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Regulation Of Commodity Pool Operators Under The Commodity Exchange Act

Jeffrey S. Rosen

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REGULATION OF COMMODITY POOL OPERATORS UNDER THE COMMODITY EXCHANGE ACT

JEFFREY S. ROSEN*

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I. THE COMMODITY POOL OPERATOR—A RECENT COMMODITY PROFESSIONAL

In 1974, Congress established the present matrix of commodity regulation by enacting the Commodity Futures Trading Commission Act of 1974 (the "Act")¹ as a series of amendments to the then-existing Commodity Exchange Act.² The Act established a new independent regulatory agency,

¹ Pub. L. No. 93-463, 88 Stat. 1389 (1974).

² 7 U.S.C. §§ 1-17 (1970) [hereinafter cited as the "Act"]. The Supreme Court discussed at length the genesis and development of the Act in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 360-67 (1982). Briefly, the Act dates from 1921 with the passage of the Futures Trading Act, 42 Stat. 187 (1921). In *Hill v. Wallace*, the Supreme Court held the Futures Trading Act unconstitutional as an improper exercise of the taxing power. 259 U.S. 44 (1922). The Grain Futures Act enacted the regulatory provisions of the Futures Trading Act. Grain Futures Act of 1922, Pub. L. No. 67-331, 42 Stat. 998 (codified as amended at 7 U.S.C. § 2 (1982)). The Supreme Court upheld the regulations under the Commerce Clause. *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 31 (1923). In 1936, new legislation changed the name of the Futures Trading Act to the Commodity Exchange Act and significantly expanded its coverage. Commodity Exchange Act, ch. 545, 49 Stat. 1491 (1936). Congress further amended the Commodity Exchange Act in 1968 and also in 1974 by establishing the Commodity Futures Trading Commission and expanding the Commodity Exchange Act to cover all commodities instead of just certain enumerated commodities. Commodity Exchange Act of 1968, Pub. L. No. 90-258, 82 Stat. 26; Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974) [hereinafter cited as the "1974 Act"]. The Act was amended again in 1978 by passage of the Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865 (1978) [hereinafter cited as the "1978 Act"] and in 1982 by the Futures Trading Act of 1982, Pub. L. No. 444, 96 Stat. 2294 (1983). See Rosen, *The Impact of the Futures Trading Act of 1982 upon Commodity Regulation*, 15 SEC. REG. & L.

the Commodity Futures Trading Commission (the "Commission" or "CFTC"), with exclusive, pervasive authority over commodity trading and professionals,³ including a previously unregulated entity, the commodity pool operator.⁴ The commodity pool operator was one of three classes of commodity professionals recognized and required to register with the Commission by the 1974 legislation, the others being commodity trading advisors and associated persons of a futures commission merchant.⁵

The new legislation defined a commodity pool operator as

. . . any person engaged in a business which is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market, but does not include such persons not within the intent of this definition as the Commission may specify by rule or regulation or by order.⁶

REP. (BNA) 142 (1983) (general discussion of 1982 legislation); Schneider & Santo, *Commodity Futures Trading Commission: A Review of the 1978 Legislation*, 34 BUS. LAW. 1755 (1979) (review of 1978 legislation); Young, *A Test of Federal Sunset: Congressional Reauthorization of the Commodity Futures Trading Commission*, 27 EMORY L. J. 853 (1978) (analysis and discussion of genesis of 1978 legislation).

³ 7 U.S.C. §§ 2, 4a (1982). Prior to 1974, the regulatory agency was the Commodity Exchange Authority of the Department of Agriculture ("CEA"). The CEA administered trading only in specifically enumerated agricultural commodities. 7 U.S.C. § 2 (1982). Congress intended that the CFTC be a regulatory agency for commodities just as the Securities and Exchange Commission regulates securities. S. REP. NO. 1131, 93d Cong., 2d Sess. 19, reprinted in 1974 U.S. CODE CONG. & AD. NEWS 1589, 1596. See generally 1982 CFTC ANN. REP. 31-106 (1982) (overviews of CFTC and CFTC operations); JOHNSON, COMMODITIES REGULATION, Vol. II, §§ 4.00-4.129 (1982) (same); Tendick & Gaine, *Introducing Regulator: the CFTC*, 35 BUS. LAW. 751 (1980) (same); Rainbolt, *Regulating the Grain Gambler and His Successor*, 6 HOFSTRA L. REV. 1 (1977) (background and discussion of 1974 Act and creation of CFTC); Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L. REV. 1, 1-20 (1976) (same).

⁴ 7 U.S.C. §§ 2, 61, 6m, 6n, 6o (1982). See *infra* text accompanying note 6 (definition of pool operator).

⁵ S. REP. NO. 850, 95th Cong., 2d Sess. 60, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 153. The same legislation brought commodity trading advisors and pool operators within the CFTC's regulatory ambit. 7 U.S.C. §§ 2, 61, 6m, 6n, 6o (1982). Section 204(a) of the 1974 Act mandated the third new registration category, associated persons of a futures commission merchant. 7 U.S.C. § 4k(1) (1982). Section 103(a) of the 1974 Act transferred regulatory purview over the previously existing registration categories, futures commission merchant and floor broker, to the CFTC. 7 U.S.C. § 6d (1982) (registration of futures commission merchant required); 7 U.S.C. § 6e (1982) (registration of floor broker required). See *infra* text accompanying notes 220-47 (discussion of interaction of pertinent registrants with commodity pool operators).

⁶ Commodity Futures Trading Commission Act of 1974 § 202, Pub. L. No. 93-463, 88 Stat. 1389, 1396 (codified at 7 U.S.C. § 2 (1982)).

Commodity pool operators previously were unregulated except that certain exchanges, recognizing the emergence of commodity pools, had adopted rules requiring members to maintain special records on pools and requiring pools to post higher margins for trades.⁷ Further, pool operators since 1968 had been subject to the general anti-fraud provisions of section 4b of the Act, which antedated the 1974 Amendments.⁸

Legislative history regarding the derivation of the concept of the commodity pool operator is sparse indeed.⁹ The legislative scheme for commodity pool operators was memorialized in section 205 of the Act¹⁰ which added four sections to the existing Act. The new section 41 of the Act¹¹ set forth Congress' finding that the activities of commodity trading advisors and pool operators are affected with a national public interest based upon the use by these professionals of the mails and the means and instrumentalities of interstate commerce, and by their involvement with the purchase and sale of commodities for future delivery on or subject to the rules of contract markets, in such volume as to substantially affect transactions on contract markets. The next section, 4m, made it unlawful

⁷ JOHNSON, *COMMODITIES REGULATION*, Vol. I, § 1.59, at 143-44 (1982).

⁸ 7 U.S.C. § 6b (1982). Section 6b had been amended in 1968 to make its anti-fraud prescription applicable to "any person," rather than the previously limited class of commodity exchanges and their correspondents, agents and employees. Act of Feb. 19, 1968 § 5, Pub. L. No. 90-258, 82 Stat. 26 (1968).

⁹ The commodity pool operator's sister registrant, the commodity trading advisor, has a regulatory analogue under federal securities laws, the investment advisor as defined and regulated by the Investment Advisors Act of 1940. 15 U.S.C. §§ 80b-1 *et seq.* (Supp. V 1981). The Commodity pool operator has no securities law analogue since no statute requires the operators of investment companies to register with the SEC.

In hearings before the House Committee on Agriculture regarding the 1974 legislation, the then Assistant Secretary of Agriculture, Dr. Clayton Yeutter stated:

One of the ways in which unsophisticated traders have lost substantial amounts of money is through commodity advisors and commodity pool operators. This bill will provide for the registration of all such persons, establish procedures under which they will be permitted to operate and specifically eliminate certain undesirable practices which have enticed unsuspecting traders into the markets with, far too often, substantial loss of funds.

H.R. REP. NO. 975, 93d Cong., 2d Sess. 79 (1974). The Commission cited the Yeutter statement when first proposing regulations for commodity pool operators in 1977 as evidence that § 4n of the Act, relating to commodity pool operators, "was designed to protect unsophisticated traders from undesirable managerial and trading practices of pool operators." 42 Fed. Reg. 9266 (1977).

Other legislative history concerning commodity pool operators mainly consists of paraphrased legislative provisions without further elucidation. *See* S. REP. NO. 1131, 93d Cong., 2d Sess. 33-35, *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 5843, 5872-75.

¹⁰ Pub. L. No. 93-463, 88 Stat. 1389, 1397-1400 (1974).

¹¹ 7 U.S.C. § 61 (1982). Section 61 provides that the activities of commodity trading advisors and commodity pool operators are of national public interest. Section 3 of the Act survived the 1974 Act amendments intact and sets forth a conceptually similar finding that commodity futures transactions are affected with a national public interest and regulation is needed for the protection of interstate commerce. 7 U.S.C. § 5 (1982).

for any commodity trading advisor or commodity pool operator not registered under the Act, to use the mails or interstate commerce in connection with his activities as a commodity trading advisor or pool operator.¹² Section 4n prescribed a registration process for commodity trading advisors and pool operators, permitted the CFTC to promulgate book and recordkeeping requirements, mandated that each commodity pool operator regularly furnish statements of account to each participant in the manner prescribed by the Commission, and specified certain registration disqualification standards for commodity pool operators and trading advisors.¹³ Finally, the new section 4o(1) of the Act¹⁴ prohibited fraud by a commodity pool operator or commodity trading advisor registered under the Act, while section 4o(2)¹⁵ forbade a commodity trading advisor or commodity pool operator to represent or imply that the United States or any agency or officer thereof had sponsored, recommended, approved, or passed upon the abilities or qualifications of the advisor or operator. The Act permitted such registrants to state that they were registered under the Act if the statement was true and did not misrepresent the effect of such registration. Congress added teeth to the statutory provisions by amending section 9(c) of the Act to include sections 4m and 4o of the Act among those sections in which a violation constituted a misdemeanor.¹⁶

The pool operator provisions of the new legislation were due to become effective on April 21, 1975.¹⁷ In view of the administrative burden imposed on the Commission in implementing the legislative program memorialized in the 1974 Act, the President signed a Congressional resolution into law on April 16, 1975 which, among other matters, authorized the Commission to defer the effectiveness of the commodity pool operator provisions for another ninety days.¹⁸ The CFTC immediately published a *Federal Register* notice exercising its authority to defer the effectiveness of the provisions until July 18, 1975 to give the Commission additional time to process an influx of registration applications from individuals and entities now required to register with it, and to perform necessary fitness checks.¹⁹

¹² 7 U.S.C. § 6m (1982). The registration provision of the Act was renumbered § 4m(1) of the Act by § 103 of the 1982 Act. Pub. L. No. 97-444, 96 Stat. 2294, 2296-97 (1983) (to be codified at 7 U.S.C. § 6m(1)).

¹³ 7 U.S.C. § 6n (1982). Sections 4m and 4n of the Act will be discussed in further detail later in this article. See *infra* Part III (registration); Part IV (CFTC regulatory scheme).

¹⁴ 7 U.S.C. § 6o(1) (1982).

¹⁵ 7 U.S.C. § 6o(2) (1982). Both subsections of § 4o of the Act, as subsequently amended, will be discussed in Part IV(F), *infra*.

¹⁶ 7 U.S.C. § 13(c) (1982). The Futures Trading Act of 1978 elevated a knowing violation of § 4o(1) to a felony, while retaining misdemeanor treatment for violation of Sections 4m and 4o(2). 7 U.S.C. §§ 13(b)-(c) (1982).

¹⁷ 1974 Act, Pub. L. No. 93-463, § 418(a), 88 Stat. 1389, 1415-16 (1974).

¹⁸ H.R.J. Res. 335a, Pub. L. No. 94-16, § 1(c), 89 Stat. 77 (1975).

¹⁹ 40 Fed. Reg. 17,409 (1975). By September 1975, 225 pool operators were registered with the CFTC, and 370 operators were registered as of April 28, 1976. *Report of the Commodity Futures Trading Commission Advisory Committee on Commodity Future Trading*

In 1979, the CFTC promulgated a comprehensive regulatory scheme for commodity pool operators that was significantly strengthened by successor regulations in 1981.²⁰ Congress, in enacting the Futures Trading Act of 1978²¹ and Futures Trading Act of 1982,²² recognized that the operation of commodity pools constitutes a significant segment of the futures industry, and has refined and expanded CFTC oversight of commodity pool registrants.

This article is intended to be a survey of the CFTC's regulation of commodity pool operators and, therefore, is specifically limited to a discussion of the general issues and questions engendered by that regulation. Although commodity pool interests are securities and the raising of capital for such pools is subject to the securities laws, the securities law implications and treatment of such interests is outside the scope of the present

Professionals, "Summary of Major Recommendations", FUT. L. REP. (CCH) ¶ 20,197 at 21,096, 21,098 n.3 (1976) [hereinafter cited as "Advisory Committee Report"]. The text of the entire Advisory Committee Report was published in COMM. FUT. L. REP. (CCH) (Special Ed. No. 29, August 20, 1976). By April 1979, 619 commodity pool operators were registered, the number growing to 786 by April 1980, an increase of 27%. 45 Fed. Reg. 51,600 (1980). During the 1982 fiscal year, the CFTC's Registration Unit processed 1,164 applications for registration and re-registration for commodity pool operator licensure. There were 727 commodity pool operators registered with the Commission as of September 30, 1982. 1982 CFTC ANN. REP. 81, 81 (1982).

The CFTC does not compile data with respect to the size of various commodity pools, therefore no definitive figures for total pool equity exist. The CFTC's Committee on Commodity Futures Trading Professionals made a rough estimate in its Report dated August 12, 1976 that pool operators currently manage about \$75,000,000. *Advisory Committee Report, supra*, at 21,098 n.3. By midsummer of 1982, the total equity of publicly offered commodity funds registered with the Securities and Exchange Commission ("SEC") was approximately \$377,500,000. 42 MANAGED ACCT. REP. 4 (1982). By March 1, 1983, the estimated total assets of the public pools had grown to \$600,000,000, caused in part by the registration of a number of large additional pools, including one for \$50,000,000. *Commodity Pools for Futures Novice*, Chi. Tribune, Feb., 1983. The \$600,000,000 figure was independently confirmed in an interview between the author and Morton S. Baratz, Research Director of *Managed Account Reports*. See Maidenberg, *Pools, Funds, Collide with Markets, Industry X*, COMMODITIES; THE MAG. OF FUT. TRADING, 39 (Dec. 1981) (estimating \$400,000,000 invested in commodity funds and pools as of July 1, 1981).

²⁰ 44 Fed. Reg. 1918 (1979). The regulatory scheme for commodity pool operators was substantially revised in 1981. 46 Fed. Reg. 26,004 (1981). The current regulations are published at 17 C.F.R. §§ 4.1-4.23 (1982) except for certain minor technical revisions published December 22, 1982. 47 Fed. Reg. 46,996, 57,011-12 (1982). The regulatory scheme is the subject matter of Part IV *infra*.

²¹ Pub. L. No. 95-405, 92 Stat. 865 (1978).

²² Pub. L. No. 97-444, 96 Stat. 2294 (1983). The primary motivation for the 1978 and 1982 Futures Trading Acts was that Congress in establishing the CFTC in 1974 enacted a rare "sunset" provision, causing the appropriations for the agency to expire in four years unless reauthorized by Congress in 1974. Pub. L. No. 93-463, § 101(d), 88 Stat. 1389, 1391 (1974) (codified at § 12(d) of the Act, 7 U.S.C. § 16(d)). The 1978 Futures Trading Act authorized the Commission's existence for another four years. Pub. L. No. 95-405, § 20, 92 Stat. 865, 875 (1978). See Young, *supra* note 2, at 853 *et seq.* (discussion of history of "sunset" provision and 1978 reauthorization process). The 1982 Act reauthorized the CFTC for an additional four years. Pub. L. No. 97-444, § 228, 96 Stat. 2294, 2318 (1983).

article.²³ Finally, this article will not discuss the tax aspects of commodity pools.

II. THE COMMODITY POOL—DEFINITION, FORM AND FUNCTION.

The entity registered with the CFTC and regulated pursuant to the Act is the commodity pool operator, and not the commodity pool. Indeed, the term "pool" is not even defined in the Act. The concepts of commodity pool and commodity pool operator, however, may not be disjoined because by organizing and operating an entity characterizable as a commodity pool, a person becomes a commodity pool operator and, therefore, is subject to CFTC purview.

A. *The Parameters of the Commodity Pool*

1. Regulatory Definition of Commodity Pool

Commission regulation 4.10(d) defines a "pool" as "any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading commodity interests."²⁴ Prior to the revision of the Commis-

²³ The question of whether or to what extent securities laws are applicable to commodity pool operators and commodity pool interests has been a matter of some controversy. The 1974 Act granted the CFTC exclusive jurisdiction over accounts, agreements and transactions involving futures contracts, commodity options and leverage contracts. Section 2(a)(1) of the Act, 7 U.S.C. § 2 (1982). See generally Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L. REV. 1 (1976); Russo & Lyon, *The Exclusive Jurisdiction of the Commodity Futures Trading Commission*, 6 HOFSTRA L. REV. 57 (1977). In *Gravois v. Fairchild*, the court dismissed a claim against a commodity pool operator predicated upon violation of state and federal securities laws on grounds of the Act's preemption. 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,872-75 (E.D. La. 1978). But see Meredith v. ContiCommodity Services, Inc., 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,107, at 24,462 (D. D.C. 1980) (dictum that true commodity pool interest is security subject to securities laws). In its rule making notice for the final set of the first pool operator regulations, the Commission stated that it had not yet taken a position on what effect the exclusive jurisdiction had on the relationship of federal securities laws to the formation of commodity pools. 44 Fed. Reg. 1918, 1922 n.19 (1979). The Deputy General Counsel of the Commission, however, opined that state securities laws were preempted. Letter of CFTC Deputy General Counsel Richard E. Nathan to Central Securities Administrators Council on Proposed Guidelines for State Regulation of Commodity Pool Operators, reprinted in 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,445 (1977). Any ambiguity regarding the applicability of at least federal securities laws was resolved by § 4m(2) of the Act. Nothing in the Act relieves a person of his obligation or duty, or affects any right or remedy available under the Securities Act of 1933 or the Securities Exchange Act of 1934. Pub. L. No. 97-444, 96 Stat. 2294, 2296-97 (codified at § 103 of the 1982 Act). The legislative history of the new § 4m(2) furnishes support for the argument that only federal securities laws are applicable to commodity pools and that states are still pre-empted. H.R. REP. NO. 565 Part I, 97th Cong., 2d Sess. at 128-29 (1982); S. REP. NO. 384, 97th Cong., 2d Sess. at 80-82 (1982). Despite the academic arguments as to the applicability of securities laws, however, as a practical matter, prudent commodity pool operators have been complying with the registration provision of both state and federal securities laws.

²⁴ 17 C.F.R. § 4.10(d) (1983).

sion's pool operator regulations in 1981, "pool" was defined as "any investment trust, syndicate or similar form of enterprise *that trades commodity interests*"(emphasis added).²⁵ In modifying the definition, the Commission stated that it intended to exclude more persons from registration as commodity pool operators by specifying that "a pool is an entity operated for the purpose of trading commodity interests."²⁶ In adopting the current regulation 4.10(d) the Commission noted that commentators, although agreeing with the objective of clarifying the scope of the term "pool", still found the proposed definition overly broad.²⁷ The Commission rejected the approach suggested by one individual that a percentage of assets tests determine what constitutes a commodity pool since such a test failed to take into account that an entity committing less than the minimum percentage to commodities trading might nevertheless be marketed and sold as a commodity pool, thus entitling its participants to the protection of the pool operator regulations.²⁸ The Commission did state, however, that it would entertain requests for staff interpretation as to whether a particular entity was outside the pool requirements. The CFTC would consider among other exemptive factors, whether (1) an entity seeking exemption only occasionally trades commodity interests, (2) the party commits a limited amount of its assets to such trading, (3) the party is hedging its other assets with commodity interests and is not speculating, and (4) the participants in the entity are knowledgeable in business matters and financially secure. The Commission reports that in fiscal year 1982, it responded to more than fifty requests for exemptions and interpretations of the commodity pool operator and commodity trading advisor rules, most concerning registration requirements and the definition of the term "pool".²⁹

2. Court Decisions on Definition of a Pool

Those few courts that have had the opportunity to consider the definition of a commodity pool have been consistent in their approach. In

²⁵ *Id.* The CFTC took an early position that the operation of a commodity pool, not just the solicitation of participant funds, make a party a commodity operator. CFTC Interpretative Letter No. 75-17, reprinted at 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,112 (1975) [hereinafter cited as *CFTC Interpretative Letter 75-17*].

²⁶ 45 Fed. Reg. 51,600 (1980).

²⁷ 46 Fed. Reg. 26,004, 26,005 (1981).

²⁸ *Id.*

²⁹ 1982 CFTC ANN. REP. 80 (1982). The CFTC Division of Trading and Markets has entertained a number of requests for interpretative letters exempting entities registered with the SEC pursuant to the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 - 80a-52 (Supp. V 1981), from the pool operator regulations. The Commission took the position as early as 1975 that registration under the Investment Company Act did not of itself exempt an entity from regulation as a commodity pool operator. *CFTC Interpretative Letter 75-17*, *supra* note 25. See Committee on Commodities Regulation, *40 Acts Applicability to Commodity Pools and Trading Advisors*, 37 REC. N.Y.B.A. 611, 645-49 (1982) (discussing and analyzing number of interpretive letters).

Meredith v. ContiCommodity Services, Inc.,³⁰ the United States District Court for the District of Columbia rejected the plaintiff's contention that his individual discretionary account should be considered part of a commodity pool because the defendant had treated his account along with others on an aggregate basis and had utilized the same trading program. The *Meredith* court rejected plaintiff's contention holding that all commodity pool investors' funds go into a single account. The pool executes transactions for the benefit of the entire account. Since profits and losses are allocated to each investor based on their contribution to the fund, the transactions are not allocated to any particular investor.³¹ The *Meredith* court then found that because the plaintiff did not claim that investors' funds were actually pooled, the fact that all accounts may have been traded the same way did not suffice to create a commodity pool.³² In *International Cattle Systems v. Parsons*,³³ the United States District Court for the District of Kansas relied on the decision in *Meredith*. In *International Cattle Systems*, the court, citing *Meredith*, determined that since each of the commodity trades in question was identified for a specific customer, the common sharing of profits or losses characteristic of a commodity pool was not present.³⁴

In *CFTC v. Heritage Capital Advisory Services, Ltd.*,³⁵ the District Court for the Northern District of Illinois relied on *Meredith* in granting a preliminary injunction and asset freeze against an alleged unregistered pool operator. In *Heritage*, the defendants had solicited and pooled public funds with the stated intention of investing approximately 97% of the proceeds in United States Treasury bills, and using the remainder to hedge the account by trading futures contracts on Treasury bills.³⁶ The *Heritage* court analyzed the mechanics of the commodity futures market and concluded that "[t]he risk to the funds of the defendants' investors far exceeded the 3% discount which was supposedly to be committed to the futures markets" because of the possibility of a rapid decrease in the applicable market or of the pool being required to take delivery of costly Treasury bills pursuant to a future contract.³⁷ The *Heritage* court relied

³⁰ 1980-82 COMM. FUT. L. REP. ¶ 21,107 (D. D.C. 1980).

³¹ *Id.* at 24,462.

³² *Id.*

³³ 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,107, at 25,753 (D. Kan. 1982).

³⁴ *Id.* at 25,756.

³⁵ Current COMM. FUT. L. REP. (CCH) ¶ 21,627, 26,377 (N.D. Ill. 1982).

³⁶ *Id.* at 26,380-82.

³⁷ *Id.* at 26,377-87. Although the *Heritage* court cited a parade of horrors culminating in a conclusion that the risk in a Treasury bill futures contract far exceeds the original margin of \$2,500 and approaches one million dollars or the estimated cost of taking delivery of the bills, such catastrophic events would be highly unlikely to occur. *Id.* at 26,383. The clearing house of the exchange upon which the contract is formed is the guarantor of contract performance, and the fulfillment of contract obligations of a clearing member is guaranteed. Powers, *Getting Started in Futures Trading*, INVESTOR PUBLICATIONS 262-63 (1974). The prudent clearing member would have ordered the contract liquidated before

on *Meredith* in finding the entity to be a commodity pool and in its organization of commodity pool operators required to be registered.³⁸

Curiously, neither the court in *Heritage Capital Advisory Services, Ltd.*, nor the courts in *Meredith* or *International Cattle Systems* referred to or discussed regulation 4.10(d).³⁹ No disparity exists, however, between the regulatory definition of a commodity pool, as promulgated and interpreted by the Commission, and the limited judicial authority construing that term. Any enterprise in which investor funds are combined, placed and traded in a single account, and in which the profits and losses are allocated on a *pro rata* basis to the participants will be considered a commodity pool, unless specifically exempted by the Commission.⁴⁰

B. *Subject Matter of the Commodity Pool—Commodity Interests*

The regulation defining "pool" requires that the enterprise be "operated for the purpose of trading commodity interests."⁴¹ The regulations define "commodity interests" as:

- (1) Any contract for the purchase or sale of a commodity for future delivery; and
- (2) Any contract, agreement or transaction subject to Commission regulation under section 4c or 19 of the Act.⁴²

The first subpart of the definition encompasses futures contracts.⁴³ In-

the delivery date if the pool did not sustain the position with required margin payment. The disclosure document mandated by the CFTC refers to this possibility: "[i]f the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the required funds within the prescribed time, your position may be liquidated at a loss, and you will be liable for any remaining deficit in your account." 17 C.F.R. § 1.55(b) (1983). See *Baker v. Edward D. Jones & Co.*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,167, at 24,768 (Opinion and Order of Commission 1981) (liquidation of futures control for futures to meet margin call, even on short notice, is not unauthorized trading).

³⁸ Current COMM. FUT. L. REP. (CCH) ¶ 21,627, at 26,386. The *Heritage* court stated that 'the salient [sic] features of a commodity pool are: 1) all investors funds are placed in a single account; 2) transactions are executed on behalf of the entire account without allocation to any particular investor; 3) investors profits and losses are then allocated by shares to individual investors based upon their *pro rata* contribution to the fund.' *Id.*

³⁹ 17 C.F.R. § 4.10(d) (1983).

⁴⁰ No minimum number of investors is necessary to constitute a commodity pool. In *Jablonski v. Andre Boesch, Inc.*, the court denied a motion to dismiss and held that an account with the plaintiff as the only participant was still a commodity pool because the account had been offered and sold as a commodity pool. Civ. No. 82-L-326 (D. Neb. February 16, 1983) (Mem. and Order).

⁴¹ 17 C.F.R. § 4.10(d) (1983).

⁴² 17 C.F.R. § 4.10(a) (1983).

⁴³ 17 C.F.R. § 4.10(d) (1983). A futures contract is defined as "a firm commitment to deliver or to receive a specified quantity and grade of a commodity during a designated month with price being determined by public auction among exchange members." CFTC, GLOSSARY OF SOME TERMS COMMONLY USED IN THE FUTURES TRADING INDUSTRY 13 (1979). See

deed, the Act's definition of "commodity pool operator" refers only to an enterprise formed "for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market..." and thus is limited to standard exchange-traded futures contracts.⁴⁴ The CFTC, however, has characterized certain off-exchange commodity contracts as illicit off-exchange futures contracts⁴⁵ and a provision of the 1982 Act strengthens and clarifies the ban on off-exchange commodity contracts.⁴⁶ An entity which invested in these off-exchange instruments, as inconceivable as that might be, would thereby come within the regulatory definition of a commodity pool.

With respect to the second subpart of the regulatory definition, the phrase "transactions subject to Commission regulation under section 4c" of the Act⁴⁷ refers to commodity option transactions.⁴⁸ The reference to section 19 of the Act⁴⁹ refers to leverage contracts.⁵⁰

In bringing option and leverage transactions within the commodity pool ambit, the Commission was aware that it was exceeding the definition of commodity pool operator in section 2(a)(1) of the Act.⁵¹ In initially proposing pool operator regulations, however, the Commission determined

Clark, *Genealogy and Genetics of "Contract of Sale for Commodity for Futures Delivery" in the Commodity Exchange Act*, 27 EMORY L. J. 1175 (1978) (discussion of history, nature and mechanics of futures contracts) [hereinafter cited as *Clark*].

⁴⁴ 7 U.S.C. § 2 (1982).

⁴⁵ See CFTC v. Co Petro Marketing Group, Inc., 502 F. Supp. 806 (C.D. Cal. 1980), *aff'd*, 680 F.2d 573 (9th Cir. 1982) (gasoline contracts held to be futures contracts not sold on designated contract market in violation of §§ 4 and 4h(1) of the Act, 7 U.S.C. §§ 6, 6(h)(1) (1976)); Johnson, *The First and Fastest Felony: Trading Future Of The Exchanges*, 35 BUS. LAW. 711 (1980).

⁴⁶ 1982 Act, Pub. L. No. 97-444, § 204, 96 Stat. 2294, 2299 (1983) (to be codified at § 4(a) of the Act, 7 U.S.C. § 6(a) (1976)).

⁴⁷ 7 U.S.C. § 6c (1982).

⁴⁸ *British American Commodity Options Corp. v. Bagley*, 552 F.2d 482, 484 (2d Cir.), *cert. denied*, 434 U.S. 938 (1977). A commodity option is "a contractual right to buy, or sell a commodity or commodity future by some specific date at a specified fixed price, known as the 'strike price'." *Id.* See generally *Clark*, *supra* note 43, at 1192-198; Lower, *The Regulation of Commodity Options*, 1978 DUKE L.J. 1095 (1978).

⁴⁹ 7 U.S.C. § 23 (1982).

⁵⁰ "A leverage contract is an agreement for the purchase or sale of a contract for the delivery at a later date of a specified commodity in a standard unit and quality, or the close-out of the contract by an offsetting transaction. The principal characteristics of the contract include: (1) standard units, quality terms and conditions; (2) payment and maintenance of margin; (3) close-out by an offsetting transaction or by delivery after payment in full; and, (4) no right or interest in a specific lot of a commodity." S. REP. NO. 850, 95th Cong., 2d Sess. 26 (1978). See Greenstone, *Leverage Transactions; On Creating A Regulatory Theme*, 27 EMORY L.J. 909, 910-16 (1978) (discussion of characteristics of leverage contracts) [hereinafter cited as *Greenstone*]; *Clark*, *supra* note 43, at 1191-92; see also Pierno, *The Leverage Ruling: Is Jonah Really Gone?*, 35 BUS. LAW. 863 (1980) (other commentary concerning regulation of leverage contracts); Weiss, *Leverage Transactions: Survival or Extinction?*, Vol. I, J. FUT. MARKETS 547 (1981).

⁵¹ 7 U.S.C. § 2 (1982).

that trading by a commodity pool in options or leverage contracts should be "be regulated in the same manner as trading in commodity futures contracts." The CFTC carried out regulations defining the term "commodity interests" to include options or leverage contracts pursuant to the Commission's specific authority for these instruments and its general rulemaking power.⁵²

Commodity options have recently enjoyed a renaissance after the CFTC regulated⁵³ and the 1978 Act suspended⁵⁴ commodity options (except for limited, tightly regulated dealer options) in response to commodity option scandals of the middle 1970's. The Commission permitted a pilot program in exchange-traded options on futures contracts to proceed⁵⁵ and recently augmented this program by supplementing existing regulations to authorize exchange-traded options on physical commodities as well.⁵⁶ Congress in the 1982 Act removed the ban on options on agricultural commodities, which had been in place since 1936.⁵⁷ The Commission anticipated trading in the new options by commodity pools. In its December 22, 1982 *Federal Register* Notice of Rulemaking dealing with options, the Commission included technical amendments to the pool operator regulations in contemplation of option trading by pools.⁵⁸ The major substantive change in commodity options trading requires that the pool operator include in its disclosure document⁵⁹ a description of the types of commodity interests that the pool will trade and any restrictions or limitations on commodity option trading established by the commodity pool operator.⁶⁰ A pool operator, therefore, must state precisely the kinds of commodity interests

⁵² 42 Fed. Reg. 9266 (1977). The specific authorizing provisions by the CFTC were §§ 2(a)(1) and 4c of the Act, for options, and § 217 of the 1974 Act, for leverage. The general rulemaking authority sections cited by the CFTC were §§ 8a(5) and 8a(8) of the Act. 7 U.S.C. §§ 12a(5), 12a(8) (1982).

⁵³ CFTC Reg. 32.11 (1978). See Fed. Reg. 16,153 *et seq.* (1978) (discussion of problems that led Commission to enact suspension provisions).

⁵⁴ 1978 Act, Pub. L. No. 95-405, § 3(3), 92 Stat. 865-67 (codified at § 4c(c) of the Act, 7 U.S.C. § 6c(c) (1982)). See Schneider & Santo, *supra* note 2, at 1766-67 (discussion of factors leading to Congressional suspension of options).

⁵⁵ 46 Fed. Reg. 5400 (1981) (codified at CFTC Reg. 33.1 *et seq.*, 17 C.F.R. § 33.1 *et seq.* (1983)).

⁵⁶ 47 Fed. Reg. 56,996 (1982).

⁵⁷ 1982 Act, Pub. L. No. 97-444, § 206, 96 Stat. 2294 (1983) (amending § 4c(c) of the Act). The CFTC has published a Federal Register notice seeking comment on an agricultural option program and announcing a series of public meetings to discuss the proposed option. 48 Fed. Reg. 6128 (1983).

⁵⁸ 47 Fed. Reg. 56,996, 57,011 (1982).

⁵⁹ 17 C.F.R. § 4.21 (1983). Regulation 4.21 requires a pool operator to prepare and disseminate a disclosure document for all pools that he operates. As matter of course, the disclosure document is combined with the offering document required under the applicable securities law provisions. *Id.* See *infra* Part IV(c) (discussing disclosure document requirement).

⁶⁰ 47 Fed. Reg. 57,011 (1982). The remaining changes are technical in nature, and basically contemplate that pool funds may be used as option premiums as well as margin for futures trading.

the pool intends to trade. It seems unlikely that pools would want to speculate in leverage contracts since the Commission has imposed a moratorium on the entry of new firms into the field, substantially limiting the number of leverage dealers.⁶¹ Moreover, leverage contracts are generally long-term and no ready market exists for them because the leverage transaction merchant is the principal and marketmaker of each such transaction.⁶² Commodity pools probably will not deal extensively, if at all, in vehicles other than standard futures contracts. Futures contracts enjoy the benefit of a maximum 32% tax rate, a favorable treatment not enjoyed by options or leverage contracts which probably are subject to standard capital gain holding periods.⁶³ Additional disclosure burdens also are present in discussions of the nature, risks, and mechanics of options and leverage contracts in the disclosure document.

C. *Form of the Commodity Pool*

1. Separate Commodity Pool Required

The present system of regulation requires separation between the commodity pool operator and the pool or pools that it operates. The CFTC requires that a commodity pool operator must operate the pool as a cognizable legal entity separate from that of the pool operator.⁶⁴ A pool operator may not commingle the property of any pool that it operates with the property of any other person, including another pool.⁶⁵ Finally,

⁶¹ 17 C.F.R. § 31.2 (1983).

⁶² H.R. REP. No. 565, Part 1, 97th Cong., 2d Sess. 112-13 (1982). See Greenstone, *supra* note 50, at 910-16.

⁶³ I.R.C. § 1256(a). The Internal Revenue Code states that regulated futures contracts are taxed as if sold for fair market value on the last day of the tax year and any gain or loss is taxed as sixty percent long term capital gain or loss and forty percent short term capital gain. *Id.* To qualify for this treatment, contracts must be marked-to-market under a daily cash flow system and must be subject to the rules of a CFTC or IRS designated contract market. I.R.C. § 1256(b). Most hedging transactions and "mixed" straddles, consisting partially of regulated contracts, may be removed by the taxpayer from § 1256 coverage. Hedging transactions produce ordinary gain or loss under I.R.C. §§ 1092 and 1256. Gain from straddles is generally ordinary under § 1091(a) and (d), 1092 and 1233(b) and (d). Non-hedging transactions falling outside § 1256 yield either long or short term capital gain or loss under the complex provisions of I.R.C. § 1233, depending on the holding period of the asset used to close out a position. See Remarks of Theodore Thomte, President, Thomte & Co., Inc. 1982, Commodities Law Institute Meeting October 7 and 8, 1982 Chicago, Illinois (unpublished) (discussion of why pools are reluctant to trade other than future contracts because of tax consideration).

⁶⁴ 17 C.F.R. § 4.20(a)(1) (1983).

⁶⁵ 17 C.F.R. § 4.20(b) (1983). In *Matter of Zurich Trading Corporation*, CFTC dkt. No. 82-27 (1982) (complaint), the Division of Enforcement charged a commodity pool operator and his principals with commingling of pool accounts in violation of regulation 4.20(c), among other matters. See *CFTC v. Northeast Investment Service, Inc.*, Civ. No. 82-0305 (C.D. Mass. February 12, 1982) (temporary restraining order) (involving allegations of commingling, among others).

consideration for the purchase of a pool interest must be received in the name of the pool, and not the pool operator.⁶⁶ The requirement of separateness of commodity pools and pool operators is a manifestation of the concept of segregation, familiar in other aspects of the commodity regulatory scheme.⁶⁷

2. Legal Structure of the Commodity Pool

Although a commodity pool may be organized as any cognizable legal entity, most are set up as limited partnerships or corporations so that investors may take advantage of the limitation of loss to initial investment, a major reason for the popularity of commodity pools.⁶⁸ The Commission took an early position that each general partner who manages a commodity pool organized as a limited partnership must register separately as a commodity pool operator.⁶⁹ The Commission, however, stated that a general partner who exercises no direction, supervision or control over the pool's funds or property, but is only a passive investor, is not required to register.⁷⁰

The requirement of separation between the pool operator and the pool generated questions concerning the offer and sale of shares by a corporate commodity pool operator who is also the pool. The Commission considered the comments received on the issue, noting that the operator of a pool organized as a corporation might be a member of the corporation's Board of Directors, the chief executive, or the financial officer. The CFTC also noted that the corporation itself was not the pool operator.⁷¹ After publication of the final rule, however, the Commission received requests for exemption from several pool operators organized as corporations for which there was no separate pool. The CFTC accordingly amended the not yet effective regulation to provide for an exemptive procedure.⁷² The Commission now may exempt a corporation from the separate entity requirement if the corporation represents that each participant will be issued stock or other evidences of ownership in the corporation for its participation interests. The corporation also must demonstrate to the satisfaction of the Commission that it has established procedures to assure compliance with the receipt of funds and anti-commingling segments of the regulation. The Commission must find that the exemption is not contrary to the public interest.⁷³

⁶⁶ 17 C.F.R. § 4.20(b) (1983).

⁶⁷ See, e.g., Section 4d(2) of the Act, 7 U.S.C. § 6d(2) (1982); 17 C.F.R. 1.20 (1983); 17 C.F.R. 32.6 (1983).

⁶⁸ JOHNSON, *COMMODITIES REGULATION*, Vol. I, Ch. 1, § 1.15, at 52-53 (1982).

⁶⁹ CFTC Interpretative Letter 75-16, reprinted at 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,104, at 20,777 (1975) [hereinafter cited as *CFTC Interpretative Letter 75-16*].

⁷⁰ CFTC Interpretative Letter 75-11, reprinted at 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,098 at 20,762 (1975).

⁷¹ 46 Fed. Reg. 26,004 (1981).

⁷² 46 Fed. Reg. 34,310 (1981).

⁷³ 17 C.F.R. § 4.20(a)(2) (1983).

D. *The Other Actors in the Commodity Pool Transaction*

1. The Commodity Trading Advisor

Pool operators need not make the trading decisions for the pools that they operate. The receipt of pooled funds and organization of the pool are the hallmarks of the commodity pool operator, and not control over the investment decisions.⁷⁴ It is permissible, and even common for a commodity pool operator to contract with one or more commodity trading advisors.⁷⁵ The advisors in turn must be registered pursuant to section 4m(1) of the Act⁷⁶ in order to call the trading signals for the pool.⁷⁷ Conversely, a commodity pool operator is not required to engage an independent trading advisor to place trades. A pool operator is exempt from registration as a trading advisor if the operator's trading advice is directed solely to, and for the sole use of, the pool or pools that he operates.⁷⁸

The pool operator who does use a trading advisor must disclose substantial information concerning the trading advisor, among other matters, in the disclosure document presented to participants by regulation 4.21.⁷⁹ This information includes the name of the trading advisor and each principal thereof, the name of the person who will make the trading decisions for the pool,⁸⁰ the business background of the trading advisor and each principal thereof for the five years preceding the date of the document,⁸¹ any actual or potential conflict of interest regarding any aspect of the pool on the part of the trading advisor or any principal thereof or an affirmative statement that there is no such conflict,⁸² any material administrative, civil or criminal action within the five years preceding the date of the document against the advisor or any of its principals, and, if no such action has occurred an affirmative statement to that effect,⁸³ and a statement indicating whether the advisor or any principal thereof has or intends to trade in commodity interests for his own account and,

⁷⁴ *CFTC v. Heritage Capital Advisory Services, Ltd.*, Current COMM. FUT. L. REP. (CCH) ¶ 21,627, at 26,387 (N.D. Ill. 1982). See *CFTC Interpretative Letter 75-16*, *supra* note 69, at 20,778.

⁷⁵ Section 2(a)(1) of the Act, 7 U.S.C. § 2 (1976). Section 2 defines a commodity trading advisor in pertinent part as:

any person who, for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in any contract for sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market, any commodity option authorized under section 4c, or any leverage transaction authorized under section 19. . . . *Id.*

⁷⁶ 7 U.S.C. § 6m(1) (1982).

⁷⁷ Mitchell, *The Regulation of Commodity Trading Advisors*, 27 EMORY L.J. 957, 959-61 (1978).

⁷⁸ 17 C.F.R. § 4.14(a)(1) (1983).

⁷⁹ 17 C.F.R. § 4.21 (1983). See *infra* Part IV (full discussion of disclosure document requirement).

⁸⁰ 17 C.F.R. §§ 4.21(a)(1)(iv)-(vi) (1983).

⁸¹ 17 C.F.R. §§ 4.21(a)(2)(iii)-(iv) (1983).

⁸² 17 C.F.R. § 4.21(a)(3) (1983).

⁸³ 17 C.F.R. § 4.21(a)(13) (1983).

if so, whether a participant will be permitted to inspect the records of that person's trades.⁸⁴ The commodity pool operator also must disclose the actual performance for three years preceding the date of the disclosure document of all accounts directed by the advisor and by each of his principals. The document should be in a mandated tabular form setting forth quarterly results current as of a date not more than three months preceding the date of the disclosure document.⁸⁵ If the pool has not commenced trading, and neither the advisor nor its principals have previously directed an account, a mandated warning must be set forth prominently.⁸⁶ Finally, the pool operator must describe all fees for trading advice to the advisor⁸⁷ and must disclose any commission or other fee paid directly or indirectly by the trading advisor or any principals thereof in connection with the solicitation of pool participation interests.⁸⁸

2. The Futures Commission Merchant

The futures commission merchant is the entity that accepts the orders for the commodity trades made by the pool and receives and holds the pool assets used to margin the trades.⁸⁹ The functions of the futures commission merchant may be performed lawfully only by an entity registered as such with the Commission pursuant to section 4d(1) of the Act.⁹⁰ A futures commission merchant must comply with elaborate regulations regarding, among other matters, the maintenance of minimum net capital,⁹¹ the segregation of customer funds,⁹² and book and recordkeeping requirements.⁹³ No prohibition exists that precludes a futures commission merchant from also being a pool operator.⁹⁴

⁸⁴ 17 C.F.R. § 4.21(a)(15) (1983).

⁸⁵ 17 C.F.R. § 4.21(a)(5) (1983).

⁸⁶ 17 C.F.R. § 4.21(a)(5)(i) (1983). The warning in section 4.21(a)(5) states:

THE COMMISSION ALSO REQUIRES THE POOL OPERATOR TO DISCLOSE THE ACTUAL PERFORMANCE RECORD OF ALL ACCOUNTS FOR WHICH THE POOL'S TRADING ADVISOR AND ITS PRINCIPALS HAVE HAD THE AUTHORITY TO CAUSE TRANSACTIONS TO BE EFFECTED WITHOUT CLIENTS' SPECIFIC AUTHORIZATION. YOU ALSO SHOULD NOTE THAT THIS POOL'S TRADING ADVISOR AND ITS PRINCIPALS PREVIOUSLY HAVE NOT HAD SUCH AUTHORITY. *Id.*

⁸⁷ 17 C.F.R. § 4.21(a)(7) (1983).

⁸⁸ 17 C.F.R. § 4.21(a)(14) (1983).

⁸⁹ Section 2(a)(1) of the Act, 7 U.S.C. § 2(a)(1) (1982). Section 2(a)(1) defines futures commission merchants as:

individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, on or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contract that result or may result therefrom. *Id.*

⁹⁰ 7 U.S.C. § 6d(1) (1982).

⁹¹ Section 4f(2) of the Act, 7 U.S.C. § 6f(2) (1982); 17 C.F.R. § 1.17 (1983).

⁹² Section 4d(2) of the Act, 7 U.S.C. § 6d(2) (1982); 17 C.F.R. §§ 1.20-1.29 (1983).

⁹³ 17 C.F.R. §§ 1.31-1.39 (1983).

⁹⁴ CFTC Reg. 1.56, 17 C.F.R. § 1.56 (1983). CFTC Regulation 1.56 prohibits a future

The regulatory scheme of the Act imposes disclosure duties upon commodity pool operators regarding futures commission merchants, but the regulations are not so onerous as those for commodity trading advisors. The commodity pool operator must identify the futures commission merchant through which the pool will execute its trades, if he is known. No requirement mandates, however, that the operator also identify the principals of the futures commission merchant and their business backgrounds, although identification of the principals of the trading advisor and pool operator is required.⁹⁵ Actual or potential conflicts of interest on the part of the futures commission merchant or any of his principals must be disclosed. The disclosure includes any arrangement whereby the commodity pool operator or trading advisor or their principals may benefit, directly or indirectly, from the maintenance of the pool's account with a particular futures commission merchant.⁹⁶ The disclosure document must identify any material administrative, civil, or criminal action against the futures commission merchant or any principal thereof within the five years preceding the document's date. If no such action has occurred, the pool operator must make a statement to that effect with respect to each such person.⁹⁷ Finally, the pool operator must describe brokerage fees incurred or expected to be paid by the pool to the futures commission merchant.⁹⁸ Although the regulatory scheme for pool operators vis-a-vis futures commission merchants places all disclosure duties and relationships with participants squarely on pool operators, the prudent futures commission merchant should be careful in accepting and monitoring commodity pool business in view of certain cases that suggest secondary liability may be present under the Act for a futures commission merchant in cases of serious violations by a pool operator.⁹⁹

3. The Associated Person of the Commodity Pool Operator

(a) Registration of Securities of Pool Participation Interests

In passing the 1982 Act, for the first time Congress required registration for solicitors of commodity pool interests and their supervisors by creating the new registration category called associated person of a com-

commission merchant from guaranteeing any commodity interest against loss and states that the regulation shall not be construed to prevent a futures commission merchant from participating as a general partner in a commodity pool. 17 C.F.R. § 1.56(d)(2) (1983).

⁹⁵ 17 C.F.R. § 4.21(a)(1)(vii) (1983).

⁹⁶ 17 C.F.R. § 4.21(a)(3)(i) (1983).

⁹⁷ 17 C.F.R. § 4.21(a)(13) (1983).

⁹⁸ 17 C.F.R. § 4.21(a)(7) (1983).

⁹⁹ See, e.g., In the Matter of Big Red Commodity Corp., 1980-82 COM. FUT. L. REP. (CCH) ¶ 21,390 (initial decision 1982) (*appeal pending*). In *Big Red*, the administrative law judge issued a civil penalty and cease and desist order against a futures commission merchant who carried several pool accounts operated by corporate pool operators. The principal operator was also an associated person of the futures commission merchant. The administrative law judge found that the factual circumstances combined to give the representation that the pool solicitations were made within the scope of the individual's employ-

modity pool operator.¹⁰⁰ Individuals registered as floor brokers, futures commission merchants, introducing brokers, commodity pool operators, or as associated persons of another category of registrant need not also register as associated persons of a commodity pool operator.¹⁰¹ The Act provides that the associated person requirement take effect on May 11, 1983, 120 days after the date of enactment of the bill.¹⁰²

The creation of the new associated person category ended a search by the Commission for an appropriate regulatory framework for solicitors of pool participation interest and their supervisors. In 1977, the Office of the General Counsel issued an interpretative letter that sales persons for a commodity trading advisor were not required to register under the Act as commodity trading advisors in their own right, a principle equally applicable to solicitors of commodity pool interests.¹⁰³ In promulgating the first version of the commodity pool operator regulations on January 8, 1979, the Commission considered proposing for comment a rule requiring non-clerical employees and agents of commodity pool operators to register in some capacity with the Commission. The CFTC was "particularly concerned about persons who engage in the business of selling interests in commodity pools for or on behalf of the pool's operator. . . ."¹⁰⁴ The Commission reiterated in its Notice proposing the revised rules that it was

ment as an associated person. *Id.* at 25,881-83. Accordingly, liability was imposed upon a theory of failure of the futures commission merchant to supervise his associated person. *Id.* at 25,883-84. See, e.g., *CFTC v. Chilcott Portfolio Management Inc.*, 1980-82 COM. FUT. L. REP. (CCH) ¶ 21,458 (D. Colo. 1982) (Opinion). In *Chilcott*, the court upheld the standing and right of an equity receiver for a defunct commodity pool operator and its pool to pursue claims against several brokerage houses which had carried the pool account. *Id.* at 26,169.

¹⁰⁰ 1982 Act, Pub. L. No. 97-444, § 212, 96 Stat. 2294, 2304 (1983) (codified at § 4k(2) of the Act, 7 U.S.C. § 6k(2)). Section 4k(2) of the Act states in pertinent part:

It shall be unlawful for any person to be associated with a commodity pool operator as a partner, officer, employee, consultant, or agent (or any person occupying a similar status or performing similar function), in any capacity that involves (i) the solicitation of funds, securities, or property for a participation in a commodity pool or (ii) the supervision of any person or persons so engaged unless such person is registered with the Commission under this chapter as an associated person of such commodity pool operator. . . . *Id.*

¹⁰¹ *Id.* The 1982 Act requires for the first time that solicitors of discretionary accounts for commodity trading advisors and their supervisors register as associated persons of the commodity advisor unless registered in another category, including commodity trading advisors, commodity pool operators or associated persons. 1982 Act, Pub. L. No. 97-444, 96 Stat. 2294, 2304-05 (codified at § 4k(3) of the Act, 7 U.S.C. § 6k(3) (1982)). An individual associated with a firm enjoys registration as a commodity pool operator and commodity trading advisor, since many such firms need select only one category of associated person registration. If the firm is also a futures commission merchant, the individual most likely will be registered as an associated person of the future commission merchant. Section 4k(1) of the Act, 7 U.S.C. § 6k(1) (1982). Therefore, the associate person need not register in either of the two new associated person categories.

¹⁰² 1982 Act, Pub. L. No. 97-444, § 239, 96 Stat. 2294 (1983).

¹⁰³ CFTC Interpretative Letter 77-3, reprinted at 1977-77 COMM. FUT. L. REP. (CCH) ¶ 20,285, at 21,587 (1977).

¹⁰⁴ 44 Fed. Reg. 1918, 1924 (1979).

considering rules to implement and facilitate the registration of non-clerical employees and agents of commodity pool operators and commodity trading advisors.¹⁰⁵

On January 15, 1982, the CFTC proposed rules requiring solicitors of commodity pool accounts or discretionary accounts for a commodity trading advisor to register with the CFTC as commodity trading advisors in their own capacity.¹⁰⁶ The CFTC interpreted the term "commodity trading advisor"¹⁰⁷ to include commodity pool solicitors on the grounds that anyone who solicits trading program clients or commodity pool participants necessarily is engaged in the business of advising others concerning the value of commodities or the advisability of trading commodities and, therefore, is acting as a commodity trading advisor.¹⁰⁸ The Commission included an exemption for solicitors registered in another category, on a provision analogous to that enacted by Congress in the 1982 Act,¹⁰⁹ and also exempted any individual who solicits customers in connection with the public offering of a commodity pool made pursuant to the provisions of section 5 of the Securities Act of 1933¹¹⁰ and who is associated with a broker or dealer registered as such with the Securities and Exchange Commission.¹¹¹

The CFTC did not promulgate the proposed rules in final form, but rather suggested the creation of the new associated person categories in the Legislative Proposals that it sent to Congress in connection with the 1982 legislative process.¹¹² Congress' reaction to the proposal was highly positive¹¹³ and accordingly, the new section of the Act¹¹⁴ was enacted requiring registration of pool solicitors as associated persons of commodity pool operators.

¹⁰⁵ 45 Fed. Reg. 51,600 (1980).

¹⁰⁶ 47 Fed. Reg. 2325 (1982).

¹⁰⁷ See *supra* note 75 (definition of commodity trading advisor).

¹⁰⁸ 47 Fed. Reg. 2325, 2328 (1982).

¹⁰⁹ 47 Fed. Reg. 2325, 2328 (1982) (proposed regulation 1.10g(d)(1)).

¹¹⁰ 15 U.S.C. § 77e (1981).

¹¹¹ 47 Fed. Reg. 2325, 2328 (1982) (proposed regulation 1.10g(d)(2)).

¹¹² CFTC Legislative Proposals §§ 4k(2) and (3), *reprinted at* 14 SEC. REG. & L. REP. (BNA) No. 6,277 at 282-83 (Feb. 10, 1982).

¹¹³ S. REP. No. 384, 97th Cong., 2d Sess. 39 (1982). The Senate Committee on Agriculture, Nutrition and Forestry stated:

The Committee believes that the registration of associated persons of commodity pool operators and commodity trading advisors is necessary to ensure that such persons are qualified to offer pool participation and investment advice to potential participants and clients and are adequately supervised. Such a registration requirement will permit the Commission to conduct fitness checks through the FBI, SEC and other sources to uncover past misconduct such as criminal convictions to proceed more effectively against individuals associated with registered persons who violate the Act, and to subject those persons to reparations claims. The need to screen these categories of commodity professionals has become more urgent because of a dramatic increase in the number of commodity pool operators and commodity trading advisors, and a concomitant increase in the number of customers and the amount of funds under management by them. *Id.*

¹¹⁴ 7 U.S.C. § 6k(2) (1982).

On April 6, 1983, the Commission proposed regulations for associated persons of commodity pool operators.¹¹⁵ The proposed regulations require, among other matters, that the commodity pool operator sponsor the applicant for registration.¹¹⁶ The regulation also exempts an individual registered with the National Association of Securities Dealers as a registered representative or a registered principal from registration as an associated person.¹¹⁷

(b) Duty of the Supervisor of Solicitors

Despite the fact that commodity pool solicitors were not required to register with the Commission until the 1982 Act, the Commission still has mandated supervision of such individuals pursuant to regulation 166.3,¹¹⁸ which became effective October 1, 1978. That provision states:

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling of all commodity interest accounts carried, operated, or advised by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.¹¹⁹

An implicit imposition of the duty to supervise commodity pool solicitors appeared in the Commission's Release interpreting the phrase "for other good cause shown" as justification for denial, suspension or revocation of Commission registration as mandated by former section 8a(2)(B)(ii) of the Act.¹²⁰ The Release states that registration disqualification might be warranted where a person has failed to prevent violations of the Act through reasonable supervision within ten years of filing an application with the CFTC.¹²¹

¹¹⁵ 48 Fed. Reg. 14,933 (1983).

¹¹⁶ 48 Fed. Reg. 14,933, 14,966 (1983) (proposed regulation 3.12(a)-(d)).

¹¹⁷ 48 Fed. Reg. 14,933, 14,966 (1983) (proposed regulation 3.12(b)(3)). The proposed regulations set forth a procedure whereby a presently registered associated person of a futures commission merchant may transfer his registration to an associated person of another category of registrant, including a commodity pool operator. Proposed Reg. 3.12a(t).

¹¹⁸ 17 C.F.R. § 166.3 (1983). See generally Markham & Meltzer, *Secondary Liability Under the Commodity Exchange Act-Respondeat Superior, Aiding and Abetting, Supervision and Scienter*, 27 EMORY L.J. 1115, 1154-62 (1978) (discussion of supervisory standards for commodity professionals).

¹¹⁹ 17 C.F.R. § 166.3 (1983). See *Polissar v. Nelson, Ghun and Associates, Inc.*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,288, at 25,477, 25,479 (1981) (Order Granting Summary Dispositions) (corporate commodity pool operator and trading advisor and president were found to have violated regulation 166.3 in failing to adequately supervise solicitor of managed account).

¹²⁰ 7 U.S.C. § 12a(2)(B)(ii) (1976).

¹²¹ 40 Fed. Reg. 28,125, 28,126 (1975). The CFTC's release was republished and slightly revised in 1980. 45 Fed. Reg. 14,210 (1980). The administrative law judge relied upon the release in imposing liability upon a futures commission merchant for the fraudulent action of a corporate commodity pool operator in *In the Matter of Big Red Commodity Corp.*, 1980-82

(c) Duty of Inquiry.

The 1982 Act adds a new section 4k(5)¹²² that makes it unlawful for any registrant, including a commodity pool operator to permit a person to become or remain an associated person if the registrant knew or should have known that such associated person was subject to one of the major statutory disqualifications set forth in the new section 8a(2) of the Act,¹²³ unless the pool operator notified the Commission of such facts and the Commission determines that the person should be registered or temporarily licensed.¹²⁴ The statutory provision, as explained by the legislative history, indicates that a commodity pool operator is not only under a duty to make certain that he does not hire an individual subject to a statutory disqualification, but also to suspend immediately the associated person if he incurs such a disqualification during his tenure with the pool operator. The operator may not reinstate the associated person until the operator has notified the Commission and the Commission has determined to take no further action.

E. *Compensation of the Pool Operator*

Neither the Act, nor any rule or regulation promulgated thereunder limits or prohibits the nature or amount of compensation of a commodity

COM. FUT. L. REP. (CCH) ¶ 25,883, at 25,884 (1982). See *supra* note 99 (*Big Red*). The administrative law judge noted that the release states that no person can be deemed to have failed to supervise if reasonable supervisory procedures were in effect and followed, but the futures commission merchant failed to supervise. *Id.* at 25,884. CFTC regulation 166.3 was not mentioned.

¹²² 1982 Act, Pub. L. No. 97-444, § 212, 96 Stat. 2294-2305 (1983) (to be codified at 7 U.S.C. 6k(5)).

¹²³ 1982 Act, Pub. L. No. 97-444, § 224(1), 96 Stat. 2294, 2310-12 (1983) (to be codified at 7 U.S.C. 12a(2)).

¹²⁴ H.R. REP. No. 565, Part I, 97th Cong., 2d Sess. 89-90 (1982). The House Committee on Agriculture has left no ambiguity with respect to the weight of the duty imposed on the commodity pool operator:

A futures commission merchant, introducing broker, commodity pool operator or a commodity trading advisor, therefore, is subject to a duty to make reasonable inquiry into the background of any person who becomes or remains associated with it as an associated person. Although "reasonable inquiry" is a concept which depends on particular facts and circumstances, it is intended to include, at a minimum, a check on the person's background with the Commission and with prior employers. In addition to a registrant jeopardizing its own registration by hiring or retaining a person subject to a statutory disqualification, under section 9(c) of the Act, it would commit a misdemeanor punishable by a fine up to \$100,000 or imprisonment up to one year, or both, together with the cost of prosecution. This provision creates a substantial disincentive for a registrant to hire or retain an associated person who is subject to a statutory disqualification. By imposing greater statutory responsibility on employers for the fitness of their employees than currently exists, section 4k(5) should lead to an upgrading of the level of employees in the industry. *Id.*

pool operator.¹²⁵ In the *Federal Register* Release first proposing the pool operator rules, the CFTC stated that it was considering adopting a restriction on the amount of management and advisory fees a commodity pool might charge.¹²⁶ After considering such a measure and the negative comments received, however, the Commission decided not to impose such a rule.¹²⁷

The Commission's regulatory approach instead has substituted disclosure for prohibition in the matter of fees. Early in its lifetime, the Commission grappled with the issue of whether to prohibit compensation based upon trading gains achieved by clients of trading advisors or pool operators. The prohibition would be analogous to the general prohibition of such incentive fees in the securities area in the Investment Advisors Act of 1940.¹²⁸ The Commission's Advisory Committee on Commodity Futures Trading Professionals decided not to recommend a prohibition of incentive fees.¹²⁹

Accordingly, the Commission in first proposing pool operator regulations stated that a prohibition of incentive fees would be unwarranted at that time. The CFTC set forth the conclusion of the Advisory Commit-

¹²⁵ Grossly excessive compensation could violate the anti-fraud standards of section 4o(1) of the Act, 7 U.S.C. 6o(1) (1982) and section 4b of the Act, 7 U.S.C. § 6b (1982). For example, the excessive generation of commissions to the benefit of the commodity pool operator constitutes churning and is inherently fraudulent. See 43 Fed. Reg. 31,886, 31,889 (1978) (CFTC did not adopt anti-churning rule because to do so merely would have codified principles implicit in the anti-fraud provisions of Act).

¹²⁶ 42 Fed. Reg. 9266, 9271 (1977).

¹²⁷ 44 Fed. Reg. 1918, 1923 (1979).

¹²⁸ 15 U.S.C. § 80b-5(1) (1976 & Supp. V 1981).

¹²⁹ COMM. FUT. L. REP. (CCH) Special No. 29, Part II, 36 (1976) (Advisory Committee report).

The apparent reason for this prohibition [in the Investment Advisors Act] was a belief that incentive fees caused undue risk-trading by portfolio managers. But since risk-trading is an accepted element of commodities speculation, there is no basis for extending the prohibition to pool operators and trading advisors. In addition, there appears to be an affirmative need for incentive fees in commodities trading. Because large trades tend to move prices significantly, there is a practical limit to the size of commodity pools, and thus a limit to the amount a pool operator can charge by way of a net asset fee [footnote omitted]. *Id.*

Although the Advisory Committee did not so state, another rationale for the incentive fee for commodity pools and not for securities investment companies is that the size of the pools is effectively limited by regulatory limits on the number of speculative positions in futures contracts held or controlled by one person. 17 C.F.R. § 150.1 *et seq.* (1982). Contract markets can, and do adopt their own speculative limits for futures contracts offered and sold. JOHNSON, COMMODITIES REGULATION, Vol. I, § 2.20, 244 (1982). The 1982 Act has been amended specifically to authorize contract markets to adopt speculative limits in an amount not exceeding any limit set by the Commission. A violation of the limit is a violation of the Act. Pub. L. No. 97-444, § 205(5), 96 Stat. 2299, 2300 (1983) (to be codified at § 4a(5) of the Act, 7 U.S.C. § 6a(5)). In contrast, investment companies are not subject to any speculative limits on the amount of securities they may hold and their growth, therefore, is not inhibited by externally imposed limitations.

tee *in haec verba* in support of its decision not to ban such fees.¹³⁰ Regulations adopted only stated that "performance or incentive fees must be clearly and fully described"¹³¹ in the disclosure document required by the rules for the first time.¹³²

When the Commission proposed the second generation of pool operator regulations in 1980, the *Federal Register* Release did not propose a ban or limit upon any specific compensation system. The CFTC, noting that descriptions of fees and expenses in disclosure documents generally have been inadequate, proposed revisions to strengthen disclosure.¹³³ Thus, the disclosure regulation on incentive fees requires that:

Where any fee is based on an increase in the value of the pool, the pool operator must specify how the increase is calculated, the period of time during which the increase is calculated, the fee to be charged at the end of that period and the value of the pool at which payment of the fee commences.¹³⁴

The present regulations require that "any arrangement whereby the commodity pool operator, commodity trading advisor, or the principals thereof may benefit, directly or indirectly, from the maintenance of the pool's account with a futures commission merchant" must be disclosed and characterized as a conflict of interest on the part of the party so benefitting.¹³⁵

III. REGISTRATION OF THE COMMODITY POOL OPERATOR

A. *Commodity Pool Operators Required to Register*

1. Background and Interpretation of the Registration Requirement.

Registration has been characterized as "the kingpin" of the commodities statutory machinery that gives the Commission information about

¹³⁰ 42 Fed. Reg. 9266, 9270-71 (1977). The Commission stated that it was considering the adoption of a rule which would prohibit incentive fees that were not based on the appreciation over the highest previous value within the past year of the account. *Id.* at 9271. Such a rule has never been proposed or adopted.

¹³¹ 44 Fed. Reg. 1918, 1923 (1979).

¹³² 17 C.F.R. § 4.21 (1979).

¹³³ 45 Fed. Reg. 51,600 (1980).

¹³⁴ 17 C.F.R. § 4.21a(7)(iii) (1983).

¹³⁵ 17 C.F.R. § 4.21(a)(3)(i)(F) (1983). In first proposing the original regulation, the Commission emphasized disclosure as a check upon a potentially abusive method of compensation, the sharing by the pool operator in brokerage commissions generated from trading. In so doing, the Commission stated:

If the pool operator or an individual principal will receive any share of such brokerage commissions or will otherwise benefit from the maintenance of the pool's account with a futures commission merchant, the possibility exists that the pool

participants in commodity trading needed to monitor and enforce the Act.¹³⁶ Section 4m(1) of the Act¹³⁷ requires that a commodity pool operator making use of the mails, or any means or instrumentality of interstate commerce in connection with his business as a commodity pool operator, register with the Commission. It is a misdemeanor for a pool operator required to be registered to use mails and interstate commerce without benefit of registration.¹³⁸

The Act gives the Commission authority to exclude persons from registration not within the intent of the pool operator definition by rule, regulation or order.¹³⁹ The Commission has never used its power to exclude persons or entities from the definition, but it has excused specific entities from pool operator regulation on an *ad hoc* basis. The CFTC has also, by regulation, exempted from registration certain operators of pools beneath a specified size and number of participants.¹⁴⁰

The CFTC commenced an informal program of granting *ad hoc* exemptions from almost the moment the registration requirements became effective in 1975. Shortly after the registration provisions became effective, the CFTC issued interpretative letters excusing a small family-owned corporation placing no more than \$40,000 of its total assets in the futures market¹⁴¹ and a trading club of eight individuals¹⁴² from registration as commodity pool operators. The CFTC justified the exemption on the grounds that each situation met the criteria for exemption set forth in a proposed exemptive regulation which the Commission had published for comment on July 10, 1975.¹⁴³ The CFTC excused from registration a

operator or individual principal may encourage, or may fail to monitor, the issuance of trading recommendations which generate excessive commissions. The Commission believes the prospective pool participants should be made aware of any affiliation or financial arrangement between the pool operator or its individual principals and any futures commission merchant carrying the pool's account. 42 Fed. Reg. 9206, 9267 (1977).

¹³⁶ CFTC v. British American Commodity Option Corp., 560 F.2d 135, 139-40 (2d Cir. 1977), *cert. denied*, 438 U.S. 905 (1978).

¹³⁷ 7 U.S.C. § 6m(1) (1982).

¹³⁸ Section 9(c) of the Act, 7 U.S.C. § 13(c) (1982). See CFTC v. Buterin, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,133, at 24,597, 24,610 (D.C. Kan. 1980) (Memorandum and Order) (privilege against self-incrimination held to bar production of individual's records in CFTC enforcement action involving allegation of functioning as unregistered commodity pool operator because of potential criminal exposure for unregistered pool operator).

¹³⁹ Section 2(a)(1) of the Act, 7 U.S.C. § 2 (1982).

¹⁴⁰ See 17 C.F.R. § 4.13 (1983) (present regulation).

¹⁴¹ CFTC Interpretative Letter 75-2, *reprinted at* 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,089, at 20,747, 20,748 (1975).

¹⁴² CFTC Interpretative Letter 75-7, *reprinted at* 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,094, at 20,755 (1975).

¹⁴³ 40 Fed. Reg. 29,091 (1975) (Proposed Regulation 1.55). The Commission published a Federal Register Notice on May 12, 1975 requesting comments as to circumstances in which exclusion from the commodity pool definition would be in the public interest so that the Commission could fashion appropriate standards. The notice stated that the CFTC would

foreign commodity pool in which no participants were American citizens and no United States sources contributed funds or capital, even though the pool did place trades on American contract markets.¹⁴⁴ The Commission however refused to excuse an SEC-registered investment company that did not intend to trade a small portion of its assets in the commodities market, was not then actively involved in the solicitation of funds, and registered both the fund and its advisors with the SEC.¹⁴⁵ The Commission rejected the investment company's contention that it need not register as a pool operator because it was not soliciting. The CFTC reasoned that the statutory definition and the regulatory scheme was intended to cover any firm or individual handling or exercising control over pooled funds, regardless of whether the entity currently is engaged in soliciting, accepting or receiving funds from the pool participants.¹⁴⁶ The Commission rejected the investment company's argument that it was exempted because of registration with the SEC, stating that Congress, in enacting the pool operator provisions, was fully cognizant of the scope of the existing federal securities laws but had not excluded SEC-regulated entities from the pool operator definition.¹⁴⁷ The Commission has never reversed or qualified its positions that the pool operator definition has no solicitation requirement, and that SEC registration does not of itself exempt an entity from the pool operator requirement.¹⁴⁸ In promulgating the present definition of the term "commodity pool" in regulation 4.10(d),¹⁴⁹ however, the Commission has invited entities that might meet certain stated criteria to seek staff exemption from the pool operator rules.¹⁵⁰ The CFTC also has passed a regulation permitting parties to seek *ad hoc* exemption from registration or any other pool operator requirement.¹⁵¹

2. Exempted Pool Operators

In promulgating the initial regulations in 1979, the Commission identified a class of operators of small pools not required to register if the

consider individual requests for exclusion. 40 Fed. Reg. 20,663 (1975). As discussed in Part I, *supra*, the Commission made the pool operator provision in the 1974 Act, including registration, effective as of July 18, 1975. 40 Fed. Reg. 17,409 (1975).

¹⁴⁴ CFTC Interpretative Letter 76-21, *reprinted at* 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,222, at 21,206 (1976).

¹⁴⁵ CFTC Interpretative Letter 75-17, *reprinted at* 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,112, at 20,809 (1975).

¹⁴⁶ *Id.* at 20,810-11.

¹⁴⁷ *Id.* at 20,811.

¹⁴⁸ See *infra* text accompanying notes 27-29.

¹⁴⁹ 17 C.F.R. § 4.10(d) (1983).

¹⁵⁰ 46 Fed. Reg. 26,004, 26,005 (1981).

¹⁵¹ 17 C.F.R. § 4.12 (1982). Regulation 4.12 allows the Commission to exempt any person or category of persons from the pool operator requirements if it finds that the exemption is not contrary to the public interest. *Id.* The exemption may be subject to whatever terms and conditions the Commission decides to impose. *Id.*

commodity pool operator met one of two sets of exemptions criteria.¹⁵² In revising the pool operator regulations, the Commission determined to broaden the exemption¹⁵³ in order to increase its availability.¹⁵⁴ The resulting exemptive regulation,¹⁵⁵ like its predecessor, contains two disjunctive sets of criteria. A person is not required to register as a commodity pool operator if he does not receive any compensation or payment for operating the pool except for reimbursement, operates only one commodity pool at one time, is not otherwise required to register with the Commission and is not a business affiliate of any person required to register, and does not advertise or systematically solicit for the pool.¹⁵⁶ This exemptive provision is identical to the first set of exemptive criteria set forth in the predecessor regulation.¹⁵⁷ A pool operator may also be exempted if the total gross contributions he receives for all pools which he operates do not exceed \$200,000 in the aggregate and if none of the pools operated by him have more than fifteen participants at any time. For purposes of computing the number of participants, the operator, commodity trading advisor, and the principals thereof, and any relative, spouse, or relative of the spouse living in the same household as the participant may be excluded.¹⁵⁸ By contrast, the analogous provision of the earlier regulation limited the net asset value of the pools to \$50,000, and somewhat circumscribed the exclusion from the fifteen allowable participants.¹⁵⁹

Although the successor regulation liberalized the exemptive criteria, it transcended its predecessor by imposing several affirmative duties upon exempted pool operators. The exempted pool operator is required to provide a disclosure document to each participant prior to accepting consideration for a participation in the pool, manually signed by the exempted operator, and describing the operator's exemption from registration.¹⁶⁰ The material must contain a statement as to the non-registration and its effects in a form dictated by the regulation.¹⁶¹ The unregistered operator must promptly furnish to each participant a copy of the monthly statement for the pool account that it receives from the futures commission merchant carrying the account and clearly show on such statement or

¹⁵² 17 C.F.R. § 4.13 (1979).

¹⁵³ 45 Fed. Reg. 51,600 (1980).

¹⁵⁴ 46 Fed. Reg. 26,004, 260 (1981).

¹⁵⁵ 17 C.F.R. § 4.13 (1983).

¹⁵⁶ 17 C.F.R. § 4.13(a)(1) (1983).

¹⁵⁷ 17 C.F.R. § 4.13(a)(1) (1979).

¹⁵⁸ 17 C.F.R. § 4.13(a)(2) (1983).

¹⁵⁹ 17 C.F.R. § 4.13(a)(2) (1979).

¹⁶⁰ 17 C.F.R. § 4.13(b)(1) (1983).

¹⁶¹ *Id.* The required statement states:

The commodity pool operator of this pool is not required to register, and has not registered with the Commodity Futures Trading Commission. Therefore, unlike a registered commodity pool operator, this commodity pool is not required by the Commission to furnish a disclosure document, periodic account statement, and an annual report to participants in the pool. *Id.*

on an accompanying supplement the net profit or loss of all commodity interests closed since the date of the previous statement.¹⁶² Finally, the unregistered operator must maintain all books and records prepared in connection with his activities as a commodity pool operator for a period of five years. The operator must keep the records accessible and open to inspection by any representative of the CFTC or the Department of Justice during the first two years of the period.¹⁶³

The exempted operator is not precluded from applying for registration as a commodity pool operator during the course of his exempted operations. If he does so, however, he must include with his application, on the form required by Commission Regulation 4.22(c), annual reports for each pool that he was operating¹⁶⁴ at the time of his application.¹⁶⁵ An exempted operator granted registration must comply prospectively with the entire panoply of pool operator regulations, covering even those pools operated during the exempted period.¹⁶⁶ Finally, the Commission has promulgated regulation 4.15,¹⁶⁷ which mandates that the anti-fraud provisions of section 4.o(1) of the Act¹⁶⁸ and expressly applies the reparation procedures of section 14¹⁶⁹ to an exempted pool operator.¹⁷⁰

B. Registration Procedure for Pool Operators

1. Requirement of Filing of Registration Application

Section 4n(1) of the Act¹⁷¹ states that a commodity pool operator may

¹⁶² 17 C.F.R. § 4.13(b)(2)(i) (1983).

¹⁶³ 17 C.F.R. § 4.13(b)(2)(ii) (1983).

¹⁶⁴ 17 C.F.R. § 4.22(c) (1983).

¹⁶⁵ 17 C.F.R. § 4.13(c) (1983).

¹⁶⁶ 17 C.F.R. §§ 4.13(c)-(d) (1983).

¹⁶⁷ 17 C.F.R. § 4.15 (1983).

¹⁶⁸ 7 U.S.C. § 6(o) (1982).

¹⁶⁹ 7 U.S.C. § 18 (1982). Reparations is an administrative procedure by which persons injured by a violation of the Act may seek redress before the CFTC. Markham, *The Seventh Amendment and CFTC Reparations Proceedings*, 68 IOWA L. REV. 87 (1982).

¹⁷⁰ 17 C.F.R. § 4.15 (1982). Regulation 4.15 is superfluous with respect to § 4o(1) of the Act. 7 U.S.C. § 6o(1) (1982). The phrase "registered under the Act" was deleted from § 4o(1) by the 1978 Act to make clear that the anti-fraud provisions apply whether a pool operator is registered or not. Pub. L. No. 95-405, § 10, 92 Stat. 865, 870 (1978). Schneider & Santo, *supra* note 2, at 1758. The viability of the provision with respect to reparations raises a dilemma. In 1978, Congress amended § 14a of the Act, 7 U.S.C. § 18a (1982) to provide that a party required to be registered under the Act was a permissible respondent in reparations, as well as a party who was registered. 1978 Act, Pub. L. No. 95-405, § 21(l), 92 Stat. 865, 875 (1978). See Rosen, *Reparation Proceedings Under the Commodity Exchange Act*, 27 EMORY L.J. 956, 1017-21 (1978) (discussion of doctrine of amenability of non-registered party to reparations). The 1982 legislation has removed the reference to "required to be registered" and has made reparations available only against "any person who is registered under this Act." Pub. L. No. 97-444, § 23(a), 96 Stat. 2294, 2319 (1982). An exempted pool operator is, by definition, *not* registered under the Act and the reparations provision of regulation 4.15 may well be *ultra vires*.

¹⁷¹ 7 U.S.C. § 6n(1) (1982).

register by filing an application containing information prescribed by the Commission's rules and regulations.¹⁷² The required information includes the name and form of organization of the operator including his capital structure, the location of his principal business and branch offices, the names and addresses of all principals of the firm, the education and business affiliation of the applicant and his principals for the past ten years, the nature of the business of the applicant, the nature and scope of the authority of the applicant with respect to the clients' funds and accounts, the basis upon which the applicant is or will be compensated, and such other information as the Commission may require to determine whether he is qualified for registration.¹⁷³ The Commission has implemented the statutory provision by promulgating regulation 3.14(a)(1),¹⁷⁴ which states that the application for initial registration as a commodity pool operator must be on form 7-R.¹⁷⁵ In addition, the pool operator applicant must complete schedules B and C of form 7-R which require disclosure of the details of each pool operated or to be operated by the applicant, including the name of the pool, dates of operation, form of organization, and net asset value as of the last month end, as well as any reciprocal business relationship between the applicant or any principal involving any commodity pools that the applicant operates with any other commodity pool or Commission registrant.¹⁷⁶ The regulations further dictate that each form 7-R must be accompanied by a form 8-R executed by each natural person who is a principal of the applicant.¹⁷⁷ Form 8-R requires background information for individual principals similar to that required by form 7-R for the applicant, including a ten year employment and residential history, as well as education background.¹⁷⁸ Form 8-R is used for principals of a commodity trading advisor and futures commission merchant, as well as for individuals registering as floor brokers and associated persons, and does not request specific information limited to principals of commodity pool operators.¹⁷⁹ Curiously, neither forms 7-R nor 8-R require information

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ 17 C.F.R. § 3.14(a)(1) (1983).

¹⁷⁵ See COMM. FUT. L. REP. (CCH) ¶ 3515, at 3605 *et seq.* (1982) (form 7-R and its instructions). Form 7-R is used for commodity trading advisors, futures commission merchants, newly introduced brokers, and commodity pool operators.

¹⁷⁶ See COMM. FUT. L. REP. (CCH) ¶ 3515, at 3612 (1982) (schedules B & C).

¹⁷⁷ 17 C.F.R. § 3.14(a)(2) (1983). A "principal" is defined in the applicable regulation as: (1) any person including, but not limited to, a sole proprietor, general partner, officer, director, branch office manager or designated supervisor, or person occupying a similar status or performing similar functions, having the power, directly or indirectly, through agreement or otherwise, to exercise a controlling influence over activities of that person which are subject to regulation by the Commission; (2) any holder of more than 10 per cent of the outstanding of any class of stock; or (3) any person who has contributed more than 10 per cent of the capital.

17 C.F.R. § 3.1(a) (1983).

¹⁷⁸ See COMM. FUT. L. REP. (CCH) ¶ 3521, at 3613 *et seq.* (1982) (form 8-R and its instruction).

¹⁷⁹ *Id.*

regarding the nature and scope of the authority from the applicant with respect to client funds and accounts or the basis upon which the applicant is or will be compensated as mandated by the pertinent provisions of section 4n(1) of the Act for pool operator applications.¹⁸⁰

The final required document in the application package is a fingerprint card for each principal of the commodity pool operator other than a principal with a current form 8-R on file at the Commission as of July 1, 1982 or one who has submitted a form 8-R and a fingerprint card in connection with an application for registration under another category.¹⁸¹ The applicant must file the registration materials with the CFTC's Central Regional Office in Chicago, Illinois.¹⁸²

The Commission has obtained Congressional authority in the 1978 Act to require an applicant for registration, and such persons associated with that applicant as the Commission may specify, to be fingerprinted and to submit the fingerprints to the Department of Justice for identification and appropriate processing.¹⁸³ The Commission expressly sought fingerprinting authority to facilitate its process of screening applicants, in the hopes that the requirement would bolster its enforcement capabilities.¹⁸⁴ The 1982 Act has continued fingerprinting authority and has extended it to associated persons of commodity pool operators.¹⁸⁵ The proposed regulation will require fingerprinting of these associated persons.¹⁸⁶

2. Fitness Standards and Proficiency Examinations

At present, neither training and experience standards, nor proficiency examinations are required for commodity pool operators, or any other Commission registrants. Until the 1982 Act, the Commission lacked the authority to promulgate regulations requiring fitness standards or proficiency examinations for commodity pool operators.¹⁸⁷ The 1982 Act has

¹⁸⁰ 7 U.S.C. §§ 6n(1)(D)-(E) (1982).

¹⁸¹ 17 C.F.R. § 3.14(a)(2) (1983).

¹⁸² 43 Fed. Reg. 19,467 (1981).

¹⁸³ 1978 Act, Pub. L. No. 95-405, § 17(1), 92 Stat. 865, 874 (1978) (amending § 8a(1) of the Act, codified at 7 U.S.C. § 12a(1) (1982)).

¹⁸⁴ H.R. REP. NO. 1181, 95 Cong., 2d Sess. 41 (1978). The Commission originally adopted regulations requiring fingerprinting on December 5, 1980. 45 Fed. Reg. 80,485 (1980). The effective date was postponed until July 1, 1982 because of the Commission's need to augment its data processing center. 46 Fed. Reg. 24,940 (1981).

¹⁸⁵ Pub. L. No. 97-444, § 223, 96 Stat. 2294, 2310 (1983) (amending § 8a(1) of the Act, 7 U.S.C. § 12(a)(1)). The 1982 Act continues the Commission authority to require fingerprinting, and extends it to the new registration categories, including associated persons of pool operators. *Id.*

¹⁸⁶ Proposed Reg. 3.116(c)(3).

¹⁸⁷ The prior legislation, section 4p of the Act, authorized the promulgation of fitness

now amended section 4p of the Act to authorize the Commission to promulgate fitness standard rules for any Commission registrant and to adopt written proficiency examinations of applicants for registration in any category.¹⁸⁸

The original provision of the 1974 Act, which granted the Commission the authority to set fitness standards and proficiency examinations,¹⁸⁹ authorized the Commission to delegate its authority to any futures association registered under section 17 of the Act.¹⁹⁰ In 1981, the Commission granted the application of the National Futures Association ("NFA")¹⁹¹ as a registered futures association pursuant to section 17 of the Act.¹⁹² In considering the 1982 legislation, the Senate Committee on Agriculture, Nutrition and Forestry stated that it envisioned that any fitness standard for registrants would be developed in cooperation with the NFA, and that administration of proficiency examinations was an area "appropriate for delegation to the National Futures Association, with oversight by the Commission."¹⁹³ In the final legislation, the Senate Conference Committee adopted a House provision¹⁹⁴ requiring the NFA to establish training standards in proficiency testing for personnel of members involved in the solicitation of transactions subject to the provisions of the Act, supervisory officials of such personnel, and all individuals for whom the NFA requires registration. The legislation also requires that the NFA establish a program to audit and enforce training standards, within ninety days of the January 11, 1983 date of effectiveness of the 1982 Act.¹⁹⁵ Accordingly, the imposition of fitness standards and proficiency examinations should occur shortly for at least the associated persons of commodity pool operators.

standards and proficiency examinations only for futures commission merchants and their associated persons and floor brokers.

¹⁸⁸ 1982 Act, Pub. L. No. 97-444, § 215, 96 Stat. 2294, 2305-306 (1983) (amending § 4p of the Act, 7 U.S.C. § 6p (1976)).

¹⁸⁹ 1974 Act, Pub. L. No. 93-463, § 206, 88 Stat. 1389, 1400 (1974) (codified at § 4p of the Act, 7 U.S.C. § 6p (1976)).

¹⁹⁰ 7 U.S.C. § 21 (1976).

¹⁹¹ See *infra* Part V (discussion of background of NFA and its role in regulation of commodity pool operators).

¹⁹² CFTC Order of September 22, 1981, reprinted in SEC. REG. & REP. (BNA) No. 621, at E-1 (Sept. 23, 1981). See H.R. REP. NO. 565, Part 1, 97th Cong., 2d Sess. 41-42 (1982) (general discussion of emergence of NFA).

¹⁹³ S. REP. NO. 384, 97th Cong., 2d Sess. 40 (1982).

¹⁹⁴ H.R. REP. NO. 964, 97th Cong., 2d Sess. 49 (1982).

¹⁹⁵ 1982 Act, Pub. L. No. 97-444, § 233(5), 96 Stat. 2294, 2930 (1983) (to be codified at Section 17(p)(1) of the Act, 7 U.S.C. § 21(p)(1)). To date, the NFA is the only futures association subsequently applying for registration must adopt and include the mandated fitness standards and proficiency examination requirements in its application for registration.

*C. Duration of Registration and Duty of Registrant to
Advise the Commission of Current Information and
Withdrawal of Registration*

1. Duration of Registration

Section 4n(2) of the Act¹⁹⁶ requires all commodity pool operator licenses to expire on June 30 of each year, and to be renewed thereafter for any period that the Commission may dictate by rule, so long as that period is not less than one year.¹⁹⁷ Application for renewal must be filed on a new form 7-R, supplying updated responses to the information requested.¹⁹⁸ The Commission is obligated to inform the applicant or registrant when the registration is granted or renewed.¹⁹⁹

2. Requirement of Keeping Information Current

The Regulations impose a continuing duty upon the commodity pool operator to keep his registration information current. Within twenty days after any natural person becomes a principal of a commodity pool operator who is registered or who has a registration application pending, the registrant must file a form 8-R with the Commission, completed by the principal and accompanied by a fingerprint card.²⁰⁰ If the new principal has a current form 8-R or its predecessor form 94 on file with the Commission on July 1, 1982, or has submitted a form 8-R and a fingerprint card in accordance with a registration application in another category,²⁰¹ the form 8-R and fingerprint card need not be filed. The pool operator, however, must notify the Commission within twenty days concerning the name of the added principal on form 3-R.²⁰² Conversely, if a principal of a commodity pool operator who is registered or has an application pending terminates his affiliation, the registrant or applicant must file a notice with the Commission on form 8-T or on a Uniform Termination Notice for Securities Industry Registration.²⁰³

The applicant, or registrant, and each principal must promptly file a form 3-R to correct any deficiency or inaccuracy in the current form 7-R or schedules B or C thereto, or in the form 8-R, including subsequent developments that make the information contained on the forms inaccurate

¹⁹⁶ 7 U.S.C. § 6n(2) (1982).

¹⁹⁷ *Id.* At present, there is no regulation lengthening the one year period. Renewal is required for the registration of every pool operator each year.

¹⁹⁸ 17 C.F.R. § 3.14(b) (1983).

¹⁹⁹ 17 C.F.R. § 3.4 (1983).

²⁰⁰ 17 C.F.R. § 3.14(c) (1983).

²⁰¹ *Id.*

²⁰² See COMM. FUT. L. REP. (CCH) ¶ 3507, at 3581-84 (1982) (form 3-R and its instructions).

²⁰³ 17 C.F.R. §§ 3.31(c)(2)-(3) (1983). See COMM. FUT. L. REP. (CCH) ¶ 3524, at 3624 (1982) (form 8-T).

or dated.²⁰⁴ The registrant or applicant and its principals have a similar duty to maintain current addresses on file with the Commission for purposes of receiving communications from the Commission, including requests for information, subpoenas, and reparation complaints.²⁰⁵ The regulation warns that each registrant while registered, and each principal while affiliated, must keep his current address on file, so that an order of default or other appropriate relief in any proceeding may be entered. The order may include a reparation commenced within two years of registration for failure to file the required response to any communication sent to the latest such address filed with the Commission.²⁰⁶ The reparation warning reflects rule 12.22 of the Commission's Rules Relating to Reparation Proceedings²⁰⁷ which permits constructive service of a reparation complaint by registered mail upon any registrant at the office designated with the Commission by that registrant for receipt of a reparation complaint. If the registrant has not filed a designation, the location for constructive service is the registrant's principal place of business as shown in the records of the Commission.²⁰⁸ If the commodity pool operator changes his name, form of organization, or, in the case of a sole proprietor, his ownership, or, in the case of a partnership, if the death or withdrawal of a partnership creates a new partnership as a matter of law, a new registration is required.²⁰⁹

3. Withdrawal from Registrations

If the commodity pool operator no longer wants to remain registered, he may wait until the forthcoming June 30 when his registration expires and simply not renew. If the pool operator decides, however, to withdraw from registration, he must comply with the procedures set forth in regulation 3.33.²¹⁰ The Commission instituted the withdrawal procedures after periodically receiving requests from registrants for permission to withdraw. The CFTC decided that in the absence of pending proceedings or other public interest considerations, withdrawal from registration should

²⁰⁴ 17 C.F.R. §§ 3.31(a)-(b) (1983).

²⁰⁵ 17 C.F.R. § 3.30 (1983).

²⁰⁶ *Id.*

²⁰⁷ 17 C.F.R. § 12.22 (1983).

²⁰⁸ *Id.* See *Troll v. Lloyd, Carr & Co.*, COMM. FUT. L. REP. (CCH) ¶ 20,676, at 22,756, 22,758 (1978) (Order taking review of proceeding, vacating initial decision, staying proceeding against two of respondents, and remanding proceeding against remaining respondents). In *Troll*, the Commission applied reparation rule 12.22 to reverse the dismissal of an unclaimed reparations complaint sent by certified mail to an address given by the respondent to a Commission employee over the telephone. *Id.* The Commission found that the would-be respondent had "in effect updated the Commission's records in the telephone conversation, and rule 12.22 was thus satisfied." *Id.* at 22,758. See Rosen, *Reparation Proceedings Under the Commodity Exchange Act*, 27 EMORY L.J. 1005, 1030-31 (1978).

²⁰⁹ 17 C.F.R. § 3.32 (1983).

²¹⁰ 17 C.F.R. § 3.33 (1983).

be available to registrants who have ceased engaging in the activities for which they were initially registered or who, subsequent to registration, decided not to begin conducting the activities requiring registration.²¹¹

A request for withdrawal must be made in writing, signed under oath, and filed with the Commission's Registration Unit of the Division of Trading and Markets at the Commission's main headquarters in Washington, D.C.²¹² A registrant may request withdrawal if he ceases or has not engaged in the activities requiring registration, is exempt from registration in such capacity, or is excluded from a class required to be registered.²¹³ Accordingly, a registered pool operator who decides not to operate pools aggregating over the exemptive limit may seek withdrawal.

The registrant seeking withdrawal must supply information in his statement, identifying the applicable basis for requesting withdrawal.²¹⁴ If a commodity pool operator certifies that he has ceased activities requiring registration, he must affirmatively state that all interest in, and assets of, any commodity pool have been redeemed, distributed, or transferred on behalf of the participants and that no obligations to any participants are outstanding, and describe the nature and extent of any pending or threatened claims by participants.²¹⁵ If withdrawal is requested on the basis of an applicable exemption, the registrant must identify the regulation permitting the exemption and the circumstances entitling the registrant to claim it.²¹⁶ The pool operator must cite the specifically applicable exemptive provision of regulation 4.13²¹⁷ and describe in some detail how present business activities qualify for the regulatory exemption.²¹⁸ A request for withdrawal will become effective thirty days after receipt by the Commission unless the Commission institutes or determines to institute a revocation or suspension proceeding, imposes terms or conditions on withdrawal, notifies the registrant that he currently is the subject of investigation into purported violations of the Act by the registrant, requests further information, or determines it would be contrary to the Act or to the public interest to permit such withdrawal.²¹⁹

D. *Registration Standards*

1. Registration by the Commission

The rationale for a complex registration program is that public pro-

²¹¹ 46 Fed. Reg. 48,915 (1981).

²¹² 17 C.F.R. §§ 3.33(c)-(d) (1983).

²¹³ 17 C.F.R. § 3.33(a) (1983).

²¹⁴ 17 C.F.R. §§ 3.33(b)(1)-(5) (1983).

²¹⁵ 17 C.F.R. §§ 3.33(b)(7)(iv)-(v) (1983).

²¹⁶ 17 C.F.R. § 3.33(b)(6) (1983).

²¹⁷ 17 C.F.R. § 4.13 (1983).

²¹⁸ See *supra* text accompanying notes 152-69.

²¹⁹ 17 C.F.R. § 3.33(f) (1983).

tection requires the Commission to screen the background of prospective registrants and their principals to eliminate undesirable firms and individuals to the extent possible.²²⁰ Thus, the registration process must operate against a background of disqualification standards. In the pertinent subsections of section 4n²²¹ of the 1974 Act, Congress elucidated standards and procedures for the denial or revocation of registration for commodity trading advisors and commodity pool operators, the only registrants for whom specific statutory standards were enacted. These provisions and the general disqualification standards set forth in sections 8a(2) and (3) of the Act²²² operated in tandem.²²³ The 1982 Act swept away the former statutory provisions. Former sections 4n(5) and (6) with their separate denial, suspension, and revocation standards for commodity pool operators and trading advisors, have been repealed.²²⁴ Sections 8a(2) and (3) of the Act have been replaced *in toto* with detailed new provisions setting forth two different classifications of statutory disqualification standards for all registrants including commodity pool operators and their associated persons.²²⁵

The Commission may deny registration, register conditionally, or suspend or replace restrictions on the registration of persons subject to the first set of enumerated disqualifications. The CFTC is not required to hold a hearing and may revoke the registration of a registrant who incurs any disqualification "with such a hearing as may be appropriate" subject to whatever regulations the Commission might promulgate.²²⁶ The eight specified disqualifications are: (1) a currently effective suspension or revocation of registration, (2) a Commission refusal after opportunity for hearing to register the applicant within the past five years, (3) a permanent or temporary injunction, including a consent decree, involving any capacity

²²⁰ See, e.g., S. REP. NO. 384, 97th Cong., 2d Sess. 39 (1982); H.R. REP. NO. 97-565, Part 1, 97th Cong., 2d Sess. 48-52 (1972); CFTC v. British American Commodity Option Corp., 560 F.2d 135, 139-40 (2d Cir. 1977), *cert. denied*, 438 U.S. 905 (1978).

²²² 7 U.S.C. §§ 12a(2)-(3) (1976). Sections 8a(2) and (3) of the Act permitted the grant or denial of an initial application, suspension, or revocation of existing registration, with a full-fledged oral hearing, except in highly limited circumstances. *Id.* The only statutory standards for denial were felony convictions, outstanding suspension or revocation, debarment from federal contracting, false or misleading statements in a registration application, Section 8a(2)(B)(i) of the Act, 7 U.S.C. § 12a(2)(B)(i) (1982) or "other good cause shown", Section 8a(2)(B)(ii) of the Act, 7 U.S.C. § 12a(2)(B)(ii) (1982). In 1975, the CFTC issued a release interpreting the phrase "for other good cause shown" and listing more detailed standards for disqualification. 40 Fed. Reg. 28,125 (1975). See *supra* text accompanying note 121.

²²³ See *In the Matter of Larry R. Williams*, 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,560, at 22,287, 22,291 (1978) (Opinion of Commission) (cases in which §§ 4n and 8a of the Act were considered together in commodity trading advisor fitness cases); *In re Savage*, 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,139, at 20,918, 20,920 (1976) (Order of Commission).

²²⁴ 1982 Act, Pub. L. No. 97-444, § 213, 96 Stat. 2294, 2305 (1983).

²²⁵ 1982 Act, Pub. L. No. 97-444, § 224, 96 Stat. 2294, 2310 (1983) codified at §§ 8a(2)-(4) of the Act, 7 U.S.C. §§ 12(a)(2)-(4) (1982)).

²²⁶ 1982 Act, Pub. L. No. 97-444, § 224(1), 88 Stat. 2294, 2310-12 (1982) (codified at § 8a(2) of the Act, 7 U.S.C. § 12a(2) (1982)).

requiring registration under the Act or federal securities laws (a registration, however, may not be revoked solely on the basis of a temporary order), (4) a felony conviction within the past ten years involving a security or any matter subject to regulation under the Act, (5) a finding, including by consent decree, of a violation within the last ten years of the Act, federal securities laws, or similar statutes in which the violation involved theft, fraud, misappropriation of assets, forgery, counterfeiting, false pretenses, bribery, or gambling, or the willful aiding or abetting of such offenses, (6) an outstanding Commission order involving sanction, such as denial of trading privileges on a contract market, (7) a willful material misstatement or omission in a registration application as to whether the applicant is subject to any of the statutory disqualifications, and (8) as to the registration of a partnership or corporate entity, a finding that the partnership or entity has a principal who is subject to any of the enumerated disqualifications.²²⁷ The disqualification provisions permit review of an adverse Commission decision to the appropriate court of appeals²²⁸ pursuant to the procedures set forth in section 6(b) of the Act.²²⁹ The purpose of the new procedure is to streamline the registration process by allowing the Commission to expeditiously weed out applicants who are subject to disqualifications that in most instances may be readily ascertained by checking official government records, thus saving the Commission staff time and effort.²³⁰

Subject to whatever rules or regulations the CFTC may choose to promulgate, the new legislation sets forth a second set of less egregious disqualification standards. The standards allow the Commission to refuse to register or register conditionally any person, or to suspend and revoke or to place restrictions upon the registration of a disqualified person, after opportunity for hearing.²³¹ These standards include a finding of violations of the Act or regulation thereunder, other than enumerated anti-fraud violations in the capacity of a registrant or the willful aiding and abetting of such violations, and an analogous provision for non-fraud related viola-

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ 7 U.S.C. § 6(a) (1982).

²³⁰ S. REP. NO. 384, 97th Cong., 2d Sess. 36 (1982); H.R. REP. NO. 565, Part 1, 97th Cong., 2d Sess. 96 (1982). The Commission has had in effect a conceptually similar regulatory procedure delegating authority to the Director or Deputy Director of the Commission's Division of Trading and Markets to deny registration to an applicant subject to one of several enumerated severe disqualifications, including felony convictions, contract debarment, serious misdemeanor, commodities or securities injunction, false statement on an application, or an adverse Commission order. The applicant, however, may request a full hearing to either contest the truth of the adverse information or to show cause why he should not be registered despite the disqualification. 17 C.F.R. § 3.20 (1983). The procedure is still in effect and probably will remain until the Commission issues regulations implementing the new registration provisions.

²³¹ 1982 Act, Pub. L. No. 97-444, §§ 224(2)-(3), 96 Stat. 2294, 2312-76 (codified at §§ 8a(3)-(4) of the Act, 7 U.S.C. §§ 12a(3)-(4) (1982)).

tions of federal or state securities laws or certain other specified federal statutes. The CFTC may also restrict registration for failure to supervise with a view towards preventing violations of the Act or specified federal and state statutes, provided that no person may be deemed to have failed to supervise reasonably, according to established procedures in effect, in order to prevent the violation. The person must have reasonably discharged the incumbent duties to supervise mandated by the procedures and systems. The standards also include a conviction for a felony within ten years not involving commodities or securities laws or a misdemeanor within the last ten years involving any matter regulated under the Act or the securities laws or conviction for felony enumerated in the prior section more than ten years preceding the filing of the application, debarment by any agency of the United States from contracting with the government, willful and material false or misleading statement in an application other than whether the applicant is subject to disqualifications, conviction in state court of a felony for conduct that would constitute a felony under federal law, failure to meet minimum financial requirements in a capacity so requiring, outstanding order denying, expelling, or suspending membership in a contract market or other self-regulatory organization or bar from an association with a member of a contract market or other self-regulatory organization, a finding by any court or federal or state agency of a violation or willful aiding or abetting of a violation of certain specified kinds of statutes, other good cause or disqualification of a principal of a registrant entity by one or more of the listed disqualifications.²³²

The second category of disqualifications includes a provision which mirrors the new section 4k(5) of the Act²³³ by including any registrant who has associated with any person that the registrant knows, or in the exercise of reasonable care should know, that such person has one of the major statutory disqualifications set forth in section 8a(2) of the Act. The disqualification does not apply if the registrant has notified the Commission of the facts and the Commission has registered or temporarily licensed the other person.²³⁴ Any determination by the Commission to deny, suspend, revoke or place restrictions upon any person pursuant to the second set of criteria is appealable to the applicable court of appeals²³⁵ in the manner provided by section 6(b) of the Act.²³⁵ The second disqualification

²³² *Id.*

²³³ 7 U.S.C. § 6k(5) (1982). The provision mirroring § 4k(5) makes it unlawful for a registrant to allow any person to become or remain associated with him if the registrant knew or should have known of facts constituting one of the § 8a(2) major disqualifications, unless the Commission has been informed of such fact and has decided that the person may be licensed or temporarily registered. *See supra* text accompanying notes 122-24.

²³⁴ 1982 Act, Pub. L. No. 97-444, § 224(3), 96 Stat. 2294, 2314 (codified at § 8a(3)(L) of the Act, 7 U.S.C. § 8a(3)(L) (1982)).

²³⁵ 1982 Act, Pub. L. No. 97-444, §§ 114(3)-(4), 96 Stat. 2294, 2315 (codified at §§ 8a(3)-(4) of the Act, 7 U.S.C. §§ 12a(3)-(4) (1982)).

²³⁶ 7 U.S.C. § 9 (1982).

category consists of offenses generally less serious, further removed from the conduct regulated under the Act than the offenses specified in the prior section 8a(2),²³⁷ requiring fact finding, or for which the Commission might consider mitigating circumstances or evidence of rehabilitation.²³⁸

The Commission has several means of ensuring that it has accurate information regarding a possible disqualification. All applicants executing form 7-R and principals filling in form 8-R are required to check a series of boxes indicating whether the executor of the form has been subject to a series of possibly disqualifying events in the past ten years. In the case of an affirmative answer, applicants and principals are required to attach documents containing the judgment, decision, verdict or other finding, and the sanction or sentence imposed or an explanation why documents are not obtainable.²³⁹ The statutory disqualification scheme set forth in the amended sections 8a(2)-(4) of the Act²⁴⁰ makes a material false or misleading statement or omission, as to any of the matters of the first category of disqualifications, a major disqualification in its own right.²⁴¹ Any other material, false or misleading statement or omission in an application is included among the second set of disqualifying categories.²⁴² Moreover, the 1978 Act categorizes a knowing false or misleading statement or omission in a registration application as a felony.²⁴³ The regulatory requirement that an applicant immediately supply on form 3-R information necessary to update the data appearing on forms 7-R and 8-R²⁴⁴ continues to place the onus of supplying possibly adverse information upon the applicant under severe penalty. The fingerprint requirement and the cross-check with the Department of Justice buttress the mandatory disclosure requirement and serve as a method for the Commission to discover disqualifications that application materials might not disclose.

2. Temporary Registration

The 1982 Act for the first time allows the Commission to grant a tem-

²³⁷ 7 U.S.C. § 12a(2) (1982).

²³⁸ S. REP. NO. 384, 97th Cong., 2d Sess. 37 (1982).

²³⁹ COMM. FUT. L. REP. (CCH) ¶ 3515, at 3609 (1982) (form 7-R, items 11-16); COMM. FUT. L. REP. (CCH) ¶ 3521, at 3613, 3620-21 (1982) (form 8-R, item 161).

²⁴⁰ 7 U.S.C. §§ 12a(2)-(4) (1982).

²⁴¹ Section 8a(2)(G) of the Act, 7 U.S.C. § 12a(2)(G) (1982).

²⁴² Section 8a(3)(G) of the Act, 7 U.S.C. § 12a(3)(a) (1982).

²⁴³ 1978 Act, Pub. L. No. 95-405, § 19(2), 92 Stat. 865, 875 (amending § 9(b) of the Act, 7 U.S.C. § 13(b)). A knowingly false or misleading application would violate 18 U.S.C. § 1001 since it constitutes a false statement to a government agency. See COMM. FUT. L. REP. (CCH) ¶ 3525, 3625, 3626 (1982) (form 94, replaced on May 11, 1977 by form 8-R) (warning of possible violation of 18 U.S.C. § 1001 for false or misleading statement).

²⁴⁴ 17 C.F.R. §§ 3.31(a)-(b) (1983). See *In the Matter of David L. Bentley*, CFTC Dkt. No. 82-6, at 5-6, 8 (Initial decision, March 9, 1983). In *Bentley*, the administrative law judge revoked the registration and imposed other sanctions upon an individual and a corporate commodity pool operator whose principal had failed to file a form 3-R reporting that he had been enjoined in a Commission enforcement action. *Id.*

porary license not to exceed six months, subject to such rules as the Commission may adopt for registration in any category.²⁴⁵ The procedure will permit an apparently qualified applicant to commence work or to conduct business prior to the completion of the formal fitness check.²⁴⁶ The granting of a temporary license, however, will not constitute registration, nor create any inference in favor of registration, nor will a denial necessarily mean that ultimate registration will be refused.²⁴⁷ As of this date, no implementing regulations have been proposed or promulgated, and the temporary registration program is not yet in effect.

IV. THE CFTC REGULATORY MATRIX FOR COMMODITY POOL OPERATORS

A. *Evolution and Development of the Regulatory Structure*

The regulatory system now in effect for commodity pool operators has been evolving since the infancy of the CFTC. Shortly after it opened its doors in 1975, the Commission appointed an Advisory Committee on Regulation of Commodity Futures Trading Professionals (the "Advisory Committee") to submit reports and recommendations to the Commission for the development of a regulatory program for commodity pool operators, among others.²⁴⁸ Among other matters, the Advisory Committee was charged to consider the definition, role, and function of commodity futures trading professionals, recordkeeping, reporting and financial responsibility requirements, customer protection standards, and possible investor information needs.²⁴⁹ The Advisory Committee presented its report on August 12, 1976. In the Summary of Major Recommendations and Conclusions to the Advisory Committee Report,²⁵⁰ the Committee noted that although the amount of trading in commodity pools was probably small in relation to other kinds of trading, the rapidly expanding nature of commodity pools, together with the high potential for abuse in the industry, dictated that the Commission "should give priority to the development of pool operator regulations."²⁵¹ The report suggested what became the leitmotifs for the regulatory system eventually adopted. The suggestions included segregated customer funds to prevent commingling of assets, book and recordkeeping requirements, a brief and understandable disclosure document, and controls on advertising, especially advertising of performance.²⁵² In the interim, the CFTC's Division of Trading and Market

²⁴⁵ 1982 Act, Pub. L. No. 97-444, § 223, 96 Stat. 2294, 2310 (1983) (amending § 8a(1) of the Act, 7 U.S.C. § 12a(1)).

²⁴⁶ H.R. REP. No. 565, 97th Cong., 2d Sess. 51 (1982).

²⁴⁷ *Id.* at 95-96.

²⁴⁸ 40 Fed. Reg. 32,866 (1975).

²⁴⁹ *Id.*

²⁵⁰ Reprinted at 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,196, at 21,096 (1976).

²⁵¹ *Id.* at 21,098.

²⁵² *Id.* at 21,098-99.

reported on July 7, 1976 that the Office of Chief Accountant and the Special Counsel of the Division were developing regulations for pool operators that would include an independent audit requirement, certain financial recordkeeping requirements, and minimum disclosure requirements for pool participants.²⁵³

On February 15, 1977, the Commission proposed for comment for the first time a comprehensive set of commodity pool operator regulations.²⁵⁴ The Commission stated that the proposals would implement the provisions of the Act which were applicable to commodity pool operators and many of the recent recommendations of the Advisory Committee.²⁵⁵ The final rules, however, were not adopted until nearly two years later, on January 8, 1979, and did not become effective until April 1, 1979.²⁵⁶ The Commission in its Notice of Rulemaking stated that the final rules were being promulgated after analyzing comments received on the proposed regulations, profiles developed by the Commission on the activities of commodity pool operators which were developed from registration applications on file and questionnaires sent to all registered pool operators, and the Advisory Committee Report.²⁵⁷ The final rules provided an exemption provision for operators of smaller pools²⁵⁸ and implemented the regulatory themes of a disclosure document.²⁵⁹ The rules also included reporting and recordkeeping requirements,²⁶⁰ and a qualified prohibition against the comingling of pool property.²⁶¹

The new rules were in effect for little more than a year when the Commission published a new set of proposed rules making substantial changes in the then effective pool operator regulations.²⁶² The Commission noted a significant increase in commodity pools and that it had had substantial experience in monitoring the implementation of and compliance with the rules.²⁶³ The Commission complained that rapid growth had increased abusive behavior in commodity interest account management and that the proposed regulations were intended to respond to those abuses and to insure that pool customers were treated fairly.²⁶⁴ After two extensions of the comment period,²⁶⁵ the Commission published final regulations

²⁵³ Memorandum of Thomas A. Russo, Director of the Division of Trading and Markets, to the CFTC on the Organizational Structure, Programs and Activities of the Division, *reprinted at* 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,186, at 21,055, 21,059 (1976).

²⁵⁴ 42 Fed. Reg. 9266 (1977).

²⁵⁵ *Id.*

²⁵⁶ 44 Fed. Reg. 1918 (1979).

²⁵⁷ *Id.*

²⁵⁸ 17 C.F.R. § 4.13(a) (1983).

²⁵⁹ 17 C.F.R. § 4.21 (1979).

²⁶⁰ 17 C.F.R. §§ 4.22-4.23 (1979).

²⁶¹ 17 C.F.R. § 4.24 (1979).

²⁶² 45 Fed. Reg. 51,600 (1980).

²⁶³ *Id.*

²⁶⁴ *Id.*

²⁶⁵ 45 Fed. Reg. 65,257 (1980); 45 Fed. Reg. 69,248 (1980). Ninety-four comment letters

on May 8, 1981.²⁶⁶ The regulations were more comprehensive and stringent than their predecessors, except for the compensatory liberalizing of the small pool operator exemption from registration.²⁶⁷ Although all rules were to become effective on July 1, 1981, the effectiveness date for rules 4.20 through 4.23,²⁶⁸ dealing respectively with segregation, disclosure documents, reporting to pool participants, and recordkeeping, was deferred until August 24, 1982.²⁶⁹ The Commission further softened the impact of new rules by stating that it would not take enforcement action against the registrant preparing his disclosure document in compliance with the superseded rules for six months after the effectiveness date for the new regulation.²⁷⁰

B. Segregation

As previously discussed, the present regulations require that a pool operate as a separate entity from the pool operator,²⁷¹ except for the special exemption procedure for a corporate pool.²⁷² The requirement that the pool be a separate entity transcends the prior regulations which had prohibited commingling on a limited basis.²⁷³ The prior regulation had contained a proviso permitting commingling of pool property, except that the pool operator was prohibited from commingling the property of separate pools in commodity interest accounts held jointly or similarly.²⁷⁴ The Commission explained this exception by stating that a pool operator could, for example, commingle the property of two commodity pools to purchase a Treasury bill that would be jointly owned by the pools, but the pools could not combine the commodity trading accounts.²⁷⁵ In removing the exception and implementing a straight prohibition against commingling, the Commission stated that through investigations and enforcement proceedings, it had become aware of several instances of abuses of customer funds resulting from the operation of a pool in the operator's name and the commingling of pool property.²⁷⁶ The Commission recognized that a pool operator who had availed himself of the exception to commingling to the advantage of his customers, and who would like to con-

were received on the proposed regulations, which also included a section regulating commodity trading advisors. 46 Fed. Reg. 26,004 (1981).

²⁶⁶ 46 Fed. Reg. 26,004 (1981).

²⁶⁷ 17 C.F.R. § 4.13 (1983). See *supra* text accompanying notes 152-70 (discussion of liberalized provisions).

²⁶⁸ 17 C.F.R. § 4.20-4.23 (1983).

²⁶⁹ 46 Fed. Reg. 34,799 (1981).

²⁷⁰ 46 Fed. Reg. 26,004, 26,005 (1981).

²⁷¹ See *supra* text accompanying notes 64-67.

²⁷² See *supra* text accompanying notes 71-73.

²⁷³ 17 C.F.R. § 4.24 (1979).

²⁷⁴ 17 C.F.R. § 4.24(b) (1979).

²⁷⁵ 44 Fed. Reg. 1918, 1923 (1979).

²⁷⁶ 45 Fed. Reg. 51,600, 51,604 (1980).

tinue to have separate pools jointly own property, could petition the Commission for an exemption.²⁷⁷

C. Requirement of the Disclosure Document

1. Requirement of Delivery of the Disclosure Document

The part of the regulatory scheme that is most visible to the pool operator customer is the requirement for preparation and delivery of a disclosure document by the pool operator for each specific commodity pool for which he solicits participation. The Advisory Committee in its Summary of Major Recommendations and Conclusion stated that pool operators must disclose to prospective participants, among other things, the nature of futures trading, the qualifications of the operator and any trading manager he may retain, complete information about the operation of the pool, fees, and the affiliation or financial arrangements between the pool operator and any futures commission merchant with which the pool maintains an account.²⁷⁸ The Advisory Committee went on to say that the disclosure document should be brief and understandable.²⁷⁹

The disclosure document requirements of the prior regulations²⁸⁰ have been substantially altered and expanded by the present regulations.²⁸¹ Under the former scheme, the commodity pool operator could prepare one document focusing upon the operator and use it in soliciting any number of pools. Under the present scheme, the commodity pool operator must prepare a disclosure document focusing on the offered pool for each pool from which he solicits interests.²⁸² This shift in emphasis conforms to the provision of the new rules requiring separation between a pool operator and the pool or pools which he operates.

²⁷⁷ *Id.* at 51,600 n.11.

²⁷⁸ 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,197, at 21,096, 21,098 (1976).

²⁷⁹ *Id.* The first proposed regulations required a disclosure document. The Commission stated:

The requirement of furnishing a written disclosure statement is designed to afford a prospective participant the opportunity to become informed of the material facts regarding the pool operator, the pool and trading in commodity interest, before investing funds in the pool. 42 Fed. Reg. 9266 (1977).

²⁸⁰ 17 C.F.R. § 4.21 (1979).

²⁸¹ 17 C.F.R. § 4.21 (1983).

²⁸² 17 C.F.R. § 4.21(a) (1983). The duty of delivery of a proper disclosure document prior to solicitation or acceptance of funds for each separate pool is clearly set forth in regulation 4.21(a):

No commodity pool operator registered or required to be registered under the Act may, directly or indirectly, solicit, accept or receive funds, securities or other property from a prospective participant in a pool that it operates or that it intends to operate unless, on or before the date that it engages in that activity, the commodity pool operator delivers or causes to be delivered to the prospective participant a Disclosure Document for the pool, in such form as the Commission may prescribe. . . . *Id.*

The disclosure document and any amendment thereto must be dated as of the day it is first used²⁸³ and the pool operator may not use a disclosure document dated more than six months preceding the date of its use.²⁸⁴ Before the pool operator accepts or receives consideration for the purchase of a pool participation interest, the operator must receive from the customer a signed and dated acknowledgment that the participant has received a disclosure document for the pool.²⁸⁵

The Commission explained the requirement that the operator deliver the disclosure document before accepting consideration as a method of ensuring that pool participants are informed about the material facts regarding the pool before they commit their funds.²⁸⁶ Failure to provide disclosure documents may leave a commodity pool operator liable for reparations to customers purchasing a pool interest,²⁸⁷ to CFTC administrative sanctions,²⁸⁸ or to civil injunctive proceedings.²⁸⁹

2. Content of the Disclosure Document

The present regulations have no less than eighteen separately numbered paragraphs setting forth items of mandated disclosure.²⁹⁰ The disclosure document must commence with a risk disclosure statement, prominently disclosed as the only language in the first portion of the disclosure document.²⁹¹ If the pool is in the form of a general partnership,

²⁸³ 17 C.F.R. § 4.21(c) (1983).

²⁸⁴ 17 C.F.R. § 4.21(e)(2) (1983).

²⁸⁵ 17 C.F.R. § 4.21(d) (1983).

²⁸⁶ 44 Fed. Reg. 1918, 1920 (1979). The prior rules concerning disclosure documents also required delivery of the disclosure document prior to receiving funds from a pool customer, although they did not require dating the document or receipt of written acknowledgement. 17 C.F.R. § 4.21(a) (1979).

²⁸⁷ See, e.g., *Silverman v. Nelson, Ghun & Associates, Inc.*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,484, at 26,249, 26,250 (1983) (Initial decision); *Shah v. David H. Siegel, Inc.*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,485, at 26,251 (1982) (Initial decision).

²⁸⁸ See, e.g., *In the Matter of Nelson, Ghun & Associates, Inc.*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,395, at 25,896 (1982) (Initial decision).

²⁸⁹ See, e.g., *CFTC v. Capital City Currencies Corp.*, 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,886, at 23,606 (D. D.C. 1979) (Order of preliminary injunction, appointment of receiver, and other ancillary relief).

²⁹⁰ 17 C.F.R. § 4.21(a)(1)(18) (1983).

²⁹¹ 17 C.F.R. § 4.21(a)(17)(i)4 (1983), amended by 47 Fed. Reg. 56,997 (1982). The risk disclosure statement reads:

RISK DISCLOSURE STATEMENT

YOU SHOULD CAREFULLY CONSIDER WHETHER YOUR FINANCIAL CONDITION PERMITS YOU TO PARTICIPATE IN A COMMODITY POOL. YOU MAY LOSE A SUBSTANTIAL PORTION OR EVEN ALL OF THE MONEY YOU PLACE IN THE POOL.

IN CONSIDERING WHETHER TO PARTICIPATE IN A COMMODITY POOL YOU SHOULD BE AWARE THAT TRADING COMMODITIES CAN QUICKLY LEAD TO LARGE LOSSES AS WELL AS GAINS. SUCH TRADING LOSSES CAN SHARPLY REDUCE THE NET ASSET VALUE OF THE POOL

or other legal structure in which the potential liability for the participant is greater than his contribution for the purchase of an interest, an additional boldface paragraph warning the participant of his possible exposure must also be included as the last paragraph of the risk disclosure statement.²⁹² The disclosure document must state the name, address, telephone number, and form of organization of both the pool and the commodity pool operator, as well as the name and five year business background of each principal of the operation.²⁹³ As discussed previously, the disclosure document must also identify in detail the pool's commodity trading advisor, and the relationship among the pool, pool operator, and the advisor,²⁹⁴ as well as information regarding the terms of the relationship with the pool's futures commission merchant.²⁹⁵ The information must include a description of any material administrative, civil, or criminal actions within the past five years preceding the date of the document against the pool operator, trading advisor, or any principal thereof, or the futures commission merchant. If no such actions have occurred, the document should include a statement to that effect with respect to each such person.²⁹⁶ This regulatory provision, like several others, requires a response, affirmative or negative, to the specified item of information.²⁹⁷ The onus is squarely on the pool operator, who cannot hide behind ignorance, to verify whether or not there has been any material litigation.²⁹⁸ The pool operator must describe any actual or potential conflict of interest regarding any aspect of the pool on the part of the pool operator, commodity trading advisor, futures commission merchant, or any principal

AND CONSEQUENTLY THE VALUE OF YOUR INTEREST IN THE POOL. ALSO, MARKET CONDITIONS MAY MAKE IT DIFFICULT OR IMPOSSIBLE FOR THE POOL TO LIQUIDATE A POSITION.

IN SOME CASES, COMMODITY POOLS ARE SUBJECT TO SUBSTANTIAL CHARGES FOR MANAGEMENT, ADVISORY AND BROKERAGE FEES. IT MAY BE NECESSARY FOR THOSE POOLS THAT ARE SUBJECT TO THESE CHARGES TO MAKE SUBSTANTIAL TRADING PROFITS TO AVOID DEPLETION OR EXHAUSTION OF THEIR ASSETS. THIS DISCLOSURE DOCUMENT CONTAINS A COMPLETE DESCRIPTION OF EACH EXPENSE TO BE CHARGED THIS POOL.

THIS BRIEF STATEMENT CANNOT DISCLOSE ALL THE RISKS AND THE SIGNIFICANT ASPECTS OF PARTICIPATING IN A COMMODITY POOL. YOU SHOULD THEREFORE CAREFULLY STUDY THIS DISCLOSURE DOCUMENT AND COMMODITY TRADING BEFORE YOU DECIDE TO PARTICIPATE IN A COMMODITY POOL. *Id.*

²⁹² 17 C.F.R. § 4.21(a)(17)(ii) (1983). The disclosure document must discuss the extent to which a participant may be held liable for funds in excess of his investment. 17 C.F.R. § 4.21(a)(1) (1983).

²⁹³ 17 C.F.R. §§ 4.21(a)(1)-(2) (1983).

²⁹⁴ See *supra* text accompanying notes 78-87.

²⁹⁵ See *supra* text accompanying notes 94-97.

²⁹⁶ 17 C.F.R. § 4.21(a)(13) (1983).

²⁹⁷ 45 Fed. Reg. 51,600, 51,602 (1980).

²⁹⁸ 46 Fed. Reg. 26,004, 26,007 (1981). In discussing the disclosure provision, the CFTC stated that the applicable standard is "known or should have known," and that a disclosure such as "[t]o the best of my knowledge and belief" is *not* acceptable. *Id.*

thereof. If no actual or potential conflict exists on the part of any of the foregoing persons, the pool operator must make a statement to that effect with respect to each person.²⁹⁹ Other matters to be disclosed include the extent of any ownership or beneficial interest in the pool held by the pool operator, trading advisor, or any principal thereof, including a statement that if any of the foregoing persons does not own any interest, the pool operator must so state with respect to each person.³⁰⁰ No such disclosure is required with respect to the futures commission merchant or his principals.

Other regulations require disclosure of any commission or other fee paid directly or indirectly by the pool, the commodity trading advisor or any principal thereof to any person in connection with the solicitation of pool participation interests.³⁰¹ Regulations also require a complete description of each kind of expense which the pool operator has incurred, or will incur, including the actual dollar amount of each expense for the fiscal year, and as nearly as possible, the estimated dollar value of each expense for the current year.³⁰² In first proposing the new regulations, the Commission stated that its "experience with descriptions of fees and expenses in Disclosure Documents generally has been that these descriptions are inadequate" and presented the present regulation 4.21(a)(7) to remedy the perceived deficiency.³⁰³

The disclosure document must contain a statement of whether the commodity pool operator or trading advisor, or any principal thereof, trades or will trade commodity interests for their own accounts, and, if so, whether the pool participant may inspect the records of that person's trades.³⁰⁴ If any of those persons does not intend to trade for themselves, the pool operator must make a statement to that effect with respect to each person.³⁰⁵ The regulatory provision is related to section 4n(3)(B) of the Act,³⁰⁶ the only statutory provision affirmatively dealing with disclosure requirements for pool operators.³⁰⁷

²⁹⁹ 17 C.F.R. § 4.21(a)(3) (1983).

³⁰⁰ 17 C.F.R. § 4.21(a)(6) (1983).

³⁰¹ 17 C.F.R. § 4.21(a)(14) (1983).

³⁰² 17 C.F.R. § 4.21(a)(7) (1983). Section 4.21(a)(7) specifically requires that when any expense is calculated by reference to a base term such as "net assets" or "gross profits", the term must be defined, specified details must be given about the method of calculation of incentive fees, and any payment of pool expenses by any person other than the pool, including by implication the pool operator, must be described. 17 C.F.R. §§ 4.21(a)(7)(ii)-(iv) (1983).

³⁰³ 45 Fed. Reg. 51,600, 51,602 (1980).

³⁰⁴ 17 C.F.R. §§ 4.21(a)(15)(i)-(ii) (1983).

³⁰⁵ 17 C.F.R. § 4.21(a)(15)(iii) (1983). The Commission has stated that the pool operator must "make inquiries of its principals and of the pool's CTA [commodity trading advisor] and its principals as to whether they intend to trade commodity interests for their own account." 46 Fed. Reg. 26,004, 26,007 n.7 (1981).

³⁰⁶ 7 U.S.C. § 6n(3)(B) (1982). Section 4n(3)(B) of the Act was renumbered, although not amended, by the 1978 Act, Pub. L. No. 95-405, § 9(1), 92 Stat. 865, 870 (1978).

³⁰⁷ *Id.* Section 4n(3)(B) of the Act provides:

Unless otherwise authorized by the Commission by rule or regulation, all com-

As originally proposed, the regulations would have required that a monthly statement of the commodity positions of the pool operator and his individual principals be given to all participants.³⁰⁸ In publishing the final regulations, however, the Commission reversed its position and enacted regulation 4.11 making the statutory section mandate inapplicable.³⁰⁹ In so doing, the Commission noted that the Advisory Committee and many commentators felt that the exemption should be granted because disclosure would be expensive, destroy the confidentiality of personal trades, and could be detrimental to the market because participants, clients and subscribers might be able to use their knowledge of a principal's positions for manipulative purposes if the principal were a large trader.³¹⁰ The Commission felt that the statutory intent could be satisfied by requiring commodity pool operators and their principals to keep records of their own trades available for Commission inspection and by requiring an affirmative statement in the disclosure document of whether the pool operator or his principals intended to trade. The document also should state whether clients would be permitted access to trading records.³¹¹ The present regulations continue to make section 4n(3)(B)³¹² inapplicable.³¹³

The centerpiece of the disclosure document is the "track record" provision, which requires that the disclosure document set forth the actual performance record in mandated form for the pool, other pools operated by the commodity pool operator, and commodity interest accounts directed by the pool's commodity trading advisor.³¹⁴ The performance disclosure requirements for the pool operator differ according to whether the pool has been traded for more than twelve months preceding the date of the document, less than twelve months preceding the date of the document, or not at all.³¹⁵ If the pool has traded commodities for twelve months or more, the pool operator must disclose the actual performance of the pool for its entire operating history, but need not go back more than three years preceding the date of the document.³¹⁶ If the pool has traded for

modity trading advisors and commodity pool operators shall make a full and complete disclosure to their subscribers, clients, or participants of all futures market positions taken or held by the individual principals of their organization. *Id.*

³⁰⁸ 42 Fed. Reg. 9266, 9275 (Proposed Reg. 4.5(a)(4) (1977)).

³⁰⁹ 17 C.F.R. § 4.11 (1979).

³¹⁰ 44 Fed. Reg. 1917, 1919 (1979).

³¹¹ *Id.*

³¹² 7 U.S.C. § 6n(3)(B) (1982).

³¹³ 17 C.F.R. § 4.11 (1983).

³¹⁴ 17 C.F.R. §§ 4.21(a)(4)-(5) (1983). *See supra* text accompanying notes 84-85 (discussion of track record requirement with respect to trading advisors).

³¹⁵ 17 C.F.R. § 4.21(a)(4)(i) (1983).

³¹⁶ 17 C.F.R. § 4.21(a)(4)(A) (1983). Surprisingly no performance disclosure requirements for any other pool that he might operate are imposed upon a commodity pool operator when the pool being offered has a history of more than twelve months. If the pool operator has called the trades for other pools within the preceding three years, and is also advising the pool that is the subject of the disclosure document, records of the other pools must

less than twelve months, the pool operator must disclose the actual performance of the pool for its entire history, as well as the record for the three years preceding the date of the document of each other pool operated by it and each of its principals.³¹⁷ If the operator and his principals previously have not operated any other pool, the document must disclose that fact in a prominently displayed warning statement.³¹⁸ If the pool has not commenced trading, that fact must be disclosed through a prominent statement and the pool operator must present the actual performance for the three years preceding the date of the document of each of the other pools operated by it and its principals.³¹⁹

All performance records must be in a tabular form indicating (1) beginning net asset value for the period, (2) all additions, withdrawals, and redemptions during the period, (3) net performance, representing the change in the net asset value, net of additions, withdrawal and redemptions, (4) ending net asset value, (5) the rate of return, calculated by dividing net performance by beginning net asset value, and (6) the number of units outstanding at the end of the period.³²⁰ The pool operator may present the performance record on a composite basis, but he must separately

be disclosed. 17 C.F.R. § 4.21(a)(5) (1983). Since regulation 4.21(h) requires disclosure of "all material information to existing or prospective pool participants even if the information is not specifically required by this section," and commodity pools are offered pursuant to the disclosure standard of securities laws, it is inconceivable that a disclosure document would omit the performance record for other pools operated by the pool operator, despite the omission of a requirement from the applicable subsection. 17 C.F.R. § 4.21(h) (1983).

³¹⁷ 17 C.F.R. § 4.21(a)(4)(B) (1983).

³¹⁸ *Id.* The warning states:

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES THE OPERATOR OF A POOL THAT HAS TRADED COMMODITY INTERESTS FOR LESS THAN 12 MONTHS TO DISCLOSE THE ACTUAL PERFORMANCE RECORD OF THE POOL FOR ITS ENTIRE OPERATING HISTORY AND THE ACTUAL PERFORMANCE RECORD OF EACH OTHER POOL OPERATED BY THE POOL OPERATOR AND ITS PRINCIPALS. YOU SHOULD NOTE THAT THE ACTUAL PERFORMANCE RECORD OF THIS POOL REPRESENTS ITS ENTIRE OPERATING HISTORY, A PERIOD OF ONLY ____ MONTHS. YOU ALSO SHOULD NOTE THAT THIS POOL OPERATOR AND ITS PRINCIPALS PREVIOUSLY HAVE NOT OPERATED ANY OTHER COMMODITY POOL. *Id.*

³¹⁹ 17 C.F.R. § 4.21(a)(4)(i)(C) (1983). The warning states:

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES A COMMODITY POOL OPERATOR TO DISCLOSE TO PROSPECTIVE POOL PARTICIPANTS THE ACTUAL PERFORMANCE RECORD OF THE POOL FOR WHICH THE OPERATOR IS SOLICITING PARTICIPANTS. YOU SHOULD NOTE THAT THIS POOL HAS NOT BEGUN TRADING AND DOES NOT HAVE ANY PERFORMANCE HISTORY. WHERE THE POOL FOR WHICH THE POOL OPERATOR IS SOLICITING PARTICIPANTS HAS NOT BEGUN TRADING, THE COMMISSION REQUIRES THE POOL OPERATOR TO DISCLOSE TO PROSPECTIVE PARTICIPANTS THE ACTUAL PERFORMANCE RECORD OF EACH OTHER POOL OPERATED BY THE POOL OPERATOR AND ITS PRINCIPALS. YOU ALSO SHOULD NOTE THAT THIS POOL OPERATOR AND ITS PRINCIPALS PREVIOUSLY HAVE NOT OPERATED A COMMODITY POOL. *Id.*

³²⁰ 17 C.F.R. § 4.21(a)(4)(ii) (1983).

disclose the record of the pool which is the subject of the disclosure document, present in a separate composite all pools traded by the same trading advisor or his principals as the pools being offered, and describe how each composite was developed.³²¹ The pool operator must also set forth the actual performance of the pool's commodity trading advisor and each of its principals for three years preceding the disclosure document. If performance is presented on a composite basis, the pool operator must describe how each composite was developed and must disclose material information from which the composite was drawn.³²²

The presentation of performance must be displayed in tables showing the information at least quarterly, current as of the date of not more than three months preceding the date of the disclosure document.³²³ As previously discussed, the disclosure document may be dated up to six months preceding the date of its use,³²⁴ causing the possibility that a solicitation could be made using a document containing a performance record for a period ending up to nine months before the time of the solicitation.³²⁵ In considering this possibility, the Commission noted that in view of the provision mandating disclosure of all material information even if not specifically required,³²⁶ a material drop in a pool's performance would mandate an amendment, the six month rule notwithstanding.³²⁷

The disclosure document must state the minimum aggregate amount of funds necessary for the pool to commence trading or, if there is no minimum, there must be a statement to that effect, as well as the maximum, or lack thereof.³²⁸ Similarly, the disclosure document must state the maximum period of time for which the pool will hold funds prior to the commencement of trading or, if there is no such period, a statement to that effect. The document must disclose the disposition of the funds if the pool does not receive the necessary amount to commence trading and the period of time within which the disposition will be made. Further, the document should include where the pool operator will deposit or invest funds pending receipt of the minimum and who will receive the interest from the escrow.³²⁹

The disclosure document must also state the manner in which the pool will fulfill its margin requirements, including the nature of non-cash items, if any, and the person receiving interest from such items.³³⁰ The disclosure

³²¹ 17 C.F.R. § 4.21(a)(4)(iv) (1983). The disclosure document must describe material differences among pools whose performance is being disclosed. 17 C.F.R. § 4.21(a)(4)(iii) (1983).

³²² 17 C.F.R. § 4.21(a)(4)(iv) (1983).

³²³ 17 C.F.R. §§ 4.21(a)(4)(ii), 4.21(a)(5)(ii) (1983).

³²⁴ 17 C.F.R. § 4.21(e)(2) (1983).

³²⁵ 46 Fed. Reg. 26,004, 26,010 (1981).

³²⁶ 17 C.F.R. § 4.21(h) (1983).

³²⁷ 46 Fed. Reg. 26,004, 26,010 (1981).

³²⁸ 17 C.F.R. §§ 4.21(a)(8)(i)-(ii) (1983).

³²⁹ 17 C.F.R. §§ 4.21(a)(8)(iii)-(iv) (1983).

³³⁰ 17 C.F.R. § 4.21(a)(9)(i) (1983).

document must further state the form in which pool funds not deposited to margin futures trade or to pay commodity option premiums will be held after commencement of trading. If pool funds are held in non-cash form, the document should disclose the form, nature, and the recipient of interest, if any.³³¹ If pool funds not deposited as margin or paid as premiums will be held outside of the United States, its territories, or possessions, the pool operator must specify where the funds will be held.³³² The Commission adopted this requirement in lieu of the proposed rule that would have required a pool operator to keep all assets of the pool not committed to trading on foreign commodities markets within the United States.³³³

The commodity pool operator must completely describe any restrictions upon the transferability of an interest in the pool, including a statement that there are no restrictions. The operator should discuss the manner in which a participant may redeem his interest, including calculation of redemption value, the condition under which a participant may redeem an interest, including terms of notification, and any restrictions upon redemption of an interest or an affirmative statement that there are no restrictions.³³⁴ Finally, the commodity pool operator must disclose the pool's policies with respect to the distributions from profits or capital and the federal income tax effects of such payments, including a discussion of the federal income tax laws applicable to the form of organization of the pool and to such payments therefrom.³³⁵

A commodity pool operator is permitted to disclose additional information on its performance record so long as the operator complies with the minimum requirements of regulation 4.21(a)(4).³³⁶ Moreover, the commodity pool operator is still obligated to disclose all material information to existing or prospective pool participants even if the section does not specifically require the information.³³⁷

The CFTC has recognized that commodity pool operators use the disclosure document to simultaneously satisfy the offering document requirements of the securities laws. The Commission granted an exemption from the technical requirements of the performance disclosure provision of the prior regulation³³⁸ to a commodity pool operator who intended to

³³¹ 17 C.F.R. § 4.21(a)(9)(ii) (1983), *amended in part by* 47 Fed. Reg. 56,996 (1982). Regulation 4.21(a)(9)(ii) is highly material because most large commodity pools never commit a substantial percentage of their assets to the commodities market at one time, but hold most pool funds in interest-bearing form.

³³² 17 C.F.R. § 4.21(a)(9)(iii), (1982), *amended in part by* 47 Fed. Reg. 45,996 (1982).

³³³ 46 Fed. Reg. 26,004 (1981). *See* 45 Fed. Reg. 51,600-51,601 (1980) (discussion of Commission's original discussion of rule).

³³⁴ 17 C.F.R. § 4.21(a)(10) (1983).

³³⁵ 17 C.F.R. § 4.21(a)(12) (1983).

³³⁶ 17 C.F.R. § 4.21(a)(4) (1983).

³³⁷ 17 C.F.R. § 4.21(h) (1983).

³³⁸ 17 C.F.R. §§ 4.21(a)(4)-(5) (1983).

use a prospectus filed with the SEC as his disclosure document when the performance disclosures had been prepared in accordance with the requirements of the SEC staff prior to the adoption of the CFTC regulation.³³⁹

3. Duty to File and Amend the Disclosure Document

The commodity pool operator must file three copies of the disclosure document for each pool that he operates with the Audit Unit of the Division of Trading and Markets of the Commission not less than twenty-one calendar days prior to the date the pool operator first intends to deliver the document to a prospective participant.³⁴⁰ In proposing the requirement, the Commission stated that it might not conduct a thorough review of each disclosure document prefiled with it. The fact that a document had been filed, therefore, could not be taken by a prospective customer to mean that the Commission had approved the document.³⁴¹

A disclosure document filed with the CFTC does not become effective, whereas a registration statement filed with the SEC pursuant to the applicable provisions of the Securities Act of 1933 does become effective.³⁴² Additionally, no analogue to a stop order proceeding exists under the Act.³⁴³ The proposed version of the current regulations did contain a provision that provided that if prior to the date when the disclosure document could be delivered lawfully, the Commission notified the pool operators that the document did not comply with the regulations of the Act, the pool operator would be prohibited from delivering the document.³⁴⁴ In its final Rulemaking Notice, the Commission did not adopt that specific requirement, but did say that it would instruct its staff to work with the pool operator to cure any deficiency that it might notice, "to the extent

³³⁹ In the Matter of Heinold Commodities, Inc., et al., 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,824, at 23,353 (1979) (Order granting exemption from certain provisions of part 4 of rules). The exemption was granted pursuant to 17 C.F.R. § 4.12 (1979) which permits the commodity pool operator to seek exemption from the Commission from the pool operator rules. The regulation continues in effect. 17 C.F.R. § 4.12 (1983). However, certainly no general rule exists that a prospectus for a commodity pool that the SEC declares effective will satisfy the CFTC. The Commission noted in promulgating the prior rules, "[i]n those case where a CPO [commodity pool operator] chooses to provide a prospectus to prospective pool participants the Commission will permit that prospectus to be supplemented to comply with the specific requirements of § 4.21" (footnote omitted, emphasis supplied). 44 Fed. Reg. 1918, 1922 (1979).

³⁴⁰ 17 C.F.R. § 4.21(a) (1982) (place of filing); 17 C.F.R. § 4.21(g)(1) (1983) (duty of filing).

³⁴¹ 45 Fed. Reg. 51,600, 51,603 (1980). The Commission rules require that the following cautionary statement be prominently displayed on the cover page of the document: THE COMMODITY FUTURES TRADING COMMISSION HAS NOT PASSED UPON THE MERITS OF PARTICIPATING IN THIS POOL NOR HAS THE COMMISSION PASSED ON THE ADEQUACY OR ACCURACY OF THIS DISCLOSURE DOCUMENT. 17 C.F.R. § 4.21(a)(18) (1983).

³⁴² Securities Act of 1933, §§ 8(a), (c), 15 U.S.C. §§ 77h(a), (c) (1976 & Supp. V 1981).

³⁴³ Securities Act of 1933, §§ 8(b), (d)-(f), 15 U.S.C. §§ 77h(b), (d)-(f) (1981).

³⁴⁴ 45 Fed. Reg. 51,600, 51,603 (1980) (Proposed Reg. § 4.21(h)(1)(iii)).

practicable consistent with other commitments and resource availability to do so."³⁴⁵

Rule 4.21(e)(1)³⁴⁶ requires that all information contained in the disclosure document be current as of the date of the document, except that performance tables need only be current as of a date not more than three months preceding the date of the document. The regulations impose an affirmative duty upon a pool operator, who knows or should know that the disclosure document is materially inaccurate or incomplete in any respect, to correct the defect. The operator must distribute the correction to all existing pool participants, and to each previously solicited participant, within twenty-one days of the date on which the pool operator first knew or had reason to know of the defect and prior to accepting funds for the pool.³⁴⁷ The correction may be furnished by way of an amended document, a sticker on the document, or other similar means.³⁴⁸ Three copies of the amendment must be filed with the Commission.³⁴⁹ In discussing the amendment requirements in the Rulemaking Notice, the Commission stated that at the end of the six month period, if no supravening material events had occurred, a disclosure document need only be revised to show the current financial information and the new date. The rules require the document to be updated only if it is being actively used to solicit prospective customers.³⁵⁰

D. *Required Reports to Participants*

The only provision of the Act aimed solely at commodity pool operators, section 4n(4),³⁵¹ affirmatively imposes a duty upon pool operators to make reports to customers.³⁵² The Commission has implemented this statutory mandate by regulation 4.22, which contemplates periodic reports³⁵³ and certified annual reports³⁵⁴ for each pool the commodity pool operator might operate.

³⁴⁵ 46 Fed. Reg. 26,004, 26,010 (1981). The author is aware of a number of occasions upon which the Division of Trading and Markets has issued detailed comment letters upon disclosure documents.

³⁴⁶ 17 C.F.R. § 4.21(e)(1) (1983).

³⁴⁷ 17 C.F.R. § 4.21(b)(1) (1983).

³⁴⁸ *Id.*

³⁴⁹ 17 C.F.R. § 4.21(g)(2) (1983).

³⁵⁰ 46 Fed. Reg. 26,004, 26,010-11 (1981).

³⁵¹ 7 U.S.C. § 6n(4) (1982). The provision was renumbered from § 4n(5) of the Act by the 1978 Act, Pub. L. No. 95-405, § 9(1), 92 Stat. 865, 870 (1978).

³⁵² 7 U.S.C. § 6n(4) (1982). Section 6n(4) provides:

Every commodity pool operator shall regularly furnish statements of account to each participant in his operations. Such statements shall be in such form and manner as may be prescribed by the Commission and shall include complete information as to the current status of all trading accounts in which such participant has an interest. *Id.*

³⁵³ 17 C.F.R. § 4.22 (1983), amended by 47 Fed. Reg. 56,996 (1982).

³⁵⁴ 17 C.F.R. §§ 4.22(c)-(d) (1983).

An account statement must be distributed at least monthly to participants in pools with net assets of more than \$500,000 at the beginning of the pool's fiscal year and at least quarterly for smaller pools. The requirement commences as of the date the pool operator first receives property to purchase a participation.³⁵⁵ No requirement mandates that the pool must actually be trading during the period for the account statement requirement to attach. The account statement must present prescribed financial information for the applicable period in the form of a statement of income (loss) and a statement of changes and net asset value.³⁵⁶ The statement of income (loss) must itemize information including the total amount of realized net gain or loss on commodity interest positions liquidated during the reporting period, the change in unrealized net gain or loss on commodity interest positions, the total net gain or loss from all other transactions in which the pool engaged during the reporting period, including interest and dividends earned on funds not used as premiums or to margin the pool's commodity interest requirements, and the total amount of management, advisory, brokerage, other commodity interest transactions, and other expenses incurred or accrued during the reporting period.³⁵⁷ The statement of changes and net asset value must itemize the net asset value of the pool as of the beginning of the reporting period, the total amount of additions and withdrawals from the pool including redemptions, the total net income or loss, the net asset value of the pool as of the end of the reporting period, and the net asset value per unit or the total value of the participant's interest or share as of the end of the reporting period.³⁵⁸ Each account statement must contain a signed oath or affirmation that the information contained therein is accurate and complete, identifying the name of the individual signing the document, the capacity in which he is signing, the name of the commodity pool operator for whom he is signing and the name of the pool for which the document is being distributed.³⁵⁹ The Commission has explained that each copy of each account statement is not required to contain a manual signature. Copies bearing a facsimile of the signature may be used if the pool operator retains the signed original for his records.³⁶⁰

The pool operator must distribute an annual report to each pool participant and must file three copies of the report with the Commission within ninety calendar days after the end of the pool's fiscal year.³⁶¹ The pool operator may elect any fiscal year not more than one year after the pool first receives funds from a participant, but if he elects a fiscal year other than the calendar year, he must give written notice of the election to all

³⁵⁵ 17 C.F.R. §§ 4.22(a)-(b) (1983), *amended by* 47 Fed. Reg. 56,997 (1982).

³⁵⁶ 17 C.F.R. § 4.22(b) (1983), *amended by* 47 Fed. Reg. 56,997 (1982).

³⁵⁷ 17 C.F.R. § 4.22(a)(1) (1983), *amended by* 47 Fed. Reg. 56,997 (1982).

³⁵⁸ 17 C.F.R. § 4.22(a)(2) (1983).

³⁵⁹ 17 C.F.R. § 4.22(h) (1983).

³⁶⁰ 46 Fed. Reg. 26,004, 26,011 (1981).

³⁶¹ 17 C.F.R. § 4.22(c) (1983).

participants and must file the notice with the Commission within ninety calendar days after first receipt.³⁶² If the notice is not given, the pool operator will be deemed to have elected the calendar year as the pool's fiscal year. The pool operator must continue to use the elected fiscal year, unless he provides written notice of the proposed change to all participants, and files the notice with the Commission at least ninety days before the change. Additionally, the Commission must not disapprove the change within thirty days of the filing of the notice.³⁶³

The annual report must contain financial information similar, but not identical to that required for the account statement.³⁶⁴ The required information includes the net asset value of the pool, each outstanding participation unit in the pool, and the total value of the participant's interest or share in the pool as of the end of each of the pool's two preceding fiscal years. The annual report must also contain a statement of financial condition as of the close of the pool's fiscal year and preceding fiscal year.³⁶⁵ The annual report must set forth statements of income (loss), itemizing and setting forth all fees and expenses and total realized and unrealized net gain or loss in commodity trading, changes in financial position, and changes in ownership equity.³⁶⁶ These statements must reflect the period between the later of either the date of the most recent annual report filed with the Commission or the date of the formation of the pool and the pool's fiscal year. The statements must also include statements for the corresponding period of the previous fiscal year.³⁶⁷ The financial statements in the annual report must be certified by an independent public accountant³⁶⁸ and must contain the same signed oath or affirmation as the periodic account statement.³⁶⁹

The regulatory structure provides for some interrelationship between the disclosure document and participant report requirements. The disclosure document must contain an affirmative statement that the commodity pool operator must provide all participants with monthly or quarterly statements of account, whichever is applicable, and a certified annual report of financial condition.³⁷⁰ Moreover, the commodity pool operator must attach to the disclosure document the most current account statement and annual report required to be distributed.³⁷¹

³⁶² 17 C.F.R. §§ 4.22(g)(1)-(2) (1983).

³⁶³ 17 C.F.R. §§ 4.22(g)(2)-(3) (1983).

³⁶⁴ 17 C.F.R. § 4.22(c) (1983).

³⁶⁵ 17 C.F.R. §§ 4.22(c)(1)-(4) (1983).

³⁶⁶ 17 C.F.R. §§ 4.22(c)(4), 4.22(e) (1983).

³⁶⁷ 17 C.F.R. § 4.22(c)(4) (1983).

³⁶⁸ 17 C.F.R. § 4.22(d) (1983).

³⁶⁹ 17 C.F.R. § 4.22(c) (1983). Regulation 4.22(c) further provides that if during any calendar year the commodity pool operator did not operate any pools, he must advise the Commission within 30 days. *Id.*

³⁷⁰ 17 C.F.R. § 4.21(a)(16) (1983).

³⁷¹ 17 C.F.R. § 4.21(f) (1983).

E. Book and Recordkeeping

Section 4n(3)(A) of the Act³⁷² requires every commodity pool operator to maintain books and records and file reports in the form and manner prescribed by the Commission, and to make these materials available for inspection by any representative of the Commission or the Department of Justice for a period of at least three years.³⁷³ The Commission implemented the statutory section for commodity pool operators in regulation 4.23,³⁷⁴ which specifies that books and records must be kept in an accurate, current and orderly manner by the commodity pool operator and must remain open for inspection by any representative of the Commission or the Department of Justice for five years.³⁷⁵ Materials concerning the pool that are required include an itemized daily record of each commodity interest transaction, all signed acknowledgments from participants of receipt of disclosure documents, a subsidiary ledger or other corporate record for each participant in the pool showing the participant's name and address and all receipts from and distributions to the participant, adjusting entries, a general ledger, copies of all confirmations, banking records, promotional materials including scripts of any radio, television, seminar or similar mass media presentation, and required financial reports and accounts.³⁷⁶ All books and records of the pool except for the disclosure document acknowledgements and the subsidiary ledger, which shows the names and addresses of all participants, must be made available to participants for inspection and copying during normal business hours at the main business address of the pool operator. Copies must be sent upon request by mail to any participant within five business days if the participant pays reasonable reproduction and distribution costs.³⁷⁷ The commodity pool operator is further required to maintain an itemized daily record of any commodity interest transaction for his own account, or that of any principal, as well as the underlying confirmations and monthly statements for such transaction.³⁷⁸ Finally, the commodity pool operator must keep available for inspection books and records "of all other transactions in

³⁷² 7 U.S.C. § 6n(3)(A) (1982). Section 6n(3)(A) was renumbered but not amended, from § 4n(4)(A) by the 1978 Act, Pub. L. No. 95-405, § 9(1), 92 Stat. 865, 870 (1978).

³⁷³ *Id.*

³⁷⁴ 17 C.F.R. § 4.23 (1983).

³⁷⁵ *Id.* Section 4.23 states that the books and records must be maintained in accordance with CFTC regulation 1.31, which recites the mandatory maintenance and inspection provisions. 17 C.F.R. § 1.31 (1983). If the main business office of the pool operator is located outside the United States, the books and records must be made available to a Commission representative, at any place in the United States which he might designate, within 72 hours after the pool operator receives the request. 17 C.F.R. § 4.23 (1983).

³⁷⁶ 17 C.F.R. § 4.23(a) (1983).

³⁷⁷ 17 C.F.R. § 4.23 (1983).

³⁷⁸ 17 C.F.R. §§ 4.23(b)(1)-(2) (1983). Disclosure of daily record information by the commodity pool operator to participants is voluntary. 17 C.F.R. § 4.23(a)(15) (1983); *see supra* text accompanying notes 304-13 (voluntary disclosure).

all other activities in which the pool operator engages," including all financial records that may have been prepared in the course of engaging in those activities.³⁷⁹

Certain commentators questioned the authority of the commission to require the maintenance and inspection of non-commodities related records. The CFTC answered by citing the unqualified wide range of section 4n(3)(A) of the Act³⁸⁰ which specifies that each registered commodity pool operator "shall maintain books and records and file such reports in such form and manner as may be prescribed by the Commission."³⁸¹ The Commission, however, stated that it did not intend to make routine inspections of these records, and would only look at them if the other required books and records indicated the need for additional inspection. For example, if the CFTC determined that pool assets were deficient, the CFTC could review the personal records of the operator.³⁸² For an individual commodity pool operator, all personal financial records of whatever variety are subject to Commission inspection, a concept that may be somewhat disconcerting.³⁸³ Of course, individuals intending to operate commodity pools who do not want such records subject to Commission inspection powers have the option of forming the commodity pool operator as a corporation or another separate legal entity, and limiting its business solely to commodity activities.

F. *Prohibited Representations and Anti-Fraud Requirements.*

1. Limitations on Certain Representations in Advertising and Promotional Materials.

Commodity pool operators must comply with provisions dealing with promotion and advertising. Section 4o(2) of the Act prohibits a commodity pool operator or his associated person from representing or implying in any manner that such person has been sponsored, recommended, or approved, or that the person's abilities or qualifications have in any respect been passed upon by the United States or any agency or officer. The person may state, however, that he is so registered, if the statement is true

³⁷⁹ 17 C.F.R. § 4.23(b)(3) (1983). The records need not be disclosed to pool participants. 17 C.F.R. § 4.23 (1983).

³⁸⁰ 7 U.S.C. § 6n(3)(A) (1982).

³⁸¹ 46 Fed. Reg. 26,004 (1981).

³⁸² *Id.*

³⁸³ The reader should note that in *CFTC v. Buterin*, 1980-82 COMM. L. FUT. REP. (CCH) ¶ 21,133, 24,597 (1980) (Memorandum and order, D. Kan. 1980), the Court in dictum pointed out that the required records of *Shapiro v. United States*, 335 U.S. 1 (1948), barring the claim of Fifth Amendment privilege against self-incrimination with respect to records required to be kept by a pertinent statute, specifically applied to required records maintained by a registered pool operator. *Id.* at 24,609-10. Thus, the records of all non-commodity transactions of the commodity pool operator, including personal financial records, if any, may fall within the required records doctrine.

and if the effect of such registration is not misrepresented.³⁸⁴ This prohibition is reiterated by regulation 4.16³⁸⁵ which makes unlawful any representation by any commodity pool operator or principal thereof implying in any manner that the pool operator has been sponsored, recommended, or approved, or that his abilities or qualifications have in any respect been passed upon, by the Commission, or any other federal agency. Violation of section 4o(2) is a misdemeanor punishable by a fine of not less than \$100,000 or imprisonment for not more than one year, or both, together with the cost of prosecution.³⁸⁶

The advertising of the performance of simulated or hypothetical commodity transactions has been a subject of regulatory attention. The original proposed regulations banned pool operators from publishing any simulated or hypothetical trading records or results.³⁸⁷ The regulation was not enacted. In proposing the present regulations in 1980, the Commission once again sought to ban the publication of simulated or hypothetical performance results³⁸⁸ on the grounds that the Commission had found that the use of hypothetical and simulated models constituted a major area of customer abuse.³⁸⁹ In promulgating the final regulation, however, the Commission once again applied its regular methodology of substituting disclosure and control for outright prohibition, and promulgated regulation 4.41³⁹⁰ which concerns advertising by commodity pool operators and commodity trading advisors. The regulation prohibits the pool operator from advertising in a manner that employs any device, scheme, or artifice to defraud, or involves any transaction that operates as a fraud or deceit upon any person.³⁹¹ The Commission explained that the regulation respects the discretion of the person advertising performance results, whether actual, simulated or hypothetical, and the format of the advertisement presentation as long as the method is not false, misleading, or deceptive.³⁹²

³⁸⁴ 7 U.S.C. § 4o(2) (1982). In *Polissar v. Nelson Ghun & Associates, Inc.*, reparations were granted against a commodity trading advisor found to have violated § 4o(2) of the Act for printing in its brochure "Nelson, Ghun is a federally registered trading advisor firm with the Commodity Futures Trading Corporation [sic]." 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,288, at 25,477-79 (1981) (order granting summary disposition).

³⁸⁵ 17 C.F.R. § 4.16 (1983).

³⁸⁶ Section 9(c) of the Act, 7 U.S.C. § 13(c) (1982).

³⁸⁷ 42 Fed. Reg. 9266, 9275 (1977) (Proposed Reg. § 4.6).

³⁸⁸ 45 Fed. Reg. 51,600, 51,614 (1980) (Proposed Reg. § 4.42). A second proposed regulation, § 4.41, would have banned the presentation of *any* performance or results other than in the form mandated for the disclosure document. 45 Fed. Reg. 51,600, 51,614 (1980).

³⁸⁹ 45 Fed. Reg. 51,600, 51,601 (1980).

³⁹⁰ 17 C.F.R. § 4.41 (1983).

³⁹¹ 17 C.F.R. § 4.41(a) (1983).

³⁹² 46 Fed. Reg. 26,004 (1981). The CFTC has identified the following advertisements, among others, to be prohibited as deceptive and misleading:

- (1) references only to successful trades if there were unsuccessful trades during the same period;
- (2) references to results during a particular time period, if the results claimed were not fairly representative of those for comparable periods;

Simulated or hypothetical trades may be presented, but only if accompanied by a warning statement that must be prominently disclosed if the presentation is other than by oral means.³⁹³ By their terms, these advertising restrictions equally apply to a pool operator exempt from registration.³⁹⁴

2. Anti-Fraud Provisions

Section 41(1)³⁹⁵ contains an anti-fraud provision modeled upon section 206 of the Investment Advisors Act of 1940³⁹⁶ and SEC Rule 10(b)-5.³⁹⁷ The provision makes it unlawful for a commodity pool operator or its associated person:

- (A) To employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or
- (B) To engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.³⁹⁸

The provision applies to a commodity pool operator even though he is exempt from registration³⁹⁹ and to a commodity pool operator who is required to register, but has not done so.⁴⁰⁰

- (3) suggestions, assurances, or claims of profit potential that do not also fairly present the possibility of loss;
- (4) statements of opinion not labelled as such, or with no reasonable basis in fact; and
- (5) failure to disclose to what extent, if any, fees or commissions are reflected in the performance results. 46 Fed. Reg. 26,004 (1981).

³⁹³ 17 C.F.R. §§ 4.41(b)(1)-(2) (1982). The warning states:

(1) Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under-or-over compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown.

(2) If the presentation of such simulated or hypothetical performance is other than oral, the prescribed statement must be prominently disclosed. *Id.*

³⁹⁴ 17 C.F.R. § 4.41(c)(2) (1983).

³⁹⁵ 7 U.S.C. § 6o(1) (1982).

³⁹⁶ 15 U.S.C. § 80b-5(1) (1981).

³⁹⁷ 17 C.F.R. § 240.10b-5 (1983).

³⁹⁸ Section 4o(1) of the Act, 7 U.S.C. § 6o(1) (1982).

³⁹⁹ 17 C.F.R. § 4.15 (1983).

⁴⁰⁰ As enacted, § 4o(1) of the Act applied only to a commodity pool operator registered under this Act. 7 U.S.C. § 16o(1) (1976). However, the 1978 Act, Pub. L. No. 95-405, § 10, 92 Stat. 865, 870 (1978) removed the provision to make clear that the anti-fraud provision applies to all pool operators including those who should have registered but did not. H.R. REP. No. 1181, 95th Cong., 2d Sess. 20-21 (1978). See Schneider & Santo, *supra* note 2, at 1758. The 1982 Act amended § 4o(1) to include associated persons of commodity pool operators. Pub. L. No. 97-447, § 214, 96 Stat. 2294, 2305 (1983).

The special anti-fraud provision operates in tandem with section 4b of the Act,⁴⁰¹ the general anti-fraud provision for futures contracts.⁴⁰² Section 4o(a)⁴⁰³ is more extensive than section 4b.⁴⁰⁴ Section 4b is limited to transactions in exchange—traded futures contracts, whereas section 4o(a) covers all activities by a commodity pool operator. Section 4o(1)⁴⁰⁵ also has been construed as requiring a lesser standard of culpability than the narrower section 4b. In *CFTC v. Savage*,⁴⁰⁶ the Court of Appeals for the Ninth Circuit held in a CFTC enforcement action that the Commission had to demonstrate scienter to prove a violation of section 4b.⁴⁰⁷ The court, however, refused to engraft a scienter requirement upon section 4o(1) in part because of the broader language of that section, but also because section 4o(1) fulfills a slightly different function than section 4b. Section 4o(1) characterizes an advisor's relationship to his clients as fiduciary. Despite these conceptual differences, courts have applied sections 4o(1) and 4b interchangeably. Thus, some pool participants have recovered reparations pursuant to section 4o(a)⁴⁰⁹ upon a violation of section 4b theory,⁴¹⁰ while other courts have cited both provisions and utilized them in tandem.⁴¹¹

⁴⁰¹ 7 U.S.C. § 6b (1976).

⁴⁰² Section 4o(1) of the Act, 7 U.S.C. § 6o(1) (1982). The anti-fraud provision makes it unlawful for any person in connection with futures contracts

- (A) to cheat or defraud or attempt to cheat or defraud such other person;
- (B) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;
- (C) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person; or
- (D) to bucket any order. . . . *Id.*

⁴⁰³ 7 U.S.C. § 6o(1) (1982).

⁴⁰⁴ 7 U.S.C. § 6b (1976).

⁴⁰⁵ 7 U.S.C. § 6o(1) (1982).

⁴⁰⁶ 611 F.2d 270 (9th Cir. 1979).

⁴⁰⁷ *Id.* at 283. Scienter is determined by whether the defendant had knowledge of the nature of his action, including constructive knowledge. *Id.*

⁴⁰⁸ *Id.* at 285. See *First Commodity Corp. of Boston v. CFTC*, 676 F.2d 1, 6 (1st Cir. 1982) (dictum in review of reparation case that § 4o is anti-fraud provision of Act that does not depend upon scienter).

⁴⁰⁹ See, e.g., *Tejeda v. Knight*, 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,647 (1978) (default judgment findings); *Stewart v. The Decade Management Company*, 1977-80 COMM. FUT. L. REP. (CCH) ¶ 20,664 (1978) (initial decision); *Lehtrek v. Commodity Investment Counselors*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,402 (1982) (initial decision).

⁴¹⁰ See, e.g., *Dwyer v. Meridian Equities Corporation*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,226 (1981) (initial decision); *Brotherton v. Peabody Trading Company of Boston*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,381 (1982) (initial decision).

⁴¹¹ See, e.g., *In the Matter of Nelson, Ghun & Associates, Inc.*, 1981-82 COMM. FUT. L. REP. (CCH) ¶ 21,395 (1982) (opinion) (disciplinary proceeding revoking licenses and imposing sanctions); *Ray v. Stanford Management Corp.*, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,439 (1982) (initial decision).

The Act makes violation of section 4o(a)⁴¹² a felony punishable by a fine of not more than \$500,000 for a firm, or not more than \$100,000 for an individual, and imprisonment for not more than five years or both together with the cost of prosecution.⁴¹³ The 1982 Act added the additional penalty of suspension from any registration under the Act, denial of registration or re-registration for five years or any longer period the Commission determines, and prohibition from trading on any market regulated by the Commission for five years or any longer period the Commission determines, unless the Commission decides that the imposition of the suspension, denial, or market bar is not required to protect the public interest.⁴¹⁴

The 1982 Act extended the scope of the prior section 9a of the Act⁴¹⁵ which imposed criminal penalties of \$500,000 for a firm or \$100,000 for an individual, or imprisonment for not more than five years, or both together with the cost of prosecution for any futures commission merchant who embezzles or converts customer property, to apply to any person registered or required to be registered under the Act, including a commodity pool operator or his associated person, whether registered or not.⁴¹⁶ The amended provision similarly includes a five year automatic registration prohibition subject to Commission extension or reduction, although there is no market bar provision.⁴¹⁷

G. *Dispute Resolution Mechanism.*

1. Private Actions.

Aggrieved commodity customers have available court litigation, arbitration, and administrative reparation actions before the CFTC for the resolution of their claims against commodity firms and professionals.⁴¹⁸ Each method is applicable to disputes involving commodity pool operators and their associated persons.

(a) Reparation Proceedings.

A reparation proceeding is a "formal complaint procedure before the Commission for the adjudication of grievances which result in violation of the Act."⁴¹⁹ The procedure is memorialized in section 14 of the Act,⁴²⁰

⁴¹² 7 U.S.C. § 6o(1) (1982).

⁴¹³ Section 9(b) of the Act, 7 U.S.C. § 13(b) (1982).

⁴¹⁴ 1982 Act, Pub. L. No. 97-444, § 227(2), 96 Stat. 2294, 2316-17 (1982) (amending § 9(b) of the Act, 7 U.S.C. § 13(b) (1982)).

⁴¹⁵ 7 U.S.C. § 13(a) (1982).

⁴¹⁶ 1982 Act, Pub. L. No. 97-444, § 227(1), 96 Stat. 2294, 2316 (1982) (amending § 9(a) of the Act, 7 U.S.C. § 13(a) (1982)).

⁴¹⁷ *Id.* at 2316.

⁴¹⁸ See 40 Fed. Reg. 55,666 (1975).

⁴¹⁹ H.R. REP. NO. 975, 93d Cong., 2d Sess. 22 (1974).

⁴²⁰ 7 U.S.C. § 18 (1982).

which sets forth a statutory framework for the conduct of administrative reparation proceedings before the Commission pursuant to whatever regulations the Commission might promulgate for judicial review of reparation decisions and enforcement of reparation awards.⁴²¹ Commodity pool operators and their associated persons, as registrants under the Act, are amenable to reparations.⁴²² Reparations may only adjudicate violations of the Act, any rule, any regulation, or an order promulgated thereunder, proximately causing damages. Section 14 has a two-year statute of limitations.⁴²³ An adverse decision in reparation is appealable in the circuit court of appeals where a reparation hearing was held or, if no hearing was held, the circuit where the appellee was located. An appeal is conditioned upon payment of a bond in double the amount of the reparation awarded against the appellant.⁴²⁴ A reparation award may be enforced in the United States district court for the district in which a non-paying respondent resides or has his principal place of business.⁴²⁵ A most devastating aspect of the reparations procedure is that unless a party against whom a reparation order has been issued shows just cause to the satisfaction of the Commission within fifteen days from the expiration of the period allowed for compliance of such order or, thirty days from the date of dismissal or adverse decision on appeal, the party will be prohibited automatically from trading on any contract market and any Commission registration will be suspended until the award and interest have been paid.⁴²⁶

(b) Arbitration

The Act recognizes arbitration as another means of resolving commodity-related disputes. Section 5a(10) of the Act⁴²⁷ requires all contract markets to provide a fair and equitable procedure of voluntary arbitration for a settlement of customers' claims and grievances against any

⁴²¹ See Markham, *The Seventh Amendment and CFTC Reparation Proceedings*, 68 IOWA L. REV. 87, 99-103, 109-22 (1982) (general information concerning reparation procedures and certain decided reparation decisions of note); Graham, *Special Reparations Actions*, 35 BUS. LAW. 773 (1980); Rosen, *Reparation Proceedings Under the Commodity Exchange Act*, 27 EMORY L.J. 1005 (1978). Section 231 of the 1982 Act, 97 Pub. L. No. 97-444, 96 Stat. 2294, 2319-20 (1982) has substantially amended § 14 of the Act to allow the CFTC fuller latitude in simplifying and restructuring its reparation program. Compare § 14(b) of the Act (codified as originally enacted at 7 U.S.C. § 18(b) (1976)), with 1982 Act, Pub. L. No. 97-444, § 231(2), 96 Stat. 2294, 2319 (current version at 7 U.S.C. § 18(b) (1982)). As of this date, the CFTC has published a notice of proposed rulemaking to obtain comments on the new course of reparations procedures. 48 Fed. Reg. 6720 (1983).

⁴²² Section 14(a) of the Act, 7 U.S.C. § 18(a) (1982). See *supra* notes 287, 409-11 (citations of representative reparations decisions involving commodity pool operators).

⁴²³ 7 U.S.C. § 18(a) (1982).

⁴²⁴ Section 14(e) of the Act, 7 U.S.C. § 18(e) (1982).

⁴²⁵ Section 14(d) of the Act, 7 U.S.C. § 18(d) (1982).

⁴²⁶ Section 14(f) of the Act, 7 U.S.C. § 18(f) (Supp. 1983).

⁴²⁷ 7 U.S.C. § 7(a)(1) (1982).

member or employee.⁴²⁸ Section 17a(10) of the Act⁴²⁹ imposes an identical requirement upon registered futures associations.⁴³⁰ The 1982 Act has recognized the contract market and registered futures association arbitrations along with reparations and the new private right of action.⁴³¹ Section 17a(10) further states nothing in the subsection "shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims upon this section, including arbitration."⁴³² The express recognition of the role of arbitration under the Act clarifies that the *Wilko v. Swan*⁴³³ doctrine will not be applied to the Act. The *Wilko v. Swan* doctrine states that an agreement to arbitrate disputes under the Securities Act of 1933⁴³⁴ is unenforceable.⁴³⁵ A commodity pool participant, therefore, may arbitrate alleged violations of the provisions of the Act, and the commodity pool operator regulations, with the commodity pool operator.⁴³⁶

(c) Court Actions

In the midst of Congress' consideration of the 1982 Act, the Supreme Court issued a 5 to 4 decision in *Merill Lynch, Pierce, Fenner & Smith v. Curran*,⁴³⁷ holding that a private right of action may be implied under

⁴²⁸ *Id.*

⁴²⁹ 7 U.S.C. § 21(b)(10) (1982). Section 217 of the 1982 Act, Pub. L. No. 97-444, 96 Stat. 2294, 2307, has amended both the contract market and registered futures association arbitration requirements to remove the prior \$15,000 ceiling on arbitrable claims.

⁴³⁰ As the only registered futures association now licensed, the NFA has adopted a Code of Arbitration and expects to have an active arbitration program. See Stassen & White, *National Futures Association: An Introduction*, (Special Report) COMM. LAW LETTER (January 1982).

⁴³¹ 1982 Act, Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322-23 (1982), § 22(a)(2) of the Act, (codified at 7 U.S.C. § 26(a)(2) (1982)).

⁴³² *Id.*

⁴³³ 346 U.S. 427 (1953).

⁴³⁴ 15 U.S.C. §§ 77a-77bb (1981).

⁴³⁵ In *Milani v. ContiCommodity Services, Inc.*, 1975-77 COMM. FUT. L. REP. (CCH) ¶ 20,227 (1976) (Memorandum and Order, N.D. Cal.), and *Basche Halsey Stuart, Inc. v. French*, 425 F. Supp. 1231, 1233 (D. D.C. 1977), the Courts applied *Wilko v. Swan*, 346 U.S. 427 (1953), to attempts to arbitrate alleged violations of the Act. But see *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1181 (2d Cir. 1977). Evidently, a pool participant may now be able to arbitrate his claims under the Act while simultaneously pursuing his securities causes of action in court.

⁴³⁶ See 17 C.F.R. §§ 180.1 *et seq.* (1982) (Commission's regulations governing arbitration). The CFTC has pending a Notice of Proposed Rulemaking to change these rules to reemphasize arbitration as opposed to reparations. 46 Fed. Reg. 60,834 (1981) (Proposed Reg. pertaining to reparation and arbitration).

⁴³⁷ 456 U.S. 353 (1982). In a recent post-*Curran* decision, *J.E. Hoelger Co. v. Ascencio*, [Current] COMM. FUT. L. REP. (CCH) ¶ 21,684 (1983) (E.D. Mich.), the court held that a customer could not recover for failure of a commodity salesman to register as an associated person of a futures commission merchant pursuant to § 4k(1) of the Act. The Supreme Court in *Curran* had predicated its decision on the fact that the sections of the Act construed in *Curran* predated the 1974 amendments and courts had previously found private rights

the Act in cases brought by a speculator against his futures commission merchant for anti-fraud violations and by speculators against a contract market, its officials, and other futures commission merchants for unlawful price manipulation that allegedly could have been prevented by the contract market's enforcement of its rules. On the heels of that decision, Congress enacted a provision explicitly authorizing private court actions and setting forth conditions under which actions are allowed and the damages recoverable.⁴³⁸ The new provision makes any violator of the Act, other than a contract market, clearing association, or registered futures association, liable for actual damages caused by the violation to any person who might have purchased, sold, or placed an order for the purchase or sale of an interest or participation in a commodity pool.⁴³⁹ The United States district courts have exclusive jurisdiction in actions brought pursuant to section 22. Section 22 contains a two-year statute of limitations, extensive with that for reparations.⁴⁴⁰ The provision is effective only with respect to causes of action accruing on or after January 11, 1983, the date of enactment of the 1982 Act. Section 22 does not affect any right of parties that may exist with respect to causes of action accruing prior to the January effectiveness date.⁴⁴¹ Therefore, an aggrieved party whose cause of action arose prior to January 11, 1983 may still maintain an action under the Act pursuant to *Curran*.⁴⁴²

2. CFTC Enforcement of the Act Against Pool Operators

Violations of the Act and the regulations not only subject pool operators and their associated persons to private claims for damages, but also subject them to possible adverse actions from the CFTC's Division of Enforcement.⁴⁴³ Enforcement actions take the form of civil injunctive proceedings in federal courts, or administrative proceedings before the CFTC's administrative law judges, with review by the Commission and the appropriate court of appeals.

of action under those sections. Congress was presumed thereby to have known of the legal context and not to have acted to extinguish the private right of action in 1974. However, § 4k(1) was added by the 1974 Act, and accordingly *Curran* was held to be inapposite. *J.E. Hoelger Co. v. Ascencio*, *supra* at 26,617-18.

⁴³⁸ 1982 Act, 97 Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322-23, (codified at § 22 of the Act, 7 U.S.C. § 26 (1982)).

⁴³⁹ Section 22(a)(1)(C)(iii) of the Act, 7 U.S.C. §§ 26(a)(1)(C)(iii) (1982).

⁴⁴⁰ Section 22(c) of the Act, 7 U.S.C. § 26(c) (1982).

⁴⁴¹ Section 22(d) of the Act, 7 U.S.C. § 26(d) (1982).

⁴⁴² No reason exists that suggests a pre-existing claim under the Act could not be prosecuted in state court as well as in federal court.

⁴⁴³ 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 (1978) (discussion of organization and work of CFTC Division of Enforcement). See also Markham, *Investigations Under the Commodity Exchange Act*, 39 AD. L. REV. 285 (1979).

(a) Civil Injunctive Actions.

Section 6c of the Act⁴⁴⁴ grants the Commission the authority to bring, and the United States district courts the jurisdiction to entertain actions to enjoin violations of the Act or to enforce compliance with it. The provision contemplates preliminary and permanent injunctions and temporary restraining orders, which may issue *ex parte* to preserve books and records or to prohibit transfers of assets.⁴⁴⁵ In cases involving commodity pool operators as well as other registrants, courts have construed this section broadly to authorize ancillary relief, including the appointment of receivers, asset freezes, and disgorgement orders, even on a temporary or preliminary basis.⁴⁴⁶

The CFTC brought a civil injunctive action against a commodity pool operator as its first and only joint enforcement action with the SEC.⁴⁴⁷ Additionally, the CFTC has maintained a number of enforcement actions in conjunction with state proceedings pursuant to section 6d of the Act,⁴⁴⁸ enabling states to seek injunctions and other relief for violations of the Act in the United States district courts⁴⁴⁹ against commodity pool operators.⁴⁵⁰

(b) Administrative Proceedings

The other weapon in the Division of Enforcement's armory is the administrative proceeding. Section 6b of the Act⁴⁵¹ permits the Commission to issue a complaint against any person who manipulates the market price

⁴⁴⁴ 7 U.S.C. § 13a-1 (1982).

⁴⁴⁵ *Id.*

⁴⁴⁶ See, e.g., CFTC v. Chilcott Portfolio Management, Inc., Civ. No. 81-999 (D. Colo. 1981) (temporary restraining order imposing asset freeze and appointing receiver); CFTC v. Northeast Investment Services, Inc., Civ. No. 82-305 (D. Mass. 1982) (temporary restraining order imposing asset freeze and appointing receiver); CFTC v. Buterin, 1980-82 COMM. FUT. L. REP. (CCH) ¶ 21,133 (D. Kan. 1980) (order granting preliminary injunction which continued limited asset freeze and prohibited destruction of books and records); CFTC v. Capital City Currencies Corp., 1978-80 COMM. FUT. L. REP. (CCH) ¶ 20,886 (D. D.C. 1979) (order granting preliminary injunction appointing receiver, directing accounting and giving receiver authority to apply for disgorgement order); CFTC v. Heritage Capital Advisory Services Ltd., [Current] COMM. FUT. L. REP. (CCH) ¶ 21,627 (N.D. Ill. 1982) (order granting preliminary injunction and freezing assets).

⁴⁴⁷ CFTC and SEC v. T & D Management Co., Civ. No. G81-0633 (D. Utah 1981) (summarized in 1981-82 FED. SEC. L. REP. (CCH) ¶ 93,266 (1981)).

⁴⁴⁸ 7 U.S.C. § 13a-2 (1982).

⁴⁴⁹ See Lower, *State Enforcement of the Commodity Exchange Act*, 27 EMORY L.J. 1057 (1978) (discussion of § 6d).

⁴⁵⁰ See, e.g., CFTC and State of Illinois v. Heritage Capital Advisory Services, Ltd., [Current] COMM. FUT. L. REP. (CCH) ¶ 21,627 (D. Kan. 1982); CFTC and State of New York v. Multi-National Holding Corp., Civ. No. 82-1931 (N.D. Ohio 1982); CFTC and Massachusetts v. Norwell Trade Winds, Ltd., Civ. No. 81-1749 (D. Mass. 1981).

⁴⁵¹ 7 U.S.C. § 9 (1982).

of any commodity, has willfully made a false or misleading statement or material omission in any registration application or report filed with the Commission, or has otherwise violated any of the provisions of the Act or the rules, regulations, or orders thereunder. A hearing is held upon the complaint before an administrative law judge, pursuant to the Commission's Rules of Practice.⁴⁵² The judge may impose sanctions including a market bar for any period, suspension of registration for a period of six months, revocation of registration, and a civil penalty not to exceed \$100,000 for each violation.⁴⁵³ The initial decision of the administrative law judge is reviewable by the Commission and by the court of appeals in the circuit in which the petitioner is doing business pursuant to the procedures set forth in section 6b.⁴⁵⁴ An administrative proceeding may also impose a cease and desist order. Any violation of the order is a misdemeanor. A cease and desist order relating to conversion or price manipulation, however, constitutes a felony.⁴⁵⁵ Additionally, the new section 8(a)(4) of the Act⁴⁵⁶ permits the Commission to suspend, revoke, or place restrictions upon the registration of any person pursuant to the administrative proceeding provisions of section 6b of the Act⁴⁵⁷ on the basis of the lesser disqualifications set forth at section 8a(3) of the Act.⁴⁵⁸ The civil injunctive and administrative proceedings are not mutually exclusive, and the Commission may maintain one or both of these proceedings in any order, even simultaneously.⁴⁵⁹

V. REGULATION BY THE NATIONAL FUTURES ASSOCIATION (NFA)

Thus far, this article has been concerned with the regulation of com-

⁴⁵² 17 C.F.R. §§ 10.1 *et seq.* (1983).

⁴⁵³ Section 6(b) of the Act, 7 U.S.C. § 4 (1982). *See generally*, Sackheim, *Administrative Enforcement of the Federal Commodities Laws by the Commodity Futures Trading Commission*, 12 SETON HALL L. REV. 445 (1982).

⁴⁵⁴ 7 U.S.C. § 4 (1982).

⁴⁵⁵ Section 6(c) of the Act, 7 U.S.C. § 13(b) (1982).

⁴⁵⁶ 7 U.S.C. § 12a(4) (1982).

⁴⁵⁷ 7 U.S.C. § 9 (1982).

⁴⁵⁸ 7 U.S.C. § 12a(3) (1982). *See supra* text accompanying notes 231-38 (discussion of disqualification categories).

⁴⁵⁹ In *Hunt v. CFTC*, 591 F.2d 1234 (7th Cir. 1979), the court affirmed the decision of the district court, refusing to enjoin an administrative proceeding filed after the CFTC had commenced a civil injunctive action predicated upon the identical underlying conduct. The *Hunt* court held that the proper remedy for review of the CFTC's motives or actions in bringing the latter proceeding would be the court of appeals' review of any adverse order in the administrative matter. *Id.* *See* In the Matter of James J. Sweeney, CFTC Dkt. No. 82-19 (1982); CFTC v. James J. Sweeney, Civ. No. 81-5651 (N.D. Ill. 1981) (recent matters where the Commission has filed both civil injunctive and administrative actions against commodity pool operators); In the Matter of R.B. Thompson Associates, Inc., CFTC Dkt. No. 82-25 (1982); CFTC v. R.B. Thompson Associates, Inc., Civ. No. 82-879 (D. Mass. 1982); In the Matter of Multi-State Advisory Corp., CFTC Dkt. No. 82-4 (1981); CFTC v. Multi-State Advisory Corp., Civ. No. 81-2953 (D. N.J. 1981).

modity pool operators by the CFTC pursuant to the machinery of the Act. However, it may well be that in the following years, the importance of the CFTC as the day-to-day regulator of the commodity pool operator will decline. The CFTC's place will be filled by the NFA, a recently-chartered registered futures association.

*A. Involvement of Commodity Pool Operators in the
NFA and the Requirement of Membership*

In 1974, Congress added a new section 17 to the Act, subsequently amended in several regards,⁴⁶⁰ creating an opportunity for the formation of one or more registered futures associations comparable in structure to the National Association of Securities Dealers.⁴⁶¹ On September 22, 1981, the Commission added a new tier to the regulatory structure by issuing an order approving the application for registration of the NFA as a futures association.⁴⁶² Membership in the NFA is mandatory for any pool operator who is involved in the active business of soliciting and operating commodity pools.⁴⁶³

The NFA is attempting to tighten the mandatory membership provision by presenting a petition for rulemaking to the Commission requesting the promulgation of a rule requiring all persons registered as futures commission merchants to be members of a registered futures association.⁴⁶⁴ In the petition, the NFA explained that although the rule is drafted only to apply to futures commission merchants rather than to all commodity professionals, the rule will have the same practical effect as requiring industry-wide membership. Futures commission merchants must execute all customer trades. If all futures commission merchants are members of the association, the NFA will be able to ensure that all pool operators are subject to its regulation through enforcement of by-law 1101.⁴⁶⁵ The 1978 Act specifically authorized the Commission to approve rules of futures

⁴⁶⁰ 7 U.S.C. § 21 (1982). Regulations expanding and implementing § 2 were promulgated in 1979. 44 Fed. Reg. 20,649 (1979). See 17 C.F.R. §§ 170.1 *et seq.* (1982).

⁴⁶¹ Johnson, 1 COMM. REG., ¶ 1.89, 199 (1982); H.R. REP. NO. 1181, 95th Cong., 2d Sess. 19 (1978).

⁴⁶² SEC. REG. & L. REP. (BNA) No. 621, at E-1 (Sept. 23, 1981) (Order of September 22, 1981).

⁴⁶³ NFA By-law 1101. The membership requirement is memorialized in NFA By-law 1101 which provides:

No Member may carry an account, accept an order, or handle a transaction, in commodity futures contracts, for or on behalf of any non-Member of NFA, or suspended member, that is required to be registered with the Commission as an FCM, Commodity Pool Operator, or Commodity Trading Advisor, or that is an Agent, and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or other person unless (a) [the non-member is a member of another futures association registered with the Commission is exempt for other stated reasons].

NFA By-law 1101.

⁴⁶⁴ 47 Fed. Reg. 53,031 (1982).

⁴⁶⁵ *Id.* at 53,031 n.3.

associations that directly or indirectly require persons eligible for membership in such associations to become members of at least one association.⁴⁶⁶ The proviso was adopted in response to the Commission's receipt of a comment letter upon the NFA's pending application for registration from the Department of Justice.⁴⁶⁷ The letter took issue with the mandatory membership requirement,⁴⁶⁸ and described it as anti-competitive.

The NFA by-laws do not discuss or make special provisions for commodity pool operators, as opposed to any other kind of member, except in two regards. Commodity pool operator members of the NFA may nominate and elect two directors⁴⁶⁹ to serve on the organization's board, which has a minimum of thirty-eight directors.⁴⁷⁰ The allocation of directors to commodity pool operators is a manifestation of the requirement of section 17b(5) of the Act⁴⁷¹ and Commission Regulation 170.3.⁴⁷² Both require a futures association to assure fair and equitable representation of the views and interests of all association members in all phases of its affairs and activities.

Additionally, it is possible, although not required, that one of the commodity pool operator directors may serve on the NFA's fifteen person executive committee. The commodity pool operator directors, along with directors representing commodity trading advisors, users of commodities, and commercial banking institutions, are classified as Industry Participant Representatives.⁴⁷³ Two Industry Participant Representative directors may serve on the Executive Committee, but they must not be from the same subcategory.⁴⁷⁴ Accordingly, it is possible, although not required, that one member of the Executive Committee be a commodity pool operator, but the Executive Committee cannot have two pool operator directors serving at the same time. Commodity pool operator members are required to pay annual dues of \$1,000, except in their first year of membership, when the dues are \$500.⁴⁷⁵

B. *Assumption of Regulatory Functions by the NFA*

1. *Delegation of Registration Process to NFA*

In enacting the 1982 Act, Congress unequivocally has expressed its

⁴⁶⁶ Section 17(m) of the Act, 7 U.S.C. § 21m (1982).

⁴⁶⁷ Comments of the United States Department of Justice, In the Matter of the National Futures Association (October 7, 1977).

⁴⁶⁸ *Id.*; see S. REP. NO. 850, 95th Cong., 2d Sess. 31 (1978) (discussion of comment letter).

⁴⁶⁹ NFA Articles of Incorporation, art. VII, § 2(c)(i)(B).

⁴⁷⁰ *Id.* § 2. The number of directors may exceed the minimum 38 directors since any contract market member that had transaction volume of more than 20% of aggregate contract market transactions during the preceding year is entitled to two directors. *Id.*

⁴⁷¹ 7 U.S.C. § 21(b)(5) (1982).

⁴⁷² 17 C.F.R. § 170.3 (1983).

⁴⁷³ NFA Articles of Incorporation, art. VII, § 2(c).

⁴⁷⁴ NFA Articles of Incorporation, art. VIII, § 3(iii).

⁴⁷⁵ NFA By-law 1301(c).

intention that the NFA play an active role in the day-to-day regulation of the commodity industry, including commodity pool operators and their associated persons. The Commission sought legislation to enable it to delegate its registration functions, with appropriate oversight, to a registered futures association.⁴⁷⁶ Congress responded by enacting a new section 8a(10) of the Act,⁴⁷⁷ authorizing the Commission to delegate any portion of the registration functions under the Act to a registered futures association in accordance with such rules as the association might present to the Commission for review pursuant to the applicable statutory procedures. A new section 17o⁴⁷⁸ states more particular standards and procedures for delegation and review of the registration functions. Pursuant to section 17o, a person aggrieved by an adverse registration order may petition the Commission to review the decision. The Commission may, under its own initiative or on petition, decline or grant review and affirm, set aside, or modify a registration order. NFA findings as to the fact, however, will be conclusive if supported by the weight of the evidence. Additionally, the Commission may review the grant of the registration application by an association. A Commission determination with respect to a registration order, or an order in which the Commission has declined review, is appealable in accordance with the provisions of section 6b of the Act.⁴⁷⁹

The NFA is further aided in its performance of the registration function by new legislation authorizing the NFA or any registered futures association to collect fingerprints from applicants and submit them to the Department of Justice for identification and screening.⁴⁸⁰ The fingerprint authority is not limited specifically to delegated Commission registration, and the NFA may adopt rules implementing the fingerprinting requirement with respect to its own membership applications. In considering the registration delegation provisions, the House Committee on Agriculture noted that the concurrent adoption of clear disqualification guidelines makes a delegation more feasible, but the discharge of the registration function by a registered futures association would not alter the fact that registrants are deemed to be registered with the Commission.⁴⁸¹ In considering the final legislation, the conference committee stated that it contemplated "that in the near future the Commission and the National Futures Association will be discussing the assumption by NFA of a portion, if not all, of the Commission's registration functions."⁴⁸² As of this date, the necessary Commission and NFA rules to implement the transfer of

⁴⁷⁶ Legislative Proposals, §§ 8a(10), 17(o), *reprinted at* 14 SEC. REG. & L. REP. (BNA) No. 6, at 270, 289, 292 (Feb. 10, 1982).

⁴⁷⁷ 7 U.S.C. § 12a(10) (1982).

⁴⁷⁸ *Id.*; 7 U.S.C. § 21(o) (1982).

⁴⁷⁹ Section 17o(2) of the Act, 7 U.S.C. § 21o(2) (1982).

⁴⁸⁰ Pub. L. No. 97-444, § 233(1), 96 Stat. 2294, 2320 (amending § 17(b)(4)(E) of the Act, 7 U.S.C. § 17(b)(4)(E)).

⁴⁸¹ H.R. REP. No. 565, Part I, 97th Cong., 2d Sess. 521 (1982).

⁴⁸² H.R. REP. No. 964, 97th Cong., 2d Sess. 49 (1982).

the registration function have not been proposed or promulgated in final form. However, in view of the Commission's own express desire to delegate, as well as the express Congressional expectation, it is logical to assume that at some point the delegation will occur.

2. Assumption of Other Regulatory Functions by NFA

In considering legislation concerning the NFA, the House Committee on Agriculture expressed the hope that a successful and competent NFA could assume some Commission duties, subject to CFTC scrutiny, specifically including oversight of pool operators.⁴⁸³ Although Congress has not set forth any time period for assumption by the NFA of responsibility for the registration function or even explicitly mandated that such a delegation be made, Congress has established an agenda for the new organization that, when fully implemented, will bear directly upon the operation of commodity pool operators and their associated persons. Congress directed the NFA to adopt rules requiring the association to establish training standards and proficiency testing for persons involved in the solicitation of commodity transactions. The NFA must adopt the rules no later than ninety days after January 11, 1982. The rules would cover pool participation units, their supervisors, and all persons for which the association has registration responsibilities. The NFA must establish a program to audit and enforce compliance with NFA standards.⁴⁸⁴ It is evident the NFA proficiency examinations will be required, at least for associated persons of commodity pool operators.

A second part of the Congressional mandate imposed the same time requirements for the establishment of minimum sales practice standards.⁴⁸⁵ The NFA rules enacted prior to the legislation presently contain minimum sales standards for commodity pool operators and other members.⁴⁸⁶ Rules of special interest to commodity pool operators include a detailed anti-fraud requirement that prohibits the conversion of any assets received from a pool participant.⁴⁸⁷

Another NFA rule prohibits any member from sharing directly or indirectly in the profits or losses accruing from commodity futures trading without the written authorization of a customer.⁴⁸⁸ Accordingly, commodity pool operators compensated in whole or in part by an incentive fee should include specific authorization in their customer account forms. The NFA

⁴⁸³ H.R. REP. NO. 565, Part I, 97th Cong., 2d Sess. 41 (1982).

⁴⁸⁴ Section 17(p)(1) of the Act, 7 U.S.C. § 21(p)(1) (1982). Section 4p of the Act permits the Commission to prescribe that, in lieu of proficiency examinations administered by it, futures associations or contract markets may assume such functions. 7 U.S.C. § 6p (1982).

⁴⁸⁵ Section 17(p)(3) of the Act, 7 U.S.C. § 21(p)(3) (1982).

⁴⁸⁶ NFA Rules, *Rules Governing the Business Conduct of Members Registered With the Commission*, rules 2-1 to 2-11.

⁴⁸⁷ *Id.* at NFA rule 2-2.

⁴⁸⁸ *Id.* at NFA rule 2-3.

has adopted compliance procedures to enforce its rules⁴⁸⁹ and may impose sanctions including expulsion or suspension of membership, bar or suspension for a specified period from association with an NFA member, censure or reprimand, a monetary fine not to exceed \$100,000 for all violations found, a cease and desist order, or any order "fitting penalty or remedial action not inconsistent with this rule."⁴⁹⁰

Congress has given the NFA until September 30, 1985 to develop a comprehensive program that fully implements NFA rules. Any futures association has two and one half years after the date of registration to comply with NFA rules.⁴⁹¹ Congress has required the CFTC to prepare a report to be submitted no later than January 1, 1986 concerning the regulatory experience of the NFA for the period beginning January 1, 1983 and ending September 30, 1985.⁴⁹² The report must discuss, among other matters, the extent to which the NFA has successfully fulfilled its statutory mandate, the working relationship between the NFA and the Commission, the extent to which problems have been encountered by the NFA, and whether and to what extent cost savings and related deficiencies have resulted from the NFA's assumption of part of the regulatory burden.⁴⁹³ Subjected to Congressional and CFTC scrutiny, the NFA should act expeditiously with the cooperation of the CFTC to assume a large share of the regular daily regulatory responsibilities for commodity pool operators and their associated persons.

VI. SUMMARY AND CONCLUSION

Commodity pools have shown themselves to be popular vehicles. For as little as \$4,000 or \$5,000, little more than the margin on one futures contract, a member of the public can have the advantage of diversifying his risks among numerous contracts and various commodities, and the advantage of professional trading advice. Moreover, in the overwhelming number of cases, the participant is free from any requirements for additional margin. Pools, therefore, provide an attractive vehicle for individuals who otherwise would never have any involvement with the futures markets. Moreover, the influx of pool money adds liquidity to the nation's commodities markets.

The CFTC has in place a mature, complex interrelated matrix of regulations for commodity pool operators and the pools they offer to the public. The CFTC may enforce its regulations through far-reaching civil, injunctive and administrative powers. Violations of major provisions carry criminal penalties. Pool participants have the advantage of arbitration,

⁴⁸⁹ NFA Rules, *Compliance Procedures*, rules 3-1 to 3-13.

⁴⁹⁰ *Id.* at NFA rule 3-11.

⁴⁹¹ Section 17(q) of the Act, 7 U.S.C. § 21(q) (1982).

⁴⁹² Pub. L. No. 97-444, § 237(2), 96 Stat. 2294, 2325 (1982).

⁴⁹³ *Id.*

express private right of action, and reparations to resolve any disputes with the commodity pool operators or their associated persons. Finally, a shift of the daily regulatory burden to the NFA is in a nascent state. Under Commission oversight, however, the NFA should provide an additional layer of public protection.

The CFTC's commodity pool regulatory structure is responsible, and is being refined further in cooperation with the NFA. It would be unfortunate if such a useful and popular vehicle as the commodity pool were to be stifled by further onerous layers of regulation under state or federal securities laws, or indeed, if the CFTC were to further tighten an already complete structure by making its regulations more stringent.