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## THE ELEMENT OF SCIENTER IN ANTIFRAUD PROVISIONS OF THE COMMODITY EXCHANGE ACT

The commodities market is a rapidly growing investment forum for the purchase or sale of contracts for specified amounts of a variety of goods and services.<sup>1</sup> Congress enacted the Commodity Exchange Act of

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<sup>1</sup> CFTC v. Sterling Capital Co., 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,777 (N.D. Ga. 1981). Commodities trading and regulation essentially is a marketplace of speculation in which investors seek to forecast the future and make profitable agreements based on their prophecy. See Board of Trade v. Christie Grain & Stock Co., 198 U.S. 236, 247-48 (1905) (citing Holmes, J.), quoted in S. REP. NO. 1131, 93RD CONG. 2D SESS. 24, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5843 [hereinafter cited as 1974 SENATE REPORT].

Commodity trading encompasses two basic transactions. H.R. REP. NO. 975, 93D CONG., 2D SESS. 41 (1974), reprinted in [1974] U.S. CODE CONG. & AD. NEWS 5787-5802 [hereinafter cited as HOUSE REPORT]. The first category includes the current or spot market in which private investors buy and sell virtually any commodity item, see note 2 *infra*, for which interest and trading volume exists. HOUSE REPORT, *supra*, at 10, [1974] U.S. CODE CONG. & AD. NEWS at 5787. The second category includes the futures market in which investors trade contracts for commodities which are grown, produced, or otherwise made available at a later time. *Id.* The futures market makes commodity trading unique and appealing to investor-speculators, since the time element combined with frequent and unexpected changes in supply and demand forces due to natural factors can produce substantial price fluctuations. See Bianco, *The Mechanics of Futures Trading: Speculation and Manipulation*, 6 HOFSTRA L. REV. 27, 29-30 (1977). Futures contracts are adhesion contracts in which a clearinghouse, as buyer or seller, is a party to the contract. Guttman, *The Futures Trading Act of 1978: The Reaffirmation of CFTC-SEC Coordinated Jurisdiction Over Security/Commodities*, 28 AM. U. L. REV. 1, 16 (1978) [hereinafter cited as Guttman]. Futures contracts are devices primarily for speculation, however, and actual delivery of the commodity involved rarely occurs. *Id.* at 17.

Futures contracts are not technically sold or traded, but rather, investors form and discharge the contracts on designated contract markets. See Clark, *Genealogy and Genetics of "Contract of Sale of a Commodity for Future Delivery" in the Commodity Exchange Act*, 27 EMORY L.J. 1175, 1175-77 (1978) [hereinafter cited as Clark]. Contract markets are boards of trade that the Commodity Future Trading Commission (CFTC), see note 6 *infra*, designates to trade futures. See Guttman, *supra*, at 18. A board of trade includes any exchange or association of persons engaged in the business of buying or selling any commodity or receiving any commodity for sale on consignment. 7 U.S.C. § 2 (1976 & Supp. III 1979). The Commodity Exchange Act, see note 2 *infra*, requires registration of all commodity trading advisors, contract markets, and companies and individuals which handle commodity investments or give trading advice. See *id.* § 6(f), (k), (n); note 10 *supra* (registration procedures).

Futures trading and volume increased from approximately 27.7 million contracts and \$571.6 billion in 1974 to approximately 41.5 million contracts and \$1.1 trillion from July 1, 1976 to June 30, 1977. S. REP. NO. 850, 95TH CONG., 2D SESS. 13, reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2101; see Russo & Lyon, *The Exclusive Jurisdiction of the Commodity Futures Trading Commission*, 6 HOFSTRA L. REV. 57, 60 (1977) (recognizing substantial increase in commodity futures trading in 1960's and early 1970's). The increased appeal of futures trading is that significant profit and loss situations result on modest capital investments. See Dept. of Treasury and Federal Reserve Bd. Study of Treasury Futures Markets, reprinted in [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,823 (May

1936<sup>2</sup> (CEA) to regulate commodities trading.<sup>3</sup> In an attempt to broaden the scope of commodities regulation,<sup>4</sup> Congress amended the CEA by the

14, 1979). Margin trading is the practice of paying only a fraction of the purchase price on a futures contract. *Id.* Leverage occurs when an investor engages in margin trading on a futures contract in the belief that a large profit will result. *Id.* "Hedging" occurs when a businessman counterbalances a position in the current or spot market with a purchase in the futures market in order to avoid the risk inherent in the spot market. *Id.* at 5799.

Options contracts are another form of commodity contract. *See* 7 U.S.C. § 2 (1976 & Supp. III 1979). Commodity options give the holder the right but not the obligation to purchase a specified amount of a commodity or a futures contract within a certain period of time at a given price. *CFTC v. United States Metals Depository Co.*, 468 F. Supp. 1149, 1155 (S.D.N.Y. 1979). *See CFTC v. Goldex Int'l Ltd.* [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,839 at 23,439 (N.D. Ill. May 17, 1979) (detailed discussion of options trading).

Originally, all commodity contracts dealt with agricultural products. *See Clark, supra*, at 1176 (discussion of evolution of changes in commodities contracts). Prior to the enactment of the Commodity Futures Trading Act of 1974 (1974 Act), Pub. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. §§ 1-22 (1976)), commodities regulated by the Department of Agriculture, *see note 3 infra*, primarily were agricultural products. *See H.R. REP. NO. 975*, 93d Cong., Sess. 41, 110 CONG. REC. 11420 (1974) (list of regulated commodities prior to 1974). Since 1974, the CFTC has been responsible for regulation of commodities. *See* 7 U.S.C. §§ 2, 4a (1976 & Supp. III 1979); *note 6 infra*. Regulated commodities now include commonly traded agricultural products and all goods and services provided for on the future contract market. 7 U.S.C. § 2 (1976 & Supp. III 1979); *see* 1974 SENATE REPORT, *supra*, at 8, [1974] U.S. CODE CONG. & AD. NEWS 5843, 5890 (list of regulated commodities since 1974).

<sup>2</sup> 7 U.S.C. §§ 1-24 (1976 & Supp. III 1979).

<sup>3</sup> *Id.*; *see Rainbolt, Regulating the Grain Gambler and His Successors*, 6 HOFSTRA L. REV. 1, 7-8 (1977) (tracing history of organized commodity regulation in United States) [hereinafter cited as Rainbolt]. The Grain Futures Act of 1922 (1922 Act), Pub. L. No. 331, 42 Stat. 988 (current version at 7 U.S.C. §§ 1-22 (1976)), was the first federal legislation to regulate commodity trading. 7 U.S.C. §§ 1-22 (1976); *see Rainbolt, supra*, at 7-8. The 1922 Act contained only sparse regulatory provisions. Rainbolt, *supra*, at 8. Although the 1922 Act empowered the Department of Agriculture to regulate commodities, the Act did not control unnecessary, fraudulent, or destructive speculation. *Id.*; *see* 7 U.S.C. § 1a (1976). Recognizing that the 1922 Act left trading abuses uncontrolled, President Roosevelt called for the enactment of legislation providing for federal regulation of exchange operations for the protection of investors, the safeguarding of values, and elimination of detrimental practices. Rainbolt, *supra*, at 8-9 n.38; *see H.R. REP. NO. 241*, 74th Cong., 1st Sess. 2, 78 CONG. REC. 2264 (1934) (President Roosevelt's call for better regulation of commodities market). Roosevelt's efforts resulted in passage of the Commodity Exchange Act of 1936 (1936 Act), Ch. 545, 49 Stat. 1491 (1936) (codified at 7 U.S.C. §§ 1-22 (1976)). *See Rainbolt, supra*, at 9.

The 1936 Act altered the structure of the 1922 Act. *Id.* The 1936 Act transferred the power to regulate commodities trade from the Department of Agriculture specifically to the Secretary of Agriculture. *See* 7 U.S.C. §§ 7a, 7b, 9 (1976). The Secretary of Agriculture administered provisions of the 1936 Act by requiring exchanges and brokerage houses dealing with commodities to register with his office. *Id.* §§ 6d, 6f-6g, 7a, 7a(1)-(7). Most importantly in the 1936 Act, Congress inserted section 4b, an antifraud provision designed to protect the fiduciary relationship between brokers and customers arising in commodities transactions. *Id.* § 6b; *see note 20 infra* (text of section 4b). Since 1936, Congress twice has amended the Commodity Exchange Act (CEA). *See note 6 infra*.

<sup>4</sup> *See* 1974 SENATE REPORT, *supra* note 1, at 11-15, [1974] U.S. CODE CONG. & AD. NEWS 5843, 5852-56 (tracing history of federal regulation of commodity futures trading); Guttman, *supra* note 1, at 9-11 (discussing delayed federal response to regulating growing commodity market).

Commodity Futures Trading Act of 1974 (1974 Act).<sup>5</sup> In the 1974 Act, Congress created the Commodity Futures Trading Commission (CFTC).<sup>6</sup>

<sup>5</sup> PUB. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. §§ 1-22 (1976 & Supp. III 1979)). See Purcell & Valdez, *The Commodity Futures Trading Act of 1974: Regulating Legislation for Commodity Futures Trading in a Market-Oriented Economy*, 21 S.D. L. REV. 555, 559-65 (1976). Congress enacted the 1974 Act to insure fair practice and honest dealing on commodity exchanges and to control speculation in order to prevent injury to producers, consumers, and market professionals. 1974 SENATE REPORT, *supra* note 1, at 18, [1974] U.S. CODE CONG. & AD. NEWS at 5856. Prior to enacting the 1974 Act, Congress found that commodity trading was taking place in large volume by the general public as well as by those engaged in buying and selling commodities in interstate commerce. *Id.*, [1974] U.S. CODE CONG. & AD. NEWS at 5856. See generally Hudson, *Customer Protection in the Commodity Futures Market*, 58 B.U. L. REV. 1 (1978). Congress found that under the 1936 Act, see note 3 *supra*, transactions and prices in commodities trade were susceptible to manipulation, control, speculation and unreasonable price fluctuations. 1974 SENATE REPORT, *supra* note 1, at 18, [1974] U.S. CODE CONG. & AD. NEWS at 5856. See generally McDermott, *Defining Manipulation in Commodity Futures Trading: The Futures "Squeeze"*, 74 NW. U. L. REV. 202 (1979).

Congress further amended the Commodity Exchange Act of 1936 by the Futures Trading Act of 1978 (1978 Act). Pub. L. No. 95-405, 92 Stat. 865 (codified at 7 U.S.C. §§ 6c & 6d (Supp. III 1979)); see note 25 *infra*.

