 (9th Cir. 1979). The court also stated that a finding of scienter could not be avoided by "ignorance brought about by willfully or carelessly ignoring the truth." *Id.*

182. Master Commodities, Inc. v. Texas Cattle Management Co., 586 F.2d 1352, 1356 (10th Cir. 1978); *see also* McIlroy v. Dittmer, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,076 (8th Cir. Apr. 11, 1984); First Commodity Corp. v. CFTC, 676 F.2d 1, 5-6 (1st Cir. 1982); Bowersox v. First Commodity Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,248 (N.D. Cal. June 27, 1984); Peavey Co. v. Mitchell, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,939 (W.D. Okla. Dec. 30, 1983); Herman v. T. & S. Commodities, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,093 (S.D.N.Y. Sept. 15, 1983); Palmer Trading Co. v. Shearson Hayden Stone, Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,900 (N.D. Ill. Apr. 20, 1979).

183. [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,016 (C.F.T.C. Apr. 10, 1980), *aff'd sub nom.*, Shearson Loeb Rhoades, Inc. v. CFTC, Civ. No. 80-7212 (9th Cir. Feb. 12, 1982) (unpublished). *Compare* Hardiman v. Nelson, Ghun & Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,629 (C.F.T.C. Nov. 30, 1982) (negligent failure to notify customer of what was happening with his account was not fraudulent) *with* Swiers v. Rosenthal & Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,817 (C.F.T.C. May 27, 1983) (failure to discuss the mechanics and risks of option trading with customer coupled with extravagant claims of profits was fraudulent). *See also* Sudal v. Shearson Loeb Rhoades, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,112 (C.F.T.C. Apr. 27, 1984); Taylor v. Peabody Trading Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,738 (C.F.T.C. May 31, 1983).

case.[184]

In *Ernst & Ernst* v. *Hochfelder*[185] the Supreme Court held that scienter was required under section 10(b) of the Securities Exchange Act of 1934[186] and rule 10b-5.[187] The Supreme Court has stated that these provisions are "similar" to the provisions of section 4b of the CEA.[188] The Supreme Court also held in *Aaron v. SEC*,[189] that scienter is required under certain of the antifraud provisions of section 17(a) of the Securities Act of 1933,[190] but, incongruously, concluded that other portions of that statute did not contain such a requirement. Although confusing, the Court's decisions in *Aaron* and *Hochfelder* draw a distinction between those instances in which a statute prohibits fraudulent *acts*, which require scienter, and those instances in which a statute prohibits the *effects* of an act. If the *effect* of the act is to defraud regardless of the intent of the actor, the statute does not require scienter. This rationale leaves judicial interpretation of section 4b uncertain because the language of the statute differs substantially from the provisions addressed by the Court in *Aaron* and *Hochfelder*.[191]

Since *Aaron*, the CFTC appears to have retreated from its previous position in *Gordon*.[192] Thus, the CFTC has since stated that the antifraud provisions of section 4b "should not be applied to situations . . . where the failure to obey the customer's instructions results not from any fraudulent conduct but rather from a

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184. Shearson Loeb Rhoades, Inc. v. CFTC, Civ. No. 80-7212 (9th Cir. Feb. 12, 1982). Unpublished decisions of the Ninth Circuit, under the rules of that Circuit, are not to be cited for authority. In Stiller v. Shearson Loeb Rhoades, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,780 (C.F.T.C. July 11, 1983), the CFTC held that an administrative law judge had erred in holding that the CEA was violated under a theory that the complainant would not have opened an account and suffered trading losses had it been informed that the respondent would subsequently violate CFTC regulations. The CFTC stated:

> Without evidence of respondents' intent, or evidence from which one may infer such intent, at the time complainants opened their account, a breach of duty at some later time cannot transform prior statements into implied misrepresentations that serve as a ground for an award based on fraud in the inducement.

Id. at 27,156 n.5.

185. 425 U.S. 185 (1976).

186. 15 U.S.C. § 78jjj(b) (1982).

187. 17 C.F.R. § 240.10b-5 (1984).

188. *See* Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 394-95 (1982).

189. 446 U.S. 680 (1980).

190. 15 U.S.C. § 77q(a) (1982).

191. *See* Markham, *The Seventh Amendment and CFTC Reparation Proceedings*, 68 IOWA L. REV. 87, 116-17 (1982).

192. *See supra* notes 173-74 and accompanying text.

clerical error — albeit negligent . . . ."[193] CFTC administrative law judges have concluded that a broker does not violate section 4b if he or she exercises due care,[194] and that breaches of contract are not violations of the CEA,[195] but a failure to follow customer instructions may still be held to be fraudulent.[196]

Other antifraud provisions in CFTC rules and the CEA are equally confusing in their scienter standards. For example, the CFTC sought to eliminate any willfulness requirement from its an-

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193. Hunter v. Madda Trading Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,242, at 25,204 n.8 (C.F.T.C. Sept. 2, 1981). The CFTC nevertheless found a violation in *Hunter* of § 4d of the CEA. 7 U.S.C. § 6d (1982). Section 4d requires customer funds to be kept in segregated trust funds and permits brokerage firms to use those funds only for customer obligations. In *Hunter* the CFTC concluded that the error was not an obligation of the customer, and, therefore, the broker was not authorized to remove the customer's funds from the segregated account to pay for the error. This, of course, allows the CFTC to impose liability in a broad array of situations that would otherwise be the subject of a fraud claim. *See* Markham, *Developments in Commodities Litigation*, 14 REV. SEC. REG. 843 (Oct. 1981).

194. *See* Bond v. Comvest, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,437 (C.F.T.C. June 18, 1982); Nebeck v. First Nat'l Monetary Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,398 (C.F.T.C. Mar. 16, 1982); Flynn v. First Nat'l Monetary Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,396 (C.F.T.C. Mar. 9, 1982); Piccioli v. Rosenthal & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,927 (C.F.T.C. Nov. 26, 1979); Issac v. Conticommodity Servs., Inc., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,606 (C.F.T.C. May 10, 1978); Friedman v. Dean Witter & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,539 (C.F.T.C. Dec. 27, 1977), *aff'd*, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,307 (C.F.T.C. Nov. 13, 1981); Tomasian v. Smith Barney, Harris Upham & Co., [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,433 (C.F.T.C. June 8, 1977); Rude v. Larson, 207 N.W.2d 709, 711 (Minn. 1973). These cases are discussed in Markham, *Commodities Litigation Developments—1982*, 15 REV. SEC. REG. 795, 799 n.52 (1982); *see also* Hardiman v. Nelson, Ghun & Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,629 (C.F.T.C. Nov. 30, 1982) (mere negligence does not violate the CEA); Gordon v. Hunt, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,626 (S.D.N.Y. Nov. 24, 1982) (intent to deceive is an essential element of a claim alleging fraud); Minpeco S.A. v. Conticommodity Servs., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,625 (S.D.N.Y. Nov. 24, 1982) (intent is an essential element of a charge of fraud); *cf.* Kao v. Ace Am., Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,669 (C.F.T.C. Jan. 21, 1983) (recklessness is sufficient for a violation of § 4b of the CEA).

195. Schramm v. Comvest, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,616 (C.F.T.C. Nov. 4, 1982); Ashlock v. Premex, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,602 (C.F.T.C. Oct. 8, 1982).

196. Jackson v. Premex, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,618 (C.F.T.C. Nov. 17, 1982); Caldwell v. Miller-Jesser, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,614 (C.F.T.C. Oct. 14, 1982); *cf.* Millman v. International Precious Metals Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,663 (C.F.T.C. Sept. 27, 1982) (failure to follow customer's instructions not a violation of the Commodity Exchange Act because the customer could not prove that he gave an unequivocal instruction).

tifraud rule for commodity options,[197] but the courts have divided on whether scienter is required under the rule.[198] Equally confusing is the CFTC antifraud rule concerning the trading of foreign futures contracts in the United States.[199] Although modeled after section 4b of the CEA, this rule does not contain an express willfulness requirement. The First Circuit held that the rule requires a finding of reckless conduct.[200] The CFTC, however, held that the same antifraud rule does not require willful conduct to establish a violation.[201] The Seventh Circuit also concluded that the CFTC antifraud rule for leverage contracts does not include a scienter requirement.[202] Furthermore, the Ninth Circuit held that the CFTC antifraud provision for commodity pools and commodity trading advisors[203] does not require scienter.[204] These provisions contain language similar to that in rule 10b-5 and section 17(a) of the Securities Act of 1933, which raises the question whether *Hochfelder* or *Aaron* ultimately will control the application of scienter.

In sum, courts tend to require some element of scienter in establishing a fraud violation under the CEA and its regulations. Nevertheless, careful scrutiny must be given to the specific antifraud provision at issue and alternative provisions of the CEA must be examined to determine if liability may be imposed without a requirement of scienter.

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197. 17 C.F.R. § 32.9 (1984). The CFTC modeled this rule after § 4b but eliminated the willfulness language. *See* 40 Fed. Reg. 26,504 (1975).

198. *Compare* CFTC v. J.S. Love & Assocs. Options, Ltd., 422 F. Supp. 652, 659-60 (S.D.N.Y. 1976) (CFTC rule 30.01 can be violated absent "willful misconduct") *with* CFTC v. United States Metals Depository Co., 468 F. Supp. 1149, 1162 n.55 (S.D.N.Y. 1979) (CFTC need not prove scienter in order to establish that defendant violated the law) *and* CFTC v. Sterling Capital Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787 (N.D. Ga. Feb. 20, 1981) (scienter or willful misconduct is a required element for a violation of 4b(A)) *and* Gravois v. Fairchild, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,878 (E.D. La. Nov. 9, 1978) (willful misconduct required to establish misrepresentation).

199. 17 C.F.R. § 30.02 (1981).

200. *See* First Commodity Corp. v. CFTC, 676 F.2d 1, 6-7 (1st Cir. 1982).

201. *See* Ruddy v. First Commodity Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,435, at 26,084 (C.F.T.C. Mar. 31, 1981); *see also* Aronow v. First Nat'l Monetary Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,282 (C.F.T.C. June 13, 1984) (antifraud rule for leverage contract does not contain security requirement).

202. *See* CFTC v. Premex, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,229, at 25,125 (7th Cir. July 28, 1981).

203. *See* 7 U.S.C. § 60 (1982).

204. *See* CFTC v. Savage, 611 F.2d 270, 283 (9th Cir. 1979); *see also* Bowersox v. First Commodity Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,248, at 29,282 n.2 (N.D. Cal. June 27, 1984); Taylor v. Peabody Trading Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,926 (C.F.T.C. Nov. 17, 1983).

V. Secondary Liability Under the CEA

Section 2(a)(1) of the CEA[205] establishes statutory liability under the doctrine of *respondeat superior* for persons subject to the Act. The CFTC has sought to apply this standard broadly to impose liability upon brokerage firms and agents. In *In re Big Red Commodity Corp.*[206] a futures commission merchant was held liable by a CFTC administrative law judge for the fraudulent acts of one of its employees, even though the futures commission merchant was unaware of the fraud and did not "knowingly participate" in that fraud.[207]

Subsequent to the decision in *Big Red Commodity*, Congress enacted a "controlling person" provision that precludes imposition of liability upon "any person who directly or indirectly, controls any person who has violated any provision of" the CEA unless it is proven that "the controlling person did not act in good faith or knowingly induced directly or indirectly, the act or acts constituting the violation."[208] In adopting this provision, Congress made clear its intention that the *respondeat superior* provision of section 2(a)(1) "not be used as a basis for imputing liability to a controlling person of a firm for acts of an employee or agent of the firm since it does not include the protections that have been care-

205. 7 U.S.C. § 2(a)(1) (1982).

206. [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,390 (C.F.T.C. Feb. 23, 1982). The associated person of the futures commission merchant was also the president of an unrelated commodity pool. The associated person defrauded the pool in bis capacity as president, and the administrative law judge imputed that fraud to the futures commission merchant. *Id.* at 26,479. *But see* Bennett v. E.F. Hutton Co., 16 Sec. Reg. & L. Rep. (BNA) No. 48, at 1934 (N.D. Ohio, Nov. 28, 1984). In Kessenich v. Rosenthal & Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,181 (C.F.T.C. Mar. 21, 1981), the CFTC refused to hold individual general partners of a partnership liable for violations of the CEA "[a]bsent proof of active participation in or aiding and abetting of the fraudulent course of conduct" of their employees. *Id.* at 24,866 n.15. The CFTC nevertheless noted that the general partners could be liable for damages because of their absolute liability as partners, even though they themselves did not violate the statute. *Id.*; *see also* CFTC v. Commodities Fluctuations Sys., Inc., 583 F. Supp. 1382 (S.D.N.Y. 1984); Behl v. Stanford Management Corp., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,353 (C.F.T.C. Sept. 10, 1984); Imhof v. Weinberg Bros. & Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,096 (C.F.T.C. Apr. 25, 1984).

207. *In re* Big Red Commodity Corp., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,390, at 25,884 (C.F.T.C. Feb. 23, 1982); *see also* Nobel v. Williston Corp., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,227 (C.F.T.C. July 24, 1981); Perkins v. First London Commodity, Ltd., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,659 (C.F.T.C. Aug. 15, 1978); McHaney v. Winchester-Hardin-Oppenheimer Trading Co., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,586 (C.F.T.C. Apr. 3, 1978); Markham & Meltzer, *supra* note 180, at 1125-34.

208. H.R. Rep. No. 964, 97th Cong., 2d Sess. 48 (1982).

fully articulated in the . . . [controlling person provision] and would make a nullity of that provision."[209] The controlling person provision does not permit imposition of liability for monetary damages; rather it is directed for use in CFTC proceedings. Therefore, the provision appears to preclude damage actions when a controlling person relationship is asserted as the basis for liability.[210]

The CEA also contains a specific statutory provision that imposes liability upon anyone who aids and abets the violations of another.[211] The CFTC has stated that liability for aiding and abetting may be imposed only when there is "proof of a specific unlawful intent to further the underlying violation," and "one must knowingly associate himself with an unlawful venture, participate in it as something that he wishes to bring about and seek by his action to make it succeed."[212] A CFTC hearing officer, however,

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209. *Id.*; *see* Bowersox v. First Commodity Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,248 (N.D. Cal. June 27, 1984).

210. The federal securities laws also contain a "controlling person" provision, but do not contain an express *respondeat superior* provision such as that in the CEA. Courts have expressed differing views on whether a controlling person provision precludes application of a common law *respondeat superior* liability under the federal securities laws. *See* Sharp v. Coopers & Lybrand, 649 F.2d 175, 181-83 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982); Marbury Management, Inc. v. Kohn, 629 F.2d 705, 712-16 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); Zweig v. Hearst Corp., 521 F.2d 1129, 1132-33 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975); Johns Hopkins Univ. v. Hutton 422 F.2d 1124, 1130 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974).

211. 7 U.S.C. § 13c(a) (1982).

212. *In re* Richardson Sec., Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,145, at 24,642, 24,646 (C.F.T.C. Jan. 27, 1981). The CFTC stated in its *Richardson* opinion that scienter would be required even if it is not required for the underlying violation upon which the aiding and abetting liability is based. *Id.* at 24,646 n.4; *see also* Causle v. Mason Nugent & Co., 2 COMM. FUT. L. REP. (CCH) ¶ 22,346 (S.D.N.Y. Aug. 28, 1984); Barlas v. Munir, [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,224 (E.D.N.Y. July 14, 1981); Bowersox v. First Commodity Corp., 2 COMM. FUT. L. REP. (CCH) ¶ 22,248 (N.D. Cal. June 27, 1984); Sirois v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,306 (C.F.T.C. Aug. 3, 1984); Bogard v. Abraham-Rietz & Co., 2 COMM. FUT. L. REP. (CCH) ¶ 22,273 (C.F.T.C. July 5, 1984); Vehik v. Incomco, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,633 (C.F.T.C. Nov. 18, 1982); *In re* Earl K. Riley Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,854 (C.F.T.C. Nov. 24, 1981). In *In re* Lincolnwood Commodities, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,986 (C.F.T.C. Jan. 31, 1984), the CFTC stated that, while an aider and abettor must know that the principal's activity was unlawful, a claimed ignorance of the law is not a defense. The CFTC also concluded that knowledge may be inferred from all the surrounding circumstances. *Id.* at 28,255; *cf.* King v. First London Commodity, Ltd., 2 COMM. FUT. L. REP. (CCH) ¶ 22,201 (C.F.T.C. May 24, 1984) (no direct evidence that defendant aided and abetted the fraudulent conduct); Cox v. Eastern Capital Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,009 (C.F.T.C. Feb. 16, 1984) (no liability for aiding and abetting despite availability to the defendant of "strong evidence of wrongdoing" by the agent).

imposed a reparations award against a salesman even though he had not been aware of the fraud committed by his firm.[213] The hearing officer concluded that the salesman had benefited by receiving commissions and ordered the salesman to repay the amount of his enrichment.[214] In 1982 the aiding and abetting provisions of the CEA were amended to allow aiding and abetting liability to be imposed in private actions for damages.[215] Previously, the statute had been limited in applicability to CFTC administrative proceedings.

Another form of secondary liability under the CEA is found in a CFTC regulation that requires commodity professionals to supervise their employees.[216] In *Big Red Commodity*,[217] a CFTC administrative law judge concluded that a futures commission merchant had failed to supervise properly a salesperson who had carried out a fraud in an unrelated commodity pool in his capacity as president of the pool.[218] Declining to enumerate any supervisory failures

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213. Zia v. United States Inv. Co., [1982-1984] COMM. FUT. L. REP. (CCH) ¶ 21,613 (C.F.T.C. Oct. 25, 1982).

214. *Id.* at 26,344; *see also In re* International Commodities Corp., [1982-1984] COMM. FUT. L. REP. (CCH) ¶ 21,822 (C.F.T.C. May 23, 1983); *cf.* Middleton v. Neil Stephens Assocs., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,923 (C.F.T.C. Nov. 30, 1983) (president and vice president of firm not liahle despite firm's liability); Lin v. Boston Trading Group, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,731 (C.F.T.C. Apr. 22, 1983) (salesman not liable for excessive commissions resulting from the fraudulent conduct of his employer because, *inter alia*, he received no commissions); Joslyn v. United States Inv. Co., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,711 (C.F.T.C. Apr. 22, 1983) (person who did nothing more than solicit account that was later deemed to involve fraudulent claims was liable for the amount of his commissions on the sale because "he should have had some idea that matters may not have been what they seemed"); Vehik v. Incomco, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,633 (C.F.T.C. Nov. 18, 1982) (that defendant was president of the futures commission merchant and "expressed knowledge of and responsibility for the handling of the accoimt" is insufficient to show that defendant aided and abetted churning of the account by a business associate).

215. *See* 7 U.S.C. § 25 (1982). The courts were previously divided on whether the limitation on the application of aiding and abetting liability to CFTC proceedings precluded its application in private actions. *Compare* Strax v. Commodity Exch., Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,243 (S.D.N.Y. Sept. 11, 1981) (no private right of action available) *with* Barlas v. Munir [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,224 (E.D.N.Y. July 14, 1981) (private right of action available).

216. 17 C.F.R. § 166.3 (1984); Rosen and Shapiro, *Regulation 166.3: Actions Under the Diligent Supervision Rule*, (Part II) 4 Comm. L. Letter 3 (Nov. 1984).

217. [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,390 (C.F.T.C. Feb. 23, 1982); *see supra* notes 206-07 and accompanying text.

218. *In re* Big Red Commodity Corp., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,390, at 25,884 (C.F.T.C. Feb. 23, 1982); *see also* CFTC v. Commodities Fluctuations Sys., Inc., 583 F. Supp. 1382 (S.D.N.Y. 1984); Shoshaoni v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,271 (C.F.T.C. July 10,

on which to base liability, the administrative law judge determined that the lack of "reasonable supervisory procedures" itself demonstrated a lack of supervision.[219]

VI. Fiduciary Duties Under the CEA

A frequent issue raised in CEA cases is whether brokers owe their customers a fiduciary duty and, if so, what is the extent of that duty. In *Robinson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[220] an action for losses in trading commodity futures contracts, the district court held that "absent an express investment advisory contract there is no fiduciary duty unless the customer is infirm or ignorant of business affairs."[221] In *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[222] however, the district court held that a *securities* broker owed certain duties even to a nondiscretionary account, including: (1) the duty to recommend a stock only after being informed as to its nature, price and financial prognosis; (2) the duty to execute the customer's orders promptly; (3) the duty to inform the customer of the risks involved in purchasing or selling the security; (4) the duty to refrain from self-dealing or failing to disclose any interests of the broker in a recommended security; (5)

1984); Berisko v. Easter Capitol Corp., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,274 (C.F.T.C. June 27, 1984); Boissonneau v. Dameron, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,016 (C.F.T.C. Feb. 22, 1984); Blome v. R.G. Dickinson & Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,916 (C.F.T.C. Nov. 18, 1983); Roberts v. Lincolnwood Commodities, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,699 (C.F.T.C. Mar. 4, 1983); Shoshaoni v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,271 (1984); Berisko v. Easter Capital Corp., 2 Comm. Fut. L. Rep. (CCH) ¶ 22,274 (1984).

219. *In re* Big Red Commodity Corp., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,390, at 25,884 (C.F.T.C. Feb. 23, 1982). The CFTC has stated that wrongful acts by an employee can be a strong indication of inadequate supervision, but tbat it "recognizes that the performance of a wrongful act by an employee of a commodity firm in the course of bis employment does not necessarily mean tbat the employee was improperly supervised. . . ." Proposed Standards of Conduct, *supra* note 57, at 44,747; *see also* Sherman v. Sokoloff, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. ¶ 21,901 (S.D.N.Y. Sept. 12, 1983) (the court held that a broker was not required to supervise a tbird party managing a customer's account); CFTC v. J.S. Love & Assocs. Options, Ltd., 422 F. Supp. 652, 660 (S.D.N.Y. 1976) (the court declined to establish the standard of absolute liability for failure to supervise); SEC v. Lum's, Inc., 365 F. Supp. 1046, 1064 (S.D.N.Y. 1973) (every violation of law "by a salesman does not necessarily imply a breacb of the employer's duty to supervise" trading). For a discussion on the importance of supervision requirements in the context of federal securities laws, see Longstretb, *Duty to Supervise Is Critical to Effective Self-Regulation*, Nat'l L.J., May 16, 1983, at 24, col. 1.

220. 337 F. Supp. 107 (N.D. Ala. 1971), *aff'd*, 453 F.2d 417 (5th Cir. 1972).

221. *Id.* at 113; *see also* McGinn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 736 F.2d 1254 (8tb Cir. 1984).

222. 461 F. Supp. 951 (E.D. Mich. 1978).

the duty not to misrepresent any material fact; and (6) the duty to execute orders only after receiving prior authorization from the customer.[223] The Court in *Leib* further stated that when the account is a discretionary one, the broker becomes the fiduciary of the customer in a "broad sense," and is required to: (1) manage the account to comport with the needs and objectives of the customer; (2) keep informed of changes in the market and act responsively to such changes; (3) keep his customer informed as to each completed transaction; and (4) explain the practical impact and potential risks of the course of dealing in which the broker is engaged.[224]

It is unclear whether the standards in *Leib* will be applied to the commodities area, particularly in light of the rejection by courts of a suitability standard in commodities trading.[225] The CFTC has concluded that a fiduciary relationship does exist between a broker and customer[226] and, therefore, even negligent conduct may constitute fraud under section 4b of the CEA.[227] As pre-

223. *Id.* at 953. The court also stated:

> Of course the precise manner in which a broker performs these duties will depend to some degree upon the intelligence and personality of his customer. For example, where the customer is uneducated or generally unsophisticated with regard to financial matters, the broker will have to define the potential risks of a particular transaction carefully and cautiously. Conversely, where a customer fully understands the dynamics of the stock market or is personally familiar with a security, the broker's explanation of such risks may be merely perfunctory.

Id. at 953; *see also*, Kenny v. Shearson/American Express, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,924 (C.F.T.C. Nov. 10, 1983).

In Marchese v. Shearson Hayden Stone, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,217 (9th Cir. June 1, 1984), the court held that a broker is in a fiduciary relationsbip with his customers and has an "affirmative duty of utmost good faith, and full and fair disclosure of all material facts." *Id.* at 29,146 (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963)). In Ray E. Friedman & Co. v. Jenkins, 2 COMM. FUT. L. REP. (CCH) ¶ 22,241 (8th Cir. June 28, 1984), however, the court held that when a nondiscretionary account is controlled by a customer, a fiduciary duty does not attach. *See also* McGinn v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,242 (8th Cir. June 22, 1984).

224. Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. at 953 (citations omitted).

225. *See supra* notes 48-71 and accompanying text. *Compare* Marchese v. Shearson Hayden Stone, Inc., 2 COMM. FUT. L. REP. (CCH) ¶ 22,217 (9th Cir. June 1, 1984) (A commodity broker has a fiduciary relationship with his customers.) *with* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Trabuluski, Civ. No. 83-5987 (9th Cir. 1984) (mem.) (no fiduciary duty where broker is simply executing orders) *and* Ray E. Friedman & Co. v. Jenkins, 2 COMM. FUT. L. REP. (CCH) ¶ 22,241 (8th Cir. June 28, 1984) (no fiduciary duty owed to a client with a nondiscretionary account).

226. Gordon v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,016 (C.F.T.C. Apr. 10, 1980), *aff'd sub nom.* Shearson Loeb Rhoades Inc., Civ. No. 80-7212 (9th Cir. Feb. 12, 1982) (unpublished opinion).

227. The fiduciary duty of brokers is described by the CFTC as follows:

viously discussed,[228] the courts, however, have rejected negligence as a sufficient basis to establish fraud. Nevertheless, the CFTC in a recent decision[229] once again stated that commodity professionals necessarily stand in a fiduciary relationship with their customers. In that decision, the CFTC held that a commodity trading advisor was liable for creating the false expectation that all of a customer's capital would not be at risk in the market.[230]

In *Wattay v. Shearson Hayden Stone, Inc.*[231] the CFTC stated that a brokerage firm employee rendering trading advice to customers had a fiduciary obligation to know all material facts that could affect the customer's trading decision and to disclose the same to the customer. In contrast, in *Rasheed v. Heinold Com-*

> For example, although an associated person may act for some customers only as the conduit for orders by transmitting the orders to an exchange floor for execution, for other customers the associated person may act in an advisory capacity. In the latter case, as here, the scope of an associated person's duties to that customer broadens substantially.
>
> As a fiduciary, an associated person giving commodity trading advice has a duty to know all material market facts which are reasonably ascertainable in connection with a customer's trading decision . . . . In addition, such as associated persons [sic] has a fiduciary duty to disclose these material facts to his customers.

Id. at 23,981 (footnotes omitted); *see also*, Notkin v. Paine, Webber, Jackson & Curtis, Inc., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,236 (C.F.T.C. Aug. 25, 1981).

228. *See supra* notes 179-204 and accompanying text.

229. Graves v. Futures Inv. Co., [1980-1982 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,457, at 26,165 n.20 (C.F.T.C. June 3, 1982).

230. *Id.*; *cf.* Sudol v. Shearson Loeb Rhodes, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 22,112 (C.F.T.C. Apr. 27, 1984). *But see* Peavey Co. v. Mitchell [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,939 (W.D. Okla. Dec. 30, 1983).

231. No. R 76-22 (C.F.T.C. Apr. 20, 1981); *accord* Vetrons v. American Ace, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,726 (C.F.T.C. May 4, 1983); *see also* Domenico v. Rufenacht, Bromegan & Hertz, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,892 (C.F.T.C. Oct. 31, 1983); Stevens v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,839 (C.F.T.C. Sept. 8, 1983); Campbell v. International Precious Metals Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REV. (CCH) ¶ 21,816 (C.F.T.C. July 22, 1983); Newman v. Bache Halsey Stuart Shields, Inc., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,811 (C.F.T.C. July 19, 1983); Sturcken v. Clayton Brokerage Co., [1982-1984 Transfer Binder] (CCH) ¶ 21,727 (C.F.T.C. May 10, 1983); Roberts v. Lincolnwood Commodities, [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,699 (C.F.T.C. Mar. 24, 1983); Mohr v. Gregory Commodity Options, Ltd., [1982-1984 Transfer Binder] (CCH) ¶ 21,688 (C.F.T.C. Mar. 24, 1983); *cf.* Graves v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder], COMM. FUT. L. REP. (CCH) ¶ 21,301, at 25,522 (C.F.T.C. Oct. 14, 1981) (futures commission merchant did not violate 4b(A) of the Commodity Exchange Act by failing to notify customer that his account fell below the required minimum equity). In Fizell v. Cayman Assocs., Ltd., No. R 79-383-80-109 (C.F.T.C. Feb. 22, 1983), a CFTC administrative law judge stated that "[a]s fiduciaries, salesmen have a duty to investigate to determine whether there is an adequate basis for opinions rendered."

modities, Inc.[232] the CFTC stated that an administrative law judge's finding that a respondent had breached its fiduciary duty by failing to disclose material facts would have been better analyzed as a case of misrepresentation rather than using a breach of fiduciary duty as a basis for liability.[233] Regardless of the scope of the duty, a broker is not "a human ticker tape machine who must spend every minute of the day reporting the current floor bids to his customers."[234]

The CFTC recently proposed an amendment to its Risk Disclosure Statements that would require these documents to state that a commodity professional is not relieved of its disclosure responsibilities merely by having a customer sign the Risk Disclosure Statement and that the Risk Disclosure Statement is not the exclusive disclosure requirement under the CEA.[235] The CFTC based this proposal on its assertion that commodity professionals stand in a fiduciary relationship with their customers and that the Risk Disclosure Statement may not, in all circumstances, meet the professionals' fiduciary obligations of disclosure.[236] Because of the CFTC's assertion of such a fiduciary duty, this proposal has met with strong industry opposition.

VII. Forums Available for Customer Remedies

A. Reparation Proceedings

The CEA contains a unique provision that allows the CFTC to award damages to customers in "reparations" proceedings for violations of the CEA by persons registered with the CFTC.[237] To fulfill this responsibility, the CFTC utilizes administrative law judges

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232. [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,837 (C.F.T.C. Aug. 19, 1983).

233. *Id.* at 27,526 n.4.

234. Gregor v. Rosenthal & Co., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,708, at 22,888 (C.F.T.C. Nov. 21, 1978); *see also* cases cited in Markham, *supra* note 194, at 789-99.

235. 47 Fed. Reg. 52,723 (1982) (to be codified at 17 C.F.R. pt. 2), *noted in* Risk Disclosure by Futures Commission Merchants, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,620 (C.F.T.C. Nov. 23, 1982).

236. *Id.* The CFTC release went to great lengths to establish a fiduciary relationship. It also noted that the duties of such a relationship vary substantially depending on the customer. "For example, it seems clear that the scope of . . . disclosure obligations is substantially broader . . . in an advisory capacity for a customer than when simply transmitting a customer's orders to an exchange floor for execution." *Id.* at 26,360; *see also* Gittemeier v. Smith Barney, Harris Upham & Co., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,929 (C.F.T.C. Nov. 30, 1983).

237. 7 U.S.C. § 18(a) (1982).

to hear evidence and make initial decisions. Governed by extensive CFTC regulations,[238] the CEA makes provision for cases to be heard without the requirement of a costly hearing.[239]

After an administrative law judge renders a decision, an appeal may be made to the CFTC, but the CFTC may determine not to review the administrative law judge's action.[240] In the event of such review, or refusal to review, a person adversely affected by a reparations decision may seek further review before a court of appeals. When a party refuses to pay a reparation award, a federal district court may enforce the award.[241] Although the CFTC provides for counterclaims by brokers in federal district court proceedings,[242] a recent circuit court decision held that the Act did not permit this.[243]

In the past, CFTC reparations proceedings were plagued by delays because of an unexpectedly large number of claims made by commodity options customers.[244] Recent legislation[245] and the CFTC's modification of its rules[246] have streamlined these proceedings. No provision exists for a jury trial in reparation proceedings for either a customer or a broker.[247] This disadvantage may be offset by the expedition of proceedings resulting from the expertise of CFTC administrative law judges. Punitive damages have not been awarded in reparations proceedings and discovery rights are limited.[248]

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238. 17 C.F.R. §§ 12.1-.27 (1984).

239. *See* Horwitz & Markham, *supra* note 41, at 94-95; Rosen, *Reparation Proceedings Under the Commodity Exchange Act*, 27 EMORY L.J. 1005 (1978); Shipe, *Private Litigation Before the Commodity Futures Trading Commission*, 33 AD. L. REV. 153 (1981); .

240. 17 C.F.R. § 12.401 (1984).

241. 7 U.S.C. § 18(d) (1982).

242. 17 C.F.R. § 12.19 (1984).

243. Schor v. CFTC, 2 COMM. FUT. L. REP. (CCH) ¶ 22,297 (D.C. Cir. Aug. 10), *reh'g denied*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,297 (D.C. Cir. 1984).

244. *See* S. REP. No. 850, 95th Cong., 2d Sess. 16 (1978).

245. Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (1982). These changes included the elimination of reparations proceedings against persons who are not registered with the CFTC. Congress found that such claims were frequently uncollectible and served only to delay other reparation cases. *See* S. REP. No. 384, 97th Cong., 2d Sess. 48 (1982). The CFTC, however, has decided not to apply this change retroactively. Nelson v. Chilcott Commodities Corp., [1982-1984 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,934 (C.F.T.C. Dec. 12, 1983).

246. 17 C.F.R. §§ 12.1-.408 (1984).

247. *See* Markham, *supra* note 191, at 88.

248. *See* 17 C.F.R. § 12 (1984). The CFTC discovery rule for reparations does not expressly provide for oral depositions. *Id.* §§ 12.30-.36.

B. Arbitration

The CEA provides for exchanges to maintain arbitration forums for customer claims.[249] A customer, however, is not required to submit to arbitration; the agreement to do so must be "voluntary." CFTC regulations governing voluntary arbitration require specified language that must be contained in the customer's account agreement and a separate customer signature agreeing to arbitration.[250] Arbitration offers the advantages of speed, lack of publicity, and reduced costs because of the absence of the formal procedures of federal district court litigation or reparations proceedings. Further, rights of appeal are extremely limited and awards are generally final.[251] As with reparations proceedings, no provision for a jury trial exists and discovery, if permitted at all, is generally very limited.

C. Private Rights of Action

In *Merrill Lynch, Pierce, Fenner & Smith v. Curran*,[252] the Supreme Court held that a private right of action exists for some violations of the CEA. Subsequently, the CEA was amended to reflect this holding and the CEA now allows private damages actions for violations of its provisions.[253] These actions, however, may be brought only by traders, and not by persons indirectly affected. The legislation limits actions against the exchange by requiring that a plaintiff show that the exchange acted in bad faith.[254]

Federal court litigation, of course, may be more expensive and time consuming than arbitration or reparations, but it offers the advantages of full discovery, the right to a jury trial, and the full right of appeal.

VIII. Conclusion

The CFTC has now been in existence for over ten years, and a rapidly developing body of case law has done much to clarify the applicable standards for customer protection under the Commodity Exchange Act. The CFTC has actively sought legislation in ar-

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249. 7 U.S.C. § 7(a)(11) (1982); *see* Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,942 (5th Cir. Dec. 16, 1983).

250. 17 C.F.R. §§ 180.1-.5 (1984).

251. 9 U.S.C. §§ 1-14 (1982).

252. 456 U.S. 353 (1982).

253. 7 U.S.C. § 25 (1982).

254. Horwitz & Markham, *supra* note 41, at 97-98.

eas in which it has found customer protection wanting. A numher of issues are, however, in need of additional clarification. More definitive standards and guidelines are needed for determining whether the level of trading in a customer's account is so excessive as to constitute churning. Additional standards should he established for unauthorized trading. The overwhelming number of cases arising under the Commodity Exchange Act are claims of unauthorized trading—claims that all too frequently appear to be motivated by the unprofitable nature of the transaction rather than a concern over lack of authority. These abuses could be stemmed, for example, by establishing more exact requirements on the duty to complain—thus reducing the number of claims and greatly alleviating the litigation calendars of the CFTC and the courts.

Finally, the creation of a National Futures Association should permit the development of a nationwide arbitration system that will permit speedy resolutions of customer disputes without prohibitive costs. The development and use of expert arbitrators should preclude the necessity of long explanations of the futures markets or the use of experts to describe those markets. The Arbitration Projects National Futures Association also should hasten the resolution of the many complex issues that arise in the context of commodities markets.

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