The 1978 Act expands the protections available to commodity traders and investors. See 7 U.S.C. § 21 (Supp. III 1979). The 1978 Act provides that persons trading in commodities may establish voluntary associations to regulate the trading practices of association members. *Id.* Under the 1978 Act, Congress also created a cause of action in favor of the states. *Id.* § 13a(2). States now may seek injunctive relief for violations of the Commodity Exchange Act on behalf of state residents. *Id.* If a person dealing in commodities appears to have violated the interest of a state resident under the Act, a state may bring an action in federal district court on behalf of the state resident to enjoin the violation, enforce compliance with the Act, and recover money damages. *Id.* See generally Schneider & Santo, *Commodity Futures Trading Commission: A Review of the 1978 Legislation*, 34 BUS. LAW. 1755 (1979). Congress has not yet created a private cause of action for investors in federal courts to redress violations of the Act. See *Recent Developments in Commodities Law—Implied Private Rights of Action Under the Commodities Acts*, 37 WASH. & LEE L. REV. 986, 997 (1980) (no implied private right of action under §§ 4c(B) and 4c(D) of CEA) [hereinafter cited as *Recent Developments*].

<sup>6</sup> See 7 U.S.C. § 4a (1976 & Supp. III 1979). The 1974 Act established the CFTC and granted the agency exclusive jurisdiction over futures trading and regulation of all commodities. See *id.* §§ 2, 4a. The CFTC contains five members appointed by the President with the advice and consent of the Senate. *Id.* Commissioners of the CFTC serve staggered five year terms. *Id.* See generally Greenstone, *The CFTC and Government Reorganization: Preserving Regulatory Independence*, 33 BUS. LAW. 164, 185-201 (1977) (legislative history of CFTC formation) [hereinafter cited as Greenstone]; Note, *The Role of the Commodity Futures Trading Commission Under the Commodity Futures Trading Commission Act of 1974*, 73 MICH. L. REV. 710, 711 (1975) (same) [hereinafter cited as *Role of Commodity Commission*].

The Securities and Exchange Commission (SEC) asserted jurisdiction over unregulated aspects of the commodities industry prior to 1974. Guttman, *supra* note 1, at 11-13. Congress enacted the 1974 Act to clarify the status of jurisdiction over commodities trading. *Id.* The 1974 Act preempted the SEC from regulating commodities under securities law. *Id.* The "exclusive" jurisdiction over commodities that Congress granted to the CFTC supercedes that of the SEC, the states, and other federal agencies. 1974 SENATE REPORT, *supra* note 2, 14, [1974] U.S. CODE CONG. & AD. NEWS at 5858; cf. Note, *Discretionary Commodity Accounts: Are They Securities and Does it Really Matter?*, 38 WASH. & LEE L. REV. 843, 844-46 (1981) (discussion of whether CFTC's jurisdiction preempts that of SEC over discretionary commodity accounts) [hereinafter cited as *Commodity Accounts*].

The CFTC, an independent federal regulatory agency,<sup>7</sup> is responsible for interpreting the CEA and promulgating rules governing commodities trade.<sup>8</sup>

Regulation of fraud in commodities transactions has proven to be a particularly difficult task for the CFTC.<sup>9</sup> The difficulty stems from the fact that regulation of commodity fraud tracks regulation of fraud in the

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<sup>7</sup> See Rainbolt, *supra* note 3, at 21. The scope of the 1974 Act indicates that Congress recognized a centralized and strong role for the CFTC as an independent, self-regulatory agency. *Id.* The CFTC is "self-regulatory" insofar as it may review the competence of commodity exchanges, withdraw or suspend an exchange's designation, deny potential investors access to the market, seek injunctions and levy penalties to enforce its provisions, and refer violations of the Commodity Exchange Act to the Department of Justice. See 7 U.S.C. §§ 12c, 13a (review competence); 7b, 8a (withdraw designation); 19, 12c (deny access); 13a(1) (enforcement provisions); 13a (refer violations) (1976 & Supp. III 1979). The duty of self-regulation additionally extends to each individual commodity exchange. *Id.* §§ 7a, 7b. For a discussion of the CFTC's and the individual commodity exchanges' duty to conduct comprehensive and effective self-regulation, see HOUSE COMM. ON AGRICULTURE, REPORT ON H.R. 13113, H.R. REP. NO. 975, 93d Cong., 2d Sess. 44-48 (1974). See also *Case & Co. v. Board of Trade*, 523 F.2d 355, 362 (7th Cir. 1975); Johnson, *Self-Regulation: A Primer on the Perils*, 27 ADEL. L. REV. 387 (1975).

The CFTC is an "independent" federal agency insofar as it operates without oversight from the Department of Agriculture or any other federal agency with the exception of Congress. 7 U.S.C. § 4a (1976 & Supp. III 1979). The CFTC has broad independent regulatory authority. Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L. REV. 1, 35-36 (1976) [hereinafter cited as *Preemption*]. Congress has provided only general standards for the CFTC to follow in the administration of commodities trade policy, encouraging agency independence. *Id.*; see text accompanying notes 140-42, 154-55 *infra*. (discussion of CFTC's need to establish approach to commodities regulation distinct from securities regulation). See generally Greenstone, *supra* note 6, at 165-68 (discussing regulatory independence of CFTC).

<sup>8</sup> See, e.g., 7 U.S.C. §§ 7b, 9, 13a, 13a(1) (1976 & Supp. III 1979). The CFTC may suspend or revoke a commodity exchange's right to operate if the exchange fails or refuses to comply with the Commodity Exchange Act or the rules, regulations, and orders that the CFTC has promulgated thereunder. *Id.* § 7b. The CFTC may bring administrative proceedings against any contract market, see note 1 *supra*, that fails to enforce CFTC rules or regulations. *Id.* § 13a. If the CFTC has reason to believe that any person has manipulated the market price of a commodity or commodity futures contract, and has made a material misrepresentation in filings with the CFTC or in prospective customer literature, or has otherwise violated the Act, the CFTC may enjoin future violations, suspend or revoke that person's right to trade, and assess a penalty of not more than \$100,000 for each violation. *Id.* § 9. The CFTC or the Attorney General may bring an action in federal district court to enjoin violations of the Act or to enforce compliance with the Act's provisions. *Id.* § 13a-1; see *CFTC v. Premex, Inc.*, 655 F.2d 779, 781 (7th Cir. 1981) (CFTC brings civil contempt action to enforce rule 30.03 of Act); text accompanying notes 172-248 *infra* (discussion of *CFTC v. Premex, Inc.*); notes 5-8 *supra* (inception and role of CFTC).

<sup>9</sup> See Nathan & Spindel, "I'm Guilty of What?"—*Emerging Concepts of Commodities Fraud*, 35 BUS. LAW. 811, 812 (1980) (survey of CFTC enforcement methods for fraud violations). For a critical discussion of the problems of commodity fraud regulation and the CFTC's performance, see Knight, *CFTC Head Outlines Plans To Prevent Commodity Fraud*, Wash. Post, Feb. 24, 1982, at D1, col. 1 (Senate hearings concerning CFTC effectiveness); Knight, *Commodity Unit Found Failing to Detect Fraud*, Wash. Post, Feb. 23, 1982, at A1, col. 1 (criticism of CFTC's ineffectiveness); Bosley, *The Assault on the Futures Industry*, COMMODITIES, Nov. 1977, at 42 (criticism of CFTC's performance). But see Sullivan, *The Future of Futures Regulation*, Wash. Post, Oct. 28, 1977, at B6, col. 5; *id.*, Oct.

securities market.<sup>10</sup> The antifraud provisions contained in the CEA and the Securities Exchange Act of 1934<sup>11</sup> (1934 Act) are similar both in language and in statutory construction.<sup>12</sup> Whether scienter<sup>13</sup> is an ele-

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27, 1977, at D10, col. 1; *id.*, Oct. 26, 1977, at E1, col. 5; *id.*, Oct. 25, 1977, at D7, col. 5 (positive assessment of CFTC's performance and problems associated therewith).

<sup>10</sup> See Wolff, *Comparative Federal Regulation of the Commodities Exchanges and the National Securities Exchanges*, 38 GEO. WASH. L. REV. 223, 224 (1969) (comparison and overview of regulation of domestic commodities and securities markets); note 9 *supra* (SEC jurisdiction over commodities prior to 1974). Historically, federal regulation linked the commodities industry and the securities industry due to jurisdictional overlaps. Bromberg, *Commodities Law and Securities Law—Overlaps and Preemptions*, 1 J. CORP. L. 217, 218-24 (1976) [hereinafter cited as Bromberg]. The congressional grant of exclusive jurisdiction to the CFTC over commodity futures in the 1974 Act preempted SEC regulation and established an independent basis for commodities regulation apart from securities regulation. See *Preemption*, *supra* note 7, at 35-37. The fraud provisions of securities law differ from the provisions of commodities law. See Bromberg, *supra*, at 287-95. Securities law provides for private rights of action for defrauded investors and contains strict registration requirements for all security traders. Hewitt, *The Line Between Commodities and Securities—Part 1*, 1 AGRIC. L.J. 291, 320 (1979) [hereinafter cited as Hewitt]; see *Mullis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 492 F. Supp. 1345, 1350-51 (D. Nev. 1980) (private action under securities law); *Westlake v. Abrams*, 504 F. Supp. 337, 345 (N.D. Ga. 1980) (same); *Commodity Accounts*, *supra* note 6, at 849. *But cf. Preemption*, *supra* note 7, at 36 (no private action available under securities law). Sections 5 and 6 of the 1933 Act proscribe the sale of unregistered securities and describe methods of proper registration with the SEC. 15 U.S.C. §§ 77e, 77f (1976).

Whether implied private rights of action exist under commodities law is still the subject of much debate among courts. See *Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, \_\_\_\_\_ U.S. \_\_\_\_\_, 101 S. Ct. 1971 (1981); *Leist v. Simplot*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,051 at 24,189 (2d Cir. 1980) (implied private right of action under CEA). *But see Stone v. Saxon & Windsor Group, Ltd.*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,000 at 23,885 (N.D. Ill. 1980) (no implied private right of action under CEA). The Commodity Exchange Act also does not make registration of commodity accounts with the CFTC mandatory. See *Preemption*, *supra* note 8, at 40-41. The CFTC regulates commodity accounts and futures contracts by regulating the contract markets in which investors trade the accounts. *Id.*; see note 1 *supra* (contract markets). Commodities law, however, does provide for CFTC enforcement proceedings against alleged defrauders, see note 8 *supra*, and administrative reparations proceedings for private parties aggrieved by violations of the Commodity Exchange Act. See Graham, *Special "Reparations" Actions*, 35 BUS. LAW. 773, 774 (1980) [hereinafter cited as Graham]. Aggrieved parties may bring complaints for alleged violations of the Act before the CFTC in a reparation proceeding. 7 U.S.C. § 18a (1976). The CFTC may award money damages upon finding a violation of the Act. *Id.* § 18c. The final determination in a CFTC reparation proceeding is not subject to de novo review by federal or state courts. *Id.* § 18g. CFTC reparations proceedings have no counterpart in securities law. Graham, *supra*, at 774.

<sup>11</sup> 15 U.S.C. §§ 78a-78kk (1976).

<sup>12</sup> Hewitt, *supra* note 10, at 321 n.169. Commentators have noted that commodity antifraud provisions are similar to securities antifraud provisions. See *id.*; Bromberg, *supra* note 10, at 76-77 & n.240; *Preemption*, *supra* note 7, at 36-38. See generally Nathan, *The Continued Relevance of the Securities Laws to Certain Commodity-Related Transactions*, COMMODITIES AND FUTURES TRADING 201, 213-14 (Prac. Law. Inst. 1975) [hereinafter cited as Nathan].

<sup>13</sup> See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976); note 68 *infra* (discussion of *Hochfelder*). The Supreme Court in *Hochfelder* used the term "scienter" to refer to a mental state embracing intent to deceive, manipulate or defraud. 425 U.S. at 193 n.12. The court

ment of proof under antifraud provisions of the CEA and the 1934 Act is subject of much judicial dispute.<sup>14</sup> Courts have addressed the issue of scienter more extensively under the securities antifraud provisions than under the comparable provisions of commodities law.<sup>15</sup> In addition, courts and parties to commodity fraud litigation often rely on securities case law to resolve questions of fraud under the CEA.<sup>16</sup> Consequently, the CFTC, as a regulatory agency independent of the SEC, has had problems fashioning its own approach to the regulation of commodity fraud.<sup>17</sup> The CFTC and the courts have been unable to achieve a uniform approach to scienter in terms of effective application of the commodities antifraud provisions.<sup>18</sup>

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noted that requisite scienter is something less than specific intent, yet more than negligence. *Id.*; see 1978-1979 *Securities Law Developments: Rule 10b-5*, 36 WASH. & LEE L. REV. 845, 923 (1978) (scienter requirements); Note, *Rule 10b-5 Liability After Hochfelder: Abandoning the Concept of Aiding and Abetting*, 45 U. CAL. L. REV. 218, 231 (1978) (specific intent to defraud not element of scienter). See also W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 154, at 669-700 (4th ed. 1971) (scienter characterizes three states of mind: (1) knowing; (2) without belief in the truth; (3) reckless) [hereinafter cited as PROSSER].

<sup>14</sup> Johnson, *Applying Hochfelder in Commodity Fraud Cases*, 20 B.C. L. REV. 633, 635 (1978). Compare *Gordon v. Shearson Hayden Stone, Inc.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,981 (CFTC Apr. 10, 1980) (scienter not element of action under § 4b(A) of CEA) and *SEC v. Aaron*, 605 F.2d 612, 623 (2d Cir. 1979), *vacated*, 446 U.S. 680 (1980) (scienter not element of action under § 10(b) of 1934 Act) with *CFTC v. Sterling Capital Co.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787 (N.D. Ga. Feb. 20, 1981) (scienter required in actions under § 4b(A) of CEA) and *SEC v. Blatt*, 583 F.2d 1325, 1332-33 (5th Cir. 1978) (scienter required in actions under § 10(b) of 1934 Act). See text accompanying notes 33-161 *infra*.

<sup>15</sup> Hewitt, *supra* note 10, at 321. Although commodities regulation in terms of the 1922 Act, see note 4 *supra*, historically predates that of securities regulation by the Securities Exchange Act of 1933 (1933 Act), 7 U.S.C. §§ 7a-77aa, commodities case law is less developed than securities case law. Hewitt, *supra* note 10, at 321. Underdevelopment of commodities law is due to the fact that no centralized regulatory authority overseeing commodity trade existed until Congress established the CFTC in 1974. See *id.*; notes 6-8 *supra* (inception of CFTC). Fraud is an example of one area in which courts have construed the provisions of securities law more thoroughly than similar commodities law provisions. Comment, *Reflections of 10b-5 in the "Pool" of Commodity Futures Antifraud*, 14 HOUS. L. REV. 899, 902 (1977) [hereinafter cited as *Commodity Futures Antifraud*]. The underdevelopment of commodities fraud case law may be a result of Congress' only recent amendments to the Commodity Exchange Act in 1974 and 1978 which emphasized the development of antifraud measures. See Hewitt, *supra* note 10, at 321; note 5 *supra* (1974 and 1978 amendments to the CEA).

<sup>16</sup> Hewitt, *supra* note 10, at 321-22. Securities antifraud case law is more fully developed than commodities fraud law. See note 17 *supra*. Consequently, courts often analogize to or rely upon the developed body of securities law rather than less developed commodities precedents to resolve commodity problems. Hewitt, *supra* note 10, at 321; see, e.g., *CFTC v. Sterling Capital Co.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786-87 (N.D. Ga. Feb. 20, 1981); *Gordon v. Shearson Hayden Stone, Inc.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,979-80 (CFTC Apr. 10, 1980).

<sup>17</sup> See Hewitt, *supra* note 10, at 322; *Preemption*, *supra* note 7, at 35-36 (recognizing difficulty in and need for development of independent body of commodities law); *Commodity Accounts*, *supra* note 8, at 861-62 (same).

<sup>18</sup> See text accompanying notes 19-161 *infra*; note 9 *supra*.

# I. SCIENTER AND PROOF OF FRAUD UNDER SECTION 4b(A) OF THE CEA AND CFTC AND CFTC RULE 32.9

The basic antifraud provision of the CEA is section 4b which prohibits any person making or connected with making futures contracts<sup>19</sup> from cheating, defrauding, or willfully deceiving others.<sup>20</sup> Section 4o<sup>21</sup> of the CEA prohibits commodity trading advisors<sup>22</sup> or pool operators<sup>23</sup> from defrauding any client or prospective client.<sup>24</sup> Under section 4c, Congress granted the CFTC the power to prohibit the sale of commodity options.<sup>25</sup> Section 4c, unlike other commodity antifraud provisions,<sup>26</sup> contains no

<sup>19</sup> See note 1 *supra*.

<sup>20</sup> 7 U.S.C. § 6b (1976 & Supp. III 1979). Section 4b of the Commodity Exchange Act provides, in pertinent part, that it is unlawful for any person connected with making a futures contract for or on behalf of another. . .

(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 agency performed with respect to such order or contract for such person; or

(D) to bucket such order, or to fill such order by offset against the order or orders of any other person, or willfully and knowingly . . . .

*Id.*

<sup>21</sup> 7 U.S.C. § 6o (1976 & Supp. III 1979). Section 4o of the Commodity Exchange Act provides that any commodity trading advisor or pool operator, either directly or indirectly, shall not "employ any device, scheme or artifice to defraud" any client or prospective client or "engage in any transaction, practice or course of dealing" which defrauds or deceives any client or prospective client. *Id.*

<sup>22</sup> *Id.* § 2. The term "commodity trading advisors" in section 4o of the Commodity Exchange Act includes any person who engages in the business of advising others, either directly or through publications, as to the value of commodities or trading in commodity futures. *Id.*; see *id.* § 6o (§ 4o of CEA). The term excludes persons whose advertising concerning commodities is done only incidentally for business purposes. *Id.* § 2.

<sup>23</sup> *Id.* § 2. The term "pool operators" in section 4o of the Commodity Exchange Act includes any person who solicits funds or property from others for an investment trust or syndicate for the purpose of trading in any commodity for future delivery. *Id.*; see *id.* § 6o (section 4o of CEA). A commodity pool is similar to a mutual fund in that it requires investors to contribute to a common fund in which an account executive trades. *Gravois v. Fairchild, Arabatzis*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,870 (E.D. La. Nov. 9, 1978).

<sup>24</sup> See note 21 *supra* (provisions of § 4o of CEA).

<sup>25</sup> *Id.* § 6c. In the Futures Trading Act of 1978, see note 5 *supra*, Congress prohibited transactions in commodity options. See 7 U.S.C. §§ 6c, 6d (Supp. III 1979). In section 6c(C) of the Commodity Exchange Act, Congress codified the CFTC's rule 32.11 which made the solicitation and sale of commodity options unlawful after June 1, 1978. *Id.* § 6c(C); 17 C.F.R. § 32.11 (1981). See generally *CFTC v. Morgan, Harris & Scott, Ltd.*, 484 F. Supp. 669 (S.D.N.Y. 1979) (discussing ramifications of ban on options trade). The CFTC permits certain businesses to continue to purchase options for use in connection with their business under a trade option exemption. See 17 C.F.R. ¶ 32.4 (1981).

<sup>26</sup> Compare 7 U.S.C. § 6c (1976 & Supp. III 1979) (general language concerning ban on



substantive conduct standards.<sup>27</sup> Subsequent to the enactment of section 4c in 1974<sup>28</sup> and under the authority of section 4c(B),<sup>29</sup> the CFTC promulgated rule 32.9<sup>30</sup> prohibiting fraud related to the offer and sale of commodity options.<sup>31</sup> Rule 32.9 prohibits conduct that cheats, defrauds, or deceives any person in connection with commodity option transactions.<sup>32</sup>

Neither the provisions of the CEA nor the rules that the CFTC has promulgated thereunder explicitly require scienter to sustain fraud violations.<sup>33</sup> The majority of courts have held that commodity antifraud provisions required proof of intentional conduct to sustain a claim of fraud.<sup>34</sup> Recent cases, however, have focused on whether scienter is a requirement for fraud violations under section 4b(A) and 4c(B) of the CEA and rule 32.9.<sup>35</sup>

In *Gordon v. Shearson Hayden Stone, Inc.*,<sup>36</sup> the CFTC determined

options trade) with 7 U.S.C. §§ 6b, 6c (1976 & Supp. III 1979) (specific proscriptions against fraudulent conduct associated with commodity sales and trading).

<sup>27</sup> 7 U.S.C. § 6c (1976 & Supp. III 1979).

<sup>28</sup> See note 25 *supra*.

<sup>29</sup> 7 U.S.C. § 6c(B) (1976 & Supp. III 1979). Section 4c(B) of the CEA gives the CFTC jurisdiction to regulate by its own terms transactions having the character of an "option." *Id.*; see *CFTC v. Crown Colony Commodity Options, Ltd.*, 434 F. Supp. 911, 914 (S.D.N.Y. 1977); note 25 *supra*.

<sup>30</sup> 17 C.F.R. § 32.9 (1981).

<sup>31</sup> *Id.*; see note 25 *supra*.

<sup>32</sup> 17 C.F.R. § 32.9 (1981).

<sup>33</sup> See, e.g., 7 U.S.C. §§ 6b, 6c, 6o (1976 & Supp. III 1979); 17 C.F.R. § 32.9 (1981). See *Commodity Futures Antifraud*, *supra* note 15, at 900-902 (scienter requirement in commodities antifraud provisions subject to various interpretations).

<sup>34</sup> See *Master Commodities, Inc. v. Texas Cattle Mgmt. Co.*, 586 F.2d 1352, 1356 (10th Cir. 1978) (private civil suit under § 4b of CEA requires scienter); *Haltmier v. CFTC*, 364 F.2d 556, 562 (2d Cir. 1977) (proof of evil motive necessary to prove fraud); *Silverman v. CFTC*, 549 F.2d 28, 31 (7th Cir. 1977) (§ 4b violations of CEA require proof of scienter).

The CFTC in *Gordon v. Shearson Hayden Stone, Inc.*, see note 36 *infra*, did not rely on prior court decisions which have held that fraud violations of the Commodity Exchange Act require proof of scienter. 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,980 (CFTC Apr. 10, 1980). The majority of cases which have required scienter for proof of commodities fraud have reached a common result by analogizing to securities fraud precedent requiring proof of scienter, rather than by an independent analysis of fraud provisions of the Commodity Exchange Act. See 586 F.2d at 1356; 364 F.2d at 562; 549 F.2d at 31. In *Gordon*, the CFTC was correct in not relying on commodity fraud case law since prior courts did not analyze the language or legislative history of the fraud provisions of the Commodity Exchange Act as carefully or thoroughly as did the CFTC in *Gordon*. See *id.*; 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,980 n.34; text accompanying notes 36-171 (discussion of proper and improper methods of interpretation of CEA fraud provisions).

<sup>35</sup> See *CFTC v. Sterling Capital Co.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 21,169-70 (N.D. Ga. 1981) (whether rule 32.9 of CFTC regulations requires proof of scienter); *Gordon v. Shearson Hayden Stone, Inc.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,981 (CFTC Apr. 10, 1980) (whether § 4b(A) of CEA requires proof of scienter); text accompanying notes 36-170 *infra*.

<sup>36</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016 (CFTC Apr. 10, 1980).

that a breach of the fiduciary duty owed by a commodities broker to a customer constitutes fraud under section 4b(A) of the CEA, even absent proof of scienter.<sup>37</sup> Plaintiff Gordon was a prospective investment customer who consulted with Philmour Hillman, an employee of Shearson Hayden Stone, Inc., (Shearson) investment corporation.<sup>38</sup> Upon the advice of Hillman, the plaintiff entered into an investment program involving spread trading in commodity futures contracts.<sup>39</sup> The plaintiff sustained a loss of approximately 8,000 dollars in less than a year as a result of investment in the commodity account that Hillman had established for her.<sup>40</sup> In her complaint to the CFTC, the plaintiff alleged that Shearson had defrauded her in violation of section 4b of the CEA by failing to inform her of the risks involved in the futures trading program that Hillman had recommended.<sup>41</sup> An administrative law judge in an initial hearing found the defendants liable for fraud under section 4b(A) and awarded Gordon the amount of her out-of-pocket losses.<sup>42</sup> Shearson filed

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<sup>37</sup> *Id.* at 23,973.

<sup>38</sup> *Id.* at 23,973-74.

<sup>39</sup> *Id.* at 23,975. In *Gordon*, the defendant-advisor Hillman used the plaintiff-investor's money to establish a spread position in 4 short contracts in hogs and 3 long contracts in cattle. 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,974.

The term "spread trading" describes the practice of purchasing one future contract in a particular delivery month against the sale of another future contract of equal size in a different delivery month, where both futures contracts are for the same or related commodities. *Id.* at 23,973 n.4. See generally 43 C.F.R. 32.92-95 (1981). Regular or "long" transactions involve the purchase of commodities in anticipation of a subsequent price rise resulting in a profit upon sale. See *House Report, supra* note 1, at 15, [1974] U.S. CODE CONG. & AD. NEWS at 5793. "Short" transactions involve initial sale of commodities with the promise of a future repurchase of the same commodity or contract. *Id.* Investor anticipation in short transactions is that the future price will decline and result in profit. *Id.*

<sup>40</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,974. In *Gordon*, the plaintiff-investor deposited a total of \$9,312.22 in a spread trading account just prior to June 1975. *Id.*; see note 39 *supra*. Upon liquidation of the account in September 1975, the plaintiff received \$1,349.22 in remittance. 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,974.

<sup>41</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,973. The plaintiff in *Gordon* filed suit against the Shearson Corporation (Shearson) under § 2a(1) of the Commodity Exchange Act which provides that any act, or omission of an agent of a corporation perpetrated within the scope of his employment is tantamount to an act or omission of the corporation as well as that of the agent. 7 U.S.C. § 2a(1) (1976 & Supp. III 1979).

<sup>42</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,973. Section 18b of the Commodity Exchange Act provides that a CFTC-designated administrative law judge initially hears complaints concerning violations of the Act before the CFTC reviews the complaint. 7 U.S.C. § 18b (1976 & Supp. III 1979). The administrative law judge (ALJ) in *Gordon* found that Hillman's failure to disclose to the plaintiff the risks involved with the spread trading investment program was unintentional and caused by his naive, good faith belief that no substantial risk existed. *Id.* at 23,975. The ALJ concluded, however, that even though Hillman's actions were unintentional, he breached the fiduciary duty of disclosure, giving rise to a fraud violation under § 4b(A). *Id.* Without directly addressing the issue of scienter, then, the ALJ in *Gordon* rejected the argument that proof of § 4b(A) violations requires proof of scienter. *Id.* Finding a fraud violation, the judge awarded the plaintiff \$7,963.00 plus 7% interest from June 1975 to the date of payment in money damages. *Id.*; see 7 U.S.C. § 18(e)

for review of the administrative law judge's decision.<sup>43</sup> The defendants urged the CFTC to re-examine whether the unintentional failure to inform a customer of the risks involved in commodity spread trading violated section 4b(A).<sup>44</sup>

The CFTC affirmed the administrative law judge's finding that the defendants violated section 4b(A) of the CEA.<sup>45</sup> The CFTC held that breach of a fiduciary duty constitutes fraud as proscribed by section 4b(A).<sup>46</sup> Plaintiff Gordon need only prove that a fiduciary relationship existed between her and the defendant and that the defendant breached its fiduciary duty.<sup>47</sup> According to the CFTC, Gordon did not have to prove that the defendant willfully or knowingly intended to defraud her to sustain a fraud action.<sup>48</sup>

The CFTC analyzed the statutory construction and legislative intent underlying the CEA in resolving the question of scienter.<sup>49</sup> Examining the language of section 4b,<sup>50</sup> the CFTC held that Congress intended a broad construction of the meaning of "to defraud."<sup>51</sup> The CFTC noted the common law distinction between actual and constructive fraud in deter-

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(1976 & Supp. III 1979) (providing for award of money damages upon violation of CEA); note 10 *supra* (CFTC enforcement and reparations proceedings).

<sup>43</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,973. Section 18c of the Commodity Exchange Act provides that after alleged violators of the Act have had the opportunity for an initial hearing, the CFTC then may review the result of the hearing and determine whether or not the respondent has violated terms of the Commodity Exchange Act. 7 U.S.C. § 18c (1976 & Supp. III 1979). In *Gordon*, the defendant Shearson sought CFTC review of the ALJ's determination holding the corporation liable for fraud under § 4b(A) of the Commodity Exchange Act. 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,973. Shearson contended that the ALJ erred as a matter of law in holding that negligent conduct, absent intent to defraud, constitutes a violation of § 4b(A). *Id.* at 23,975. On review, Shearson asserted that since negligent conduct is insufficient to support securities fraud violations, such conduct is not sufficient evidence to sustain § 4b(A) fraud violations of the Commodity Exchange Act. *Id.*; see text accompanying notes 65-84 *infra*.

<sup>44</sup> *Id.* Until the CFTC in *Gordon* confronted the issue of scienter under § 4b(A) of the Commodity Exchange Act, no court had considered whether an unintentional breach of fiduciary duty constituted fraud under § 4b(A).

<sup>45</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,982.

<sup>46</sup> *Id.* at 23,981.

<sup>47</sup> *Id.* In *Gordon*, the CFTC noted that the specific duties and degree of care imposed upon a particular agent-fiduciary, which give rise to § 4b(A) liability, directly stem from the nature of the relationship with the customer. *Id.* As a result of *Gordon*, then, failure to inform a customer of the risks involved in spread trading may or may not give rise to fraud liability, depending on the capacity in which the commodity broker is operating. See *id.* at 23,981 n.37 (contrasting different liability when broker acts as trusted agent versus perfunctory advisor). *Gordon* announces no per se rule concerning negligent broker conduct, but rather, proscribes breach of the fiduciary duty. Consequently, the issue for courts applying *Gordon* will be to determine the existence of a fiduciary relationship between plaintiffs and defendants.

<sup>48</sup> *Id.*; see note 47 *supra*.

<sup>49</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,976.

<sup>50</sup> 7 U.S.C. § 6b (1976 & Supp. III 1979); see note 20 *supra*.

<sup>51</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,976.

mining the scope of fraud under section 4b.<sup>52</sup> Cases of actual fraud, or fraud at law, usually involve arm's length transactions between parties and require the plaintiff to prove intent to defraud and resultant injury.<sup>53</sup> Constructive fraud, or fraud in equity, however, applies to parties involved in a fiduciary relationship and does not require proof of scienter.<sup>54</sup> In *Gordon*, the CFTC reasoned that because Congress designed the CEA as remedial legislation applicable to fiduciary transactions, the flexible notions of constructive fraud control the construction of section 4b(A).<sup>55</sup> The CFTC noted that a non-scienter construction of section 4b(A) is consistent with judicial interpretation of similar antifraud provisions of the CEA regulating fraud in connection with the fiduciary duties of commodity trading advisors.<sup>56</sup> The CFTC concluded, therefore, that proof of scienter was not a prerequisite to Gordon's fraud action under section 4b(A).<sup>57</sup>

The CFTC also noted the distinctions between section 4b(A) and sections 4b(B) through 4b(D)<sup>58</sup> of the CEA.<sup>59</sup> Sections 4b(B) through (D) contain the words "willfully" and "knowingly" which the CFTC acknowledged as prohibiting fraudulent acts committed with intent to defraud, cheat, or deceive.<sup>60</sup> The CFTC stressed the absence of willful or inten-

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<sup>52</sup> *Id.*

<sup>53</sup> See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192 (1963). In common law actions for fraud in law, scienter is an essential element of proof. *Id.* Proof of intent to deceive is necessary to fraud actions at law since monetary damages is the form of relief the court may award in such actions. See *Aaron v. SEC*, 446 U.S. 680, 693 (1980). The punitive effects and harm that monetary damages may have on a defendant require a stricter standard of proof for fraud at law. *Id.* Actual intent to deceive, or scienter, therefore is an important element for common law fraud actions at law. 375 U.S. at 192.

<sup>54</sup> *Id.* at 193-94. In common law actions for fraud in equity between fiduciary parties, proof of scienter is unnecessary. *Id.* Equitable relief remedies for fraud include reformation of contracts, rescission, and equitable liens resulting in a void of the fraudulent transaction. PROSSER, *supra* note 13, at 387-88. Since equitable remedies for fraud do not have the same punitive effect as monetary damages, see note 53 *supra*, proof of fraud in equity does not contain the strict requirement of scienter as an element of proof. See *Aaron v. SEC*, 446 U.S. 680, 693 (1980).

<sup>55</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,976; see notes 3 & 5 *supra* (remedial nature of CEA).

<sup>56</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,980.

<sup>57</sup> *Id.* at 23,977.

<sup>58</sup> 7 U.S.C. §§ 6b(B)-(D) (1976 & Supp. III 1979); see note 20 *supra* (text of §§ 4b(B)-(D) of CEA).

<sup>59</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,977.

<sup>60</sup> *Id.*; see 7 U.S.C. §§ 6b(B)-(D) (1976 & Supp. III 1979) (§§ 4b(B)-(D) of CEA). The CFTC noted that it is a well-established norm of statutory construction that when Congress includes a word in one section of a statute and omits the word in another section, agencies or persons construing the statute should not imply the word in the section in which Congress omitted the word. 2 COMM. FUT. L. REP. (CCH) at 23,977. See also *United States v. Atchison, T. & S. F. Ry., Co.*, 220 U.S. 37, 44 (1911); *Corn Prod. Ref. Co. v. Benson*, 232 F.2d 554, 562 (2d Cir. 1956).

tional language in section 4b(A).<sup>61</sup> The CFTC held that 4b(A) governs all actions to defraud including actions unintentionally committed.<sup>62</sup> The legislative history underlying the enactment of section 4b supports the CFTC's literal reading of 4b(A).<sup>63</sup> Congress rejected formulations of 4b(A) that specifically required scienter and enacted the provision without the "willful" or "knowing" requirements contained in sections 4b(B) through 4b(D).<sup>64</sup>

The CFTC also distinguished the requirements necessary to prove fraud under section 4b(A) of the CEA from the provisions of section 10(b)<sup>65</sup> of the Securities Exchange Act of 1934.<sup>66</sup> To sustain a fraud action under section 10(b) of the 1934 Act and rule 10b-5<sup>67</sup> promulgated thereunder, the Supreme Court in *Ernst & Ernst v. Hochfelder*<sup>68</sup> held that scienter is a necessary requirement for recovery of damages.<sup>69</sup> The CFTC rejected the *Hochfelder* holding as inapposite in *Gordon*.<sup>70</sup> The CFTC compared the language used in section 10(b) of the 1934 Act with

<sup>61</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,977; see note 4 *supra* (enactment of § 4b of CEA); note 20 *supra* (text of § 4b(A) of CEA).

<sup>62</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,977.

<sup>63</sup> *Id.* at 23,979. Congress considered H.R. 7608 containing a proposed version of § 4b(A) of the Commodity Exchange Act as an amendment to the 1922 Act. *Id.*; see note 3 *supra* (amendment of 1922 Commodity Act). Proposed House Rule 7608 proscribed knowing conduct with the intent to defraud in connection with the making of futures contracts. H.R. 7608, 73d CONG., 1st SESS. 32, § 4A (1932).

<sup>64</sup> See 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,979; 7 U.S.C. §§ 6b(A)-(D) (1976 & Supp. III 1979); note 63 *supra*.

<sup>65</sup> 15 U.S.C. § 78j(b) (1976). Section 10(b) of the 1934 Securities Act makes it unlawful for any person to employ any manipulative or deceptive device or contrivance in connection with the purchase or sale of securities. *Id.* Congress enacted § 10(b) of the 1934 Act in the public interest for protection of securities investors. *Id.*

<sup>66</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,979-80; see text accompanying notes 67-80 *infra*.

<sup>67</sup> 17 C.F.R. § 240.10b-5 (1981). The SEC promulgated rule 10b-5 pursuant to a grant of rulemaking authority in § 10(b) of the 1934 Act. See 15 U.S.C. § 78j(b) (1976).

Rule 10b-5 makes it unlawful for any person to employ any device, scheme or artifice to defraud or engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (1981).

<sup>68</sup> 425 U.S. 185 (1976). In *Hochfelder*, plaintiff investors brought a private damage action against an accounting firm for securities law violations. *Id.* at 188-89. The president of a securities brokerage firm fraudulently induced customers to invest funds in certain securities accounts. *Id.* The president then converted the investor funds and the firm's books never reflected the account. *Id.* After the suicide of the brokerage's president, the defrauded investors brought suit against the accounting firm which audited the brokerage firm's books. *Id.* at 189-90. The plaintiffs alleged that under § 10(b) of the 1934 Act and SEC rule 10b-5, the accounting firm was negligent in not discovering the fraudulent transactions of the president. *Id.* at 190. Determining that a scienter requirement existed under § 10(b) and rule 10b-5, the Supreme Court dismissed the case since the plaintiffs disclaimed any intentional conduct by the defendant accounting firm. *Id.* at 191.

<sup>69</sup> *Id.* at 193.

<sup>70</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,979-80.

that of section 4b of the CEA.<sup>71</sup> Although section 10(b) of the 1934 Act contains no language requiring willful or knowing conduct,<sup>72</sup> the *Hochfelder* Court concluded that such terms as "manipulative," "deceptive," and "contrivance" of section 10(b) suggested that Congress intended to proscribe intentional misconduct.<sup>73</sup> Section 4b(A) contains no language regulating manipulative or deceptive conduct, but only generally prohibits cheating or defrauding in transactions involving commodity futures.<sup>74</sup> The CFTC held, therefore, that, unlike section 10(b) of the 1934 Act, section 4b(A) of the CEA contained no scienter requirement.<sup>75</sup>

The CFTC in *Gordon* also distinguished *Hochfelder* on the grounds that the prohibitions of section 10(b) of the 1934 Act encompass both fiduciary and nonfiduciary relationships.<sup>76</sup> Although section 10(b) applies to any person involved in a securities transaction,<sup>77</sup> section 4b(A) of the CEA regulates fraud in fiduciary relationships.<sup>78</sup> Since persons acting in a fiduciary capacity have an affirmative duty to act non-negligently,<sup>79</sup> the CFTC in *Gordon* held that an unintentional breach of a fiduciary duty is a proper standard of culpability in section 4b(A) fraud actions.<sup>80</sup> The defendant in *Gordon* stood in an advisory capacity to the plaintiff on behalf of Shearson,<sup>81</sup> and the defendant failed to inform the plaintiff of

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<sup>71</sup> *Id.* Compare 15 U.S.C. § 78j(b) (1976) (language proscribing conduct related to use of manipulative or deceptive devices associated with securities sales) with 7 U.S.C. § 6b (1976 & Supp. III 1979) (language generally prohibiting fraud associated with commodities sales).

<sup>72</sup> See 15 U.S.C. § 78j(b) (1976).

<sup>73</sup> See 425 U.S. at 197. The Supreme Court in *Hochfelder* noted that the term "manipulative" is a term of art connoting intentional or willful conduct. *Id.* at 199. "Contrivance" means a device intended to deceive. BLACK'S LAW DICTIONARY 298 (5th ed. 1979).

<sup>74</sup> See 7 U.S.C. § 6b(A) (1976 & Supp. III 1979); see note 20 *supra* (text of § 4b(A) of CEA).

<sup>75</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,980.

<sup>76</sup> See 15 U.S.C. § 78j(b) (1976).

<sup>77</sup> *Id.* Section 10(b) of the 1934 Act covers the acts of "any person . . . in connection with the purchase and sale of securities." *Id.*

<sup>78</sup> See 7 U.S.C. § 6b(A) (1976 & Supp. III 1979). Section 4b of the Commodity Exchange Act covers the acts of "any person connected with making a futures contract for or on behalf of another . . ." *Id.* § 6b. The CFTC has recognized that those persons effecting futures transactions for or on behalf of others stand in a fiduciary relationship of trust and confidence to customers. See *Savage v. CFTC*, 348 F.2d 192, 196 (7th Cir. 1977) (futures broker owes fiduciary duty to client); *Klatt v. International Trading Group, Ltd.*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,636, at 22,598 (June 21, 1978) (same).

<sup>79</sup> PROSSER, *supra* note 13, at 534-35.

<sup>80</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,981; see notes 52-57 *supra*.

<sup>81</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,973 & n.3. The administrative law judge in the initial hearing in *Gordon* found Shearson jointly liable with the defendant Hillman under § 2a(1) of the CEA. *Id.*; see 7 U.S.C. § 2a(1) (1976 & Supp. III 1974); note 41 *supra* (§ 2a(1) of CEA). The defendants in *Gordon* did not raise the issue of joint liability in the later CFTC proceeding. The CFTC, therefore, allowed the administrative law judge's finding of joint liability under § 2a(1) of the Commodity Exchange Act to stand. 2 COMM. FUT. L. REP. (CCH) at 23,983 n.40.

commodities investment risks,<sup>82</sup> thereby breaching his fiduciary duty to the plaintiff.<sup>83</sup> Consequently, the CFTC held that, absent proof of scienter, a defendant's breach of a fiduciary duty constitutes fraud under section 4b(A) of the CEA.<sup>84</sup>

In *CFTC v. Sterling Capital Co.*,<sup>85</sup> the District Court for the Northern District of Georgia disagreed with the CFTC's decision in *Gordon*<sup>86</sup> and held that violations of section 4b(A) of the CEA require proof of scienter.<sup>87</sup> The Sterling Capital Corporation (Sterling) was responsible for marketing and selling commodity contracts known as "Fixed Cost/Fixed Maturity Contracts" (FC/FM contracts).<sup>88</sup> The CFTC sought to enjoin Sterling from selling the FC/FM contracts on the grounds that the contracts constituted commodity options.<sup>89</sup> The CFTC alleged not only that Sterling had violated section 4c(C) of the CEA<sup>90</sup> prohibiting the offer and sale of certain commodity options,<sup>91</sup> but also that Sterling's conduct violated section 4c(B) and rule 32.9 prohibiting fraud in connection with the offer and sale of commodity options.<sup>92</sup> In determining whether scienter is an element of fraud associated with the sale of commodity op-

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<sup>82</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,974. The CFTC specifically has recognized the importance of disclosure of risk by commodity trading advisors, *see* note 22 *supra*, to investor customers due to the uncertainty involved in commodity investments. *See* 17 C.F.R. § 1.55 (1981) (CFTC rule 1.55 requiring disclosure of commodity trading risks).

<sup>83</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,982.

<sup>84</sup> *Id.*

<sup>85</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, 21,170 (N.D. Ga. 1981).

<sup>86</sup> *Id.* ¶ 21,016, at 23,981.

<sup>87</sup> *See* *CFTC v. Sterling Capital Co.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, 21,170 (N.D. Ga. Feb. 20, 1981); text accompanying notes 88-128 *infra*.

<sup>88</sup> *Id.* at 24,776. In *Sterling*, the "Fixed Cost/Fixed Maturity Contracts" (FC/FM contracts) entitled purchasers, on the payment of a one-time non-refundable service fee, to take delivery of a specific amount of foreign currency at a fixed price on a specified future date. *Id.* A transaction in foreign currency may involve an exchange of cash for foreign currency or a contract for sale of the foreign currency for future delivery. *CFTC v. American Bd. of Trade, Inc.*, 473 F. Supp. 1177, 1182 (S.D.N.Y. 1979). Congress noted in passing the 1974 Act that bank regulatory agencies adequately supervise transactions in foreign currency. *See* 1974 SENATE REPORT, *supra* note 1, at 5863. The 1974 Act, however, does not exempt trading in foreign currency. 473 F. Supp. at 1183; *see* 7 U.S.C. § 6c(B) (1976 & Supp. III 1979). Section 4c(B) of the Commodity Exchange Act applies specifically to transactions that involve any commodity regulated under the Act and that have the character of an option. 7 U.S.C. § 6c(B) (1976 & Supp. III 1979); *see* note 25 *supra*. The foreign currency transactions in *Sterling* involved contracts for future delivery, which the court concluded were options contracts, and therefore subject to regulation. 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,784.

<sup>89</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,776; *see* note 25 *supra* (discussion of commodity options).

<sup>90</sup> 7 U.S.C. § 6c(C) (1976 & Supp. III 1979) (§ 4c(C) of the CEA); *see* note 25 *supra* (illegality of commodity options).

<sup>91</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,779; *see* note 25 *supra* (illegality of commodity options).

<sup>92</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,784.

tions,<sup>93</sup> the district court examined the requirements of CFTC rule 32.9.<sup>94</sup> The *Sterling* court initially reasoned that the requirements of section 4b(A)<sup>95</sup> of the CEA controlled whether rule 32.9 required scienter.<sup>96</sup> Concluding that section 4b(A) requires proof of scienter,<sup>97</sup> the court held that rule 32.9 also requires proof of scienter.<sup>98</sup> Since the CFTC had not proved scienter on Sterling's part in conjunction with the sale of commodity options,<sup>99</sup> the court refused to permanently enjoin Sterling's FC/FM contracts activity.<sup>100</sup> Subsequently, the CFTC moved for clarification of that portion of the court's order requiring proof of scienter.<sup>101</sup> The *Sterling* court granted the motion<sup>102</sup> and re-examined the requirements for option fraud violations under rule 32.9.<sup>103</sup> The court looked to the requirements of section 4c(B)<sup>104</sup> of the CEA as the statutory basis for rule 32.9.<sup>105</sup> Based upon the language of section 4c(B),<sup>106</sup> the court amended its earlier opinion to hold that scienter is not an element of section 4c(B) of the CEA nor rule 32.9 of CFTC regulations.<sup>107</sup> The *Sterling* court, however, left undisturbed the finding that section 4b(A) requires proof of scienter.<sup>108</sup>

In the *Sterling* court's initial consideration of the issue of scienter, the court examined the language of the substantive prohibitions contained in section 4b of the CEA.<sup>109</sup> The court determined from the language of the section and from a cursory look at the legislative history underlying enactment of section 4b that the commission of a fraudulent act requires knowledge of the nature and character of the act or scienter.<sup>110</sup> The court relied on the analogous fraud provisions of section 17(a) of the Securities Exchange Act of 1933<sup>111</sup> (1933 Act) and judicial interpretation of the

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<sup>93</sup> See note 25 *supra* (discussion of commodity options trading).

<sup>94</sup> 17 C.F.R. § 32.9 (1981); see text accompanying notes 29-32 *supra*.

<sup>95</sup> 7 U.S.C. § 6b(A) (1976 & Supp. III 1979); see note 20 *supra* (text of § 4b(A) of CEA).

<sup>96</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,785-87.

<sup>97</sup> *Id.* at 24,787.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788 (N.D. Ga. 1981).

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> 7 U.S.C. § 6c(B) (1976 & Supp. III 1979); see text accompanying notes 124-28 *infra*.

<sup>105</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788.

<sup>106</sup> See text accompanying notes 124-28 *infra*.

<sup>107</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788.

<sup>108</sup> *Id.*; see *id.* ¶ 21,169, at 24,787.

<sup>109</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see note 20 *supra* (text of § 4b of CEA).

<sup>110</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see note 13 *supra* (scienter).

<sup>111</sup> 15 U.S.C. §§ 77a-77aa (1976). Section 17(a)(1) of the Securities Exchange Act of 1933 (1933 Act) makes it unlawful "to employ any device, scheme or artifice to defraud" in the sale of investment securities. *Id.* § 77q(a)(1).



securities provisions requiring scienter as an element in fraud violations to buttress its conclusion.<sup>112</sup>

The district court examined the Supreme Court's decision in *Aaron v. SEC*,<sup>113</sup> which held that scienter is an element of fraud violations under section 17(a)(1) of the 1933 Act.<sup>114</sup> The *Sterling* court compared the language of 17(a)(1) of the 1933 Act to the language of 4b(A) of the CEA.<sup>115</sup> The court noted that the policy thrust of both provisions is to prohibit efforts to defraud in the sale of investment instruments.<sup>116</sup> By analogy, the *Sterling* court reasoned that because scienter is an element of proof under section 17(a)(1) of the 1933 Act, scienter should be an element of proof under section 4b(A) of the CEA.<sup>117</sup>

The *Sterling* court erred in examining the issue of commodity options fraud under the provisions of section 4b(A) of the CEA. The CFTC in *Sterling* alleged that the defendant committed fraud in violation of rule 32.9.<sup>118</sup> The CFTC promulgated rule 32.9 under the authority of section 4c(B) of the CEA, as amended by the Futures Trading Act of 1978.<sup>119</sup>

<sup>112</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787; see *Aaron v. SEC*, 605 F.2d 612, 614 (2d Cir. 1979), *vacated on other grounds*, 446 U.S. 680 (1980); note 113 *infra*.

<sup>113</sup> 605 F.2d 612, 614 (2d Cir. 1979), *vacated on other grounds*, 446 U.S. 680 (1980). In *Aaron*, the SEC alleged that the defendant, an employee of a securities brokerage firm, aided in violating section 17(a)(1) of the 1933 Act by failing to prevent fraudulent practices of registered brokerage representative of which the defendant knew. 446 U.S. at 683. A federal district court granted injunctive relief, finding that Aaron had aided in a violation of § 17(a)(1) and other securities provisions. See *SEC v. Aaron*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,043, at 91,687 (S.D.N.Y. 1977), *aff'd*, 605 F.2d 612 (2d Cir. 1979). The Supreme Court granted certiorari to determine whether scienter was an element of an injunctive action under § 17(a)(1) of the 1933 Act. See 446 U.S. at 686. The Court held that § 17(a)(1) does contain a scienter requirement. *Id.* at 701-02.

<sup>114</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787; see *Aaron v. SEC*, 446 U.S. at 701-02; note 113 *supra*.

<sup>115</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787. Compare 15 U.S.C. § 77q(a)(1) (1976) (unlawful for any person to use device, scheme, artifice to defraud in connection with securities sales) with 7 U.S.C. § 6b(a) (1976 & Supp. III 1979) (prohibiting commodity futures merchants from cheating or defrauding in connection with futures contracts).

<sup>116</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787.

<sup>117</sup> *Id.* The *Sterling* court was correct in the assertion that both §§ 17(a)(1) of the 1933 Act and 4b(A) of the Commodity Exchange Act prohibit fraud in the sale of investment instruments. *Id.* Because both sections proscribe fraud, however, does not mean that the required elements of proof for each section are the same. For example, under § 17(a) of the 1933 Act, three subsections prohibit defrauding with regard to investment security transactions. 15 U.S.C. §§ 77q(a)(2) & (3) (1976). Although subsections §§ 17(a)(2) and (3) of the 1933 Act prohibit fraud as does § 17(a)(1), the Supreme Court in *Aaron* held that only § 17(a)(1) requires proof of scienter. See 446 U.S. at 697. The *Sterling* court erred in generalizing between § 17(a)(1) of the 1933 Act and § 4b(A) of the CEA concerning a scienter requirement on the basis that the thrust of both sections is the policing of antifraud and when the language of the two sections reasonably differs. See 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787.

<sup>118</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,776; see 17 C.F.R. § 32.9 (1981); text accompanying notes 28-32 *supra* (rule 32.9 of CFTC regulations).

<sup>119</sup> See 7 U.S.C. § 6c(B) (1976 & Supp. III 1979); see note 1 *supra* (discussing Futures Trading Act of 1978 and commodity options ban).

Since section 4c(B) is the statutory basis of rule 32.9, the *Sterling* court should have examined section 4c(B) in determining whether rule 32.9 requires scienter.<sup>120</sup> The *Sterling* court incorrectly equated the antifraud policy aspects of section 17(a)(1) of the 1933 Act and 4b(A) of the CEA in holding that rule 32.9 requires proof of scienter.<sup>121</sup> Statutory language and legislative history, rather than policy considerations, control construction of federal regulatory provisions.<sup>122</sup> The starting point for the *Sterling* court's analysis of rule 32.9, then, should have been the language of section 4c(B) of the CEA.

On rehearing upon the CFTC's motion to clarify,<sup>123</sup> the *Sterling* court analyzed the issue of scienter under section 4c(B).<sup>124</sup> The court noted that nothing in the language of section 4c(B) connotes a standard of conduct requiring scienter for fraud violations.<sup>125</sup> Section 4c(B) of the CEA permits the CFTC to prescribe, in the CFTC's own terms, conduct associated with the sale of commodity options.<sup>126</sup> The legislative history underlying section 4c(B) indicates that Congress conferred broad authority on the CFTC to achieve effective regulation of fraudulent options transactions.<sup>127</sup> The *Sterling* court concluded that scienter is not an element of commodity option fraud actions, based upon the absence of a scienter requirement in the language and history of section 4c(B) of the CEA.<sup>128</sup>

*Sterling* and *Gordon* illustrate two methods of analysis to determine whether commodity antifraud provisions require scienter. The CFTC's decision in *Gordon* that section 4b(A) of the CEA does not require proof of scienter is correct.<sup>129</sup> The *Sterling* court erred in reaching the opposite result.<sup>130</sup> The *Sterling* court inadvertently analyzed section 4b(A) in construing the requirements of rule 32.9.<sup>131</sup> Since the *Sterling* court later

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<sup>120</sup> See text accompanying note 158 *infra* (rulemaking power of federal agencies only as extensive as authorizing statute).

<sup>121</sup> See 2 COMM. FUT. L. REP. ¶ 21,169, at 24,787.

<sup>122</sup> *United States v. Oregon*, 366 U.S. 643, 648 (1961).

<sup>123</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788. In *Sterling*, the district court deferred awarding the plaintiff injunctive relief against the defendants until the plaintiff could establish scienter in accordance with CFTC rule 32.9 concerning the defendants' option contract activity. *Id.* ¶ 21,169, at 24,787. The CFTC, as plaintiff, sought modification of the *Sterling* court's order requiring proof of scienter under rule 32.9. *Id.* ¶ 21,170, at 24,788.

<sup>124</sup> *Id.* ¶ 21,170, at 24,788.

<sup>125</sup> *Id.*

<sup>126</sup> 7 U.S.C. § 6c(B) (1976 & Supp. III 1979); see 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,778 n.7 (text of § 4c(B) of CEA).

<sup>127</sup> See S. REP. NO. 95-850, 95th Cong., 2d Sess. 14 reprinted in [1978] U.S. CODE CONG. & AD. NEWS 2087, 2101 (discussing congressional intent to empower CFTC to achieve effective regulation of commodity options).

<sup>128</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788.

<sup>129</sup> See *id.* ¶ 21,016, at 23,981; text accompanying notes 133-42 *infra*.

<sup>130</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787; text accompanying notes 133-46 *infra*.

<sup>131</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788.

changed the basis for its decision to section 4c(B)<sup>132</sup> of the CEA, however, future courts may overrule *Sterling's* conclusion concerning 4b(A) or treat the conclusion as dicta. Nonetheless, an examination of the *Gordon* and *Sterling* analyses of section 4b(A) provides an important comparison of methods of statutory interpretation.

The CFTC's decision in *Gordon* is the proper approach for courts to follow when interpreting provisions of the CEA. The *Gordon* analysis takes into account the factors of legislative history, congressional intent, and public policy relevant to problems of statutory construction.<sup>133</sup> The CFTC properly reasoned that a review of the express language of a statute is a primary means to determine the underlying intent of the statute's requirements.<sup>134</sup> In *Gordon*, the CFTC carefully weighed the language of section 4b(A), the congressional intent in enacting the provision, and the remedial purposes of the CEA to reach the correct result that no scienter requirement exists for fraud violations under 4b(A).<sup>135</sup>

The CFTC's analysis in *Gordon* comports with the method of statutory construction that the Supreme Court undertook in *Hochfelder*.<sup>136</sup> The *Hochfelder* Court held that the language and legislative history of federal securities laws are dispositive of judicial construction of statutes.<sup>137</sup> The express language of statutory provisions overrides policy considerations when problems of interpretation arise.<sup>138</sup> Accordingly, the CFTC in *Gordon* relied upon the language of section 4b(A) of the CEA to distinguish the holding of *Hochfelder* requiring proof of scienter for securities fraud violations.<sup>139</sup> In this way, *Gordon* highlights the fundamental policy differences between commodities and securities laws.<sup>140</sup> The CEA and the 1933 and 1934 Acts embody

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<sup>132</sup> *Id.*

<sup>133</sup> See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-212 (1976) (legislative history and congressional intent relevant to determining scienter in statutory SEC provisions); *Train v. Colo. Pub. Interest Research Group*, 426 U.S. 1, 9-10 (1975) (policies and purposes underlying statutory scheme relevant to determine statute's intent).

<sup>134</sup> See *United States v. Oregon*, 366 U.S. 643, 648 (1961) (clear language of statute controls interpretation); *United States v. Hartwell*, 73 U.S. (6 Wall.) 385, 396 (1867) (language of statute conclusive of meaning).

<sup>135</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,976-81; see text accompanying notes 49-84 *supra*.

<sup>136</sup> See 425 U.S. 185, 197-212; note 68 *supra*.

<sup>137</sup> See 425 U.S. 185, 212-14; note 68 *supra*.

<sup>138</sup> See 425 U.S. at 214 n.33 (language controls construction of federal statutes); accord *Aaron v. SEC*, 446 U.S. 680, 691 (1980).

<sup>139</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,979-80; see text accompanying notes 65-80 *supra*.

<sup>140</sup> See Bromberg, *supra* note 10, at 288. Basic differences exist between commodity futures and securities. See Bromberg, *Securities Law—Relationship to Commodities Law*, 35 BUS. LAW. 787, 794-96 (1980). Recognizing the difference between the two industries, Congress chose to regulate commodities and securities separately. See 119 CONG. REC. 41335-37 (1973); note 10 *supra*; note 141 *infra*.

dissimilar approaches to the regulation and redress of fraud violations.<sup>141</sup> By a reasoned analysis of the different language and legislative intent of section 4b(A) of the CEA and section 10(b) of the 1934 Act, the CFTC in *Gordon* discourages arbitrary application of the policy of securities case law to commodities problems.<sup>142</sup> *Gordon* offers a logical and methodic approach to the construction of CEA antifraud provisions that facilitates development of an independent body of commodities fraud case law.

In contrast to *Gordon*, the *Sterling* court's method of analysis of section 4b(A) was incorrect. The district court in *Sterling* recognized that the basis for statutory construction problems is an examination of the language of the statute in question.<sup>143</sup> The court then examined the language of section 4b as a whole.<sup>144</sup>

In examining section 4b, the *Sterling* court erred in failing to distinguish provision 4b(A) from provisions (B) through (D).<sup>145</sup> Unlike the CFTC in *Gordon*,<sup>146</sup> the district court in *Sterling* disregarded the fact that provisions 4b(B) through (D) contain language suggesting a willful conduct requirement which 4b(A) does not.<sup>147</sup> Although recognizing the primary importance that language plays in the interpretation of a statute, the *Sterling* court overlooked the express language of 4b(A) which contains no scienter requirement.<sup>148</sup> The court also failed to examine the legislative intent relevant to the enactment of section 4b(A).<sup>149</sup> Had the *Sterling* court examined the history underlying the adoption of 4b(A), the court would have discovered that Congress deliberately omitted words suggesting scienter from the provision.<sup>150</sup> A thorough review

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<sup>141</sup> See notes 8 & 10 *supra*. Since securities law provides for implied private rights of action making the courts more readily available to individual investors, a scienter requirement in securities fraud provisions may be a means to limit the number of possible aggrieved plaintiffs. See note 10 *supra*. Proof of intentional conduct under commodity fraud provisions may be an unduly harsh requirement, however, where no implied private right of action exists and where an agency decision in reparation proceedings is not subject to review. *Id.*; 7 U.S.C. § 18g (1976 & Supp. III 1979).

<sup>142</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,976. The CFTC in *Gordon* recommended that courts look to the words of the statute itself, the legislative intent peculiar to the Commodity Exchange Act, other provisions of the statute, and the policies and purposes underlying the statutory scheme. *Id.* The CFTC cautioned against uncritical application of analogous provisions or legislative similarities related to the enactment of securities law when evaluating commodity problems. *Id.*

<sup>143</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976); text accompanying notes 134 & 138 *supra*.

<sup>144</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see note 20 *supra* (text of § 4b of CEA).

<sup>145</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see *United States v. Naftalin*, 441 U.S. 768, 774 (1979) (courts should construe statutory subsections independently of one another); *United States v. Birrell*, 266 F. Supp. 539, 543 (S.D.N.Y. 1967) (same).

<sup>146</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,977; see notes 58-64 *supra*.

<sup>147</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see note 20 *supra*.

<sup>148</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786; see notes 58-64 *supra*.

<sup>149</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,786.

<sup>150</sup> See notes 57 & 70 *supra* (enactment of § 4b(A) without language of intentional conduct).

of the congressional intent underlying 4b(A) would have aided the *Sterling* court in recognizing the error of its interpretation of section 4b(A) as requiring scienter. The *Sterling* court additionally did not consider the remedial purposes of the CEA that the CFTC in *Gordon* held to suggest a broad reading of the requirements to prove fraud under 4b(A).<sup>151</sup> The district court analogized instead to securities law.<sup>152</sup> The *Sterling* court reasoned that because both commodities and securities law espouse anti-fraud policies, the scienter requirement of section 17(a)(2) of the 1934 Act supports a scienter construction of 4b(A) of the CEA.<sup>153</sup> The policy considerations that support a scienter requirement in securities fraud actions, however, should not control the interpretation of the proof requirements of antifraud provisions of the CEA.<sup>154</sup> Judicial reliance upon securities precedent inhibits the growth of a solid foundation of commodity fraud case law and is a practice that Congress has discouraged.<sup>155</sup>

The *Sterling* court failed to recognize the unique aspects of provision 4b(A) and the CEA in erroneously concluding that scienter is an element of section 4b(A) fraud actions.<sup>156</sup> Although the *Sterling* court erred in concluding that section 4b(A) requires proof of scienter, the court's holding that rule 32.9 does not require scienter is correct. The district court in *Sterling* recognized that the CFTC promulgated rule 32.9 pursuant to section 4c(B) of the CEA.<sup>157</sup> The rulemaking authority of federal agencies consists of the power to enact regulations consistent with the legislative intent embodied in the authorizing statutes.<sup>158</sup> Consequently, the proof requirements for options fraud under section 4c(B) of the CEA control judicial interpretation of rule 32.9 of CFTC regulations in accordance with *Sterling*. The *Sterling* court found no restrictive conduct standards requiring intent or proof of scienter, examining the language and legislative intent of section 4c(B).<sup>159</sup> The court correctly concluded, therefore, that scienter is not an element of proof for rule 32.9 fraud violations.<sup>160</sup>

As a result of *Gordon*, scienter is not an element of proof of fraud under section 4b(A) of the CEA. Similarly, scienter is not a requirement

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<sup>151</sup> See notes 49-57 *supra*.

<sup>152</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787.

<sup>153</sup> *Id.*; see text accompanying notes 113-17 *supra*.

<sup>154</sup> See note 141 *supra*.

<sup>155</sup> See Preemption, *supra* note 7, at 41; notes 6 & 10 *supra*. The legislative history underlying enactment of the 1974 amendments to the Commodity Exchange Act shows that Congress supported separation of the regulation and enforcement of commodities and securities laws due to the differences between futures and securities as investment mediums. 119 CONG. REC. 41335 (1973).

<sup>156</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,169, at 24,787.

<sup>157</sup> *Id.* ¶ 21,170, at 24,788; see text accompanying notes 123-28 *supra*.

<sup>158</sup> *Aaron v. SEC*, 446 U.S. 680, 691 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213-14 (1976); *Dixon v. United States*, 381 U.S. 68, 74 (1965).

<sup>159</sup> 2 COMM. FUT. L. REP. (CCH) ¶ 21,170, at 24,788.

<sup>160</sup> *Id.*

for options fraud under CFTC rule 32.9 after *Sterling*. The *Gordon* and *Sterling* decisions should facilitate more effective CFTC enforcement of fraud in the commodity market since section 4b(A) and rule 32.9 no longer require proof of a defendant's intent to defraud. The remedial nature of the CEA also suggests that requiring scienter for commodity options fraud violations might make fraud too difficult for the CFTC to police and thereby defeat the CEA's purposes in protecting investors.<sup>161</sup> In addition, *Gordon* provides a logical method of analysis for future courts to follow when deciding questions of statutory construction concerning antifraud provisions of commodities law. Insofar as the *Sterling* court correctly construed the requirements of rule 32.9 pursuant to the statute which authorized enactment of the rule, *Sterling* also provides instructive precedent for future courts construing the requirements of CFTC regulations. Consideration of the *Gordon* and *Sterling* decisions emphasizes that careful judicial scrutiny of the language and intent underlying commodity antifraud provisions is imperative to better enable the CFTC to regulate fraud and preserve a sound commodities market while protecting investor interests.

## II. THE INTENT ELEMENT AND CIVIL CONTEMPT IN CFTC ACTIONS

Under the Commodity Futures Trading Act of 1974<sup>162</sup> (1974 Act) Congress granted the CFTC broad regulatory control over all aspects of commodities trading.<sup>163</sup> Section 13<sup>164</sup> of the 1974 Act grants the CFTC power to bring civil actions in federal district court to enjoin violations of the Act or to enforce compliance with the Act's provisions.<sup>165</sup> Typically courts will issue injunctions or consent decrees<sup>166</sup> to require compliance with specific provisions of the CEA.<sup>167</sup> When a defendant party to a

<sup>161</sup> See notes 3 & 5 *supra* (remedial nature of CEA).

<sup>162</sup> 7 U.S.C. §§ 1-24 (1976 & Supp. III 1979); see note 5 *supra* (discussing 1974 amendments to CEA).

<sup>163</sup> 7 U.S.C. §§ 2, 4a (1976 & Supp. III 1979); see notes 6-8 *supra* (discussing formation of CFTC); *Role of Commodity Commission*, *supra* note 6, at 711-20; *Preemption*, *supra* note 7, at 30-35.

<sup>164</sup> 7 U.S.C. §§ 13(A)-(C) (1976 & Supp. III 1979).

<sup>165</sup> *Id.*; see Schief, *Enforcement*, in *COMMODITIES AND FUTURES TRADING* 227, 228-29 (Prac. Law Inst. 1976). To enforce compliance with the Commodity Exchange Act, the CFTC may seek injunctions or restraining orders in federal courts proscribing the violative conduct. 7 U.S.C. § 13a(1) (1976 & Supp. III 1979). The CFTC may also assess fines up to \$100,000, *id.* § 13a, and refer criminal violations of the Act to the Justice Department. *Id.*; see note 10 *supra* (general CFTC enforcement powers).

<sup>166</sup> See *Offutt v. United States*, 232 F.2d 69, 72 (D.C. Cir.), *cert. denied*, 351 U.S. 988 (1956). Consent decrees are voluntary agreements by defendants to stop activities that are illegal. *Id.* When the court approves a consent decree, the court extinguishes the plaintiff's action against the defendant for asserted illegal conduct. *Id.* A consent decree requires the consent of both parties to the action. *Id.* The requirements of consent decrees bind only the consenting parties, not the court. *Id.*

<sup>167</sup> See Dobbs, *Contempt of Court: A Survey*, 56 CORNELL L. REV. 183, 185 (1971) [hereinafter cited as Dobbs]. See text accompanying notes 171-84 *infra*.

CFTC enforcement action<sup>168</sup> disobeys a court injunction or judicial decree, a contempt violation results.<sup>169</sup> Recently, one court has sought to integrate the express protections and requirements of the CEA within the framework of traditional notions of contempt.<sup>170</sup>

In *CFTC v. Premex, Inc.*,<sup>171</sup> the Seventh Circuit considered the nature of civil and criminal contempt<sup>172</sup> in relation to commodity fraud violations.<sup>173</sup> The court addressed whether civil contempt of a consent decree ordering compliance with antifraud provisions of the CEA required proof of specific intent to violate the decree.<sup>174</sup> Based upon the language of the decree<sup>175</sup> and the statutory basis underlying issuance of

<sup>168</sup> 7 U.S.C. § 13a(1) (1976 & Supp. III 1979); see notes 10 & 165 *supra* (types of CFTC enforcement powers).

<sup>169</sup> Dobbs, *supra* note 167, at 235-36. The nature of contempt violations, whether civil or criminal, is a topic of much commentary. See Dobbs, *supra* note 167, at 235; Moskowitz, *Contempt of Injunctions, Civil and Criminal*, 43 COLUM. L.J. 780, 783 (1943) [hereinafter cited as Moskowitz]; Note, *The Intent Element in Contempt of Injunctions, Decrees and Court Orders*, 48 MICH. L. REV. 860, 866 (1950) [hereinafter cited as *Intent Element*]; *Civil and Criminal Contempt in the Federal Courts*, 57 YALE L.J. 83, 107 (1948). The distinction between civil and criminal contempt hinges on the purpose for which the court imposes the contempt sentence. Dobbs, *supra* note 167, at 235. If the court's purpose is remedial, designed to compel obedience of a court order or secure relief for the opposing party, the contempt charge is civil. *Id.* If the court's purpose is punitive, however, designed to punish the violator and vindicate the court's authority, the contempt charge is criminal. *Id.* See generally DOBBS, REMEDIES § 2.9, at 103-05 (1973).

<sup>170</sup> See text accompanying notes 161 *supra*, 214 *infra*. Many courts have faced the problem of intergrading the provisions of the Commodity Exchange Act with common methods of judicial relief. For example, courts have struggled with the question of whether the Commodity Exchange Act implies a private right of action for plaintiffs. See, e.g., *Alken v. Lerner*, 485 F. Supp. 871, 879 (D.N.J. 1980) (implied private right of action exists); *Stone v. Saxon & Windsor Group, Ltd.*, [1979-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 21,000, at 23,885 (N.D. Ill. 1980) (no implied private right of action); *Fischer v. Rosenthal & Co.*, 481 F. Supp. 53, 56-57 (N.D. Tex. 1979) (no implied private right of action); *Smith v. Groover*, 468 F. Supp. 105, 107-08 (N.D. Ill. 1979) (implied private right of action exists). See also *Recent Developments in Commodities Law*, 37 WASH. & LEE L. REV. 986, 997 (1980). Translating the CFTC's broad grant of authority in the 1974 Act and the general standards that Congress provided for interpretation of the Act is a difficult job for the courts. See *Preemption*, *supra* note 7, at 35.

<sup>171</sup> 655 F.2d 779 (7th Cir. 1981).

<sup>172</sup> See note 169 *supra*; text accompanying notes 223-28 *infra*.

<sup>173</sup> 655 F.2d at 781.

<sup>174</sup> *Id.* at 782.

<sup>175</sup> *Id.* The relevant portion of the consent decree in *Premex* enjoined the defendants in paragraph A(1) from use of the mails or any instrumentality of interstate commerce to directly or indirectly employ any device to defraud. *Id.* Paragraph A(2) enjoined use of the mails to directly or indirectly make untrue statements or omit statements of material facts in connection with the sale of leverage contracts. *Id.*

Leverage contracts confer upon the purchaser the right, but not the obligation, to buy a specific quantity of gold or silver bullion or coins, at a fixed price on or before a specified date. *CFTC v. Goldex Int'l Ltd.*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,839, at 23,440-41 (N.D. Ill. 1979); see 7 U.S.C. § 15a (1976 & Supp. III 1979) (statutory codification encompassing leverage contracts).

the decree,<sup>176</sup> the Seventh Circuit held that scienter is not a requirement to establish a civil contempt violation.<sup>177</sup>

In *Premex*, the CFTC instituted a civil action against Premex, Inc.<sup>178</sup> (Premex) in January 1978, alleging that the corporation was violating the CEA by means of fraud and promotional misrepresentation.<sup>179</sup> Pursuant to the CFTC's complaint, Premex voluntarily agreed to the entry of a permanent consent decree enjoining the corporation from employing any device or scheme to defraud and making untrue statements of material facts.<sup>180</sup> In February 1980, a CFTC investigator received promotional literature from Premex containing further misrepresentations about the corporation.<sup>181</sup> The CFTC consequently petitioned the district court to show cause why the court should not hold Premex in civil contempt for violation of the earlier consent decree.<sup>182</sup>

Finding clear and convincing evidence that the defendant's statements in the February literature had violated portions of the consent decree, the district court held Premex in civil contempt.<sup>183</sup> The court also required that the defendants pay the CFTC's expenses incurred in enforcing compliance with the decree.<sup>184</sup> Subsequently, the defendants appealed the district court's holding to the Seventh Circuit.<sup>185</sup> Premex argued that proof of scienter<sup>186</sup> was a prerequisite to a violation of the

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<sup>176</sup> See text accompanying notes 194-204 *infra*.

<sup>177</sup> 655 F.2d at 784.

<sup>178</sup> *Id.* at 781. In *Premex*, the defendant, Premex, Inc. (Premex), was a corporation engaged in the offer and sale of precious metals leverage contracts. *Id.*; see note 175 *supra* (leverage contracts). To solicit public customers for investment in the leverage contracts, Premex distributed promotional literature to purchasers and prospective buyers of the contracts. 655 F.2d at 781. Under the provisions of the Commodity Exchange Act, Premex was a commodity trading advisor. 7 U.S.C. § 2 (1976 & Supp. III 1979); see note 22 *supra*; note 181 *infra*.

<sup>179</sup> 655 F.2d at 781.

<sup>180</sup> *Id.*; see note 175 *supra*.

<sup>181</sup> 655 F.2d at 781. In *Premex*, the literature that the CFTC investigator received contained misrepresentations concerning the corporation's registration, financial insurance, and the protective regulatory oversight that the CFTC exercised over the corporation. *Id.* The literature stated that the CFTC had registered Premex as a Commodity Trading Advisor. *Id.* Premex's CFTC registration as an advisor, however, had expired several months prior to the investigator's receipt of the literature. *Id.* Premex had not yet renewed its registration at the time of trial. *Id.* The literature also assured prospective customers that if the corporation encountered financial difficulty, the CFTC would transfer all customer account balances to another company so as not to harm customer funds. *Id.* In fact, Premex was behind in processing the posting of customer accounts which rendered CFTC surveillance difficult. *Id.* at 782. Additionally, neither the CFTC nor any exchange regulated Premex's activities as the literature stated. *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Id.* The district court in *Premex* required the defendants to pay \$3,102.92 in attorney's fees and \$979.71 for other expenses incurred by the CFTC in enforcing compliance with the court's order. *Id.*

<sup>185</sup> *Id.* at 781.

<sup>186</sup> See note 13 *supra*.



consent decree.<sup>187</sup> Since the CFTC did not prove scienter, Premex contended that the district court improperly held the defendants in civil contempt for violation of the decree.<sup>188</sup>

On appeal, the Seventh Circuit rejected the defendant's argument that proof of scienter forms the basis of a civil contempt violation.<sup>189</sup> In evaluating Premex's claim, the court first looked to the consent decree.<sup>190</sup> The court held that the four corners of the consent decree contained the requirements of the document.<sup>191</sup> Since the decree did not contain language specifying willful, intentional, or purposeful conduct,<sup>192</sup> the *Premex* court concluded that no scienter requirement existed within the decree.<sup>193</sup>

Second, the Seventh Circuit relied on the regulatory basis of the decree to determine whether a violation of the decree required scienter.<sup>194</sup> The CFTC alleged that Premex had violated paragraph A(2)<sup>195</sup> of the consent decree, enjoining Premex from fraudulent action in connection with the sale of precious metals leverage contracts.<sup>196</sup> The language of paragraph A(2) contained the same proscriptions as rule 30.03(b),<sup>197</sup> an antifraud regulation promulgated by the CFTC.<sup>198</sup> Examining rule 30.03, the Seventh Circuit noted that the rule contained no

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<sup>187</sup> 655 F.2d at 782.

<sup>188</sup> *Id.* at 781.

<sup>189</sup> *Id.* In *Premex*, the defendants argued that the statutory basis for issuance of the consent decree was § 40 of the Commodity Exchange Act. *Id.* at 782 n.3; see 7 U.S.C. § 60 (1976 & Supp. III 1979) (§ 40 of CEA); note 21 *supra* (same). Section 40 of the Act generally prohibits commodity trading advisors, see note 22 *supra*, or pool operators, see note 23 *supra*, from defrauding any client or prospective client. 7 U.S.C. § 60. Premex asserted that since violations of § 40 require proof of intentional conduct, and because § 40 formed the basis for the consent decree, a violation of the consent decree required proof of scienter. 655 F.2d at 782; see *CFTC v. Savage*, 611 F.2d 270, 286 (9th Cir. 1979) (proof of scienter required for violations of § 40 of CEA); note 194 *infra* (Premex incorrect in citing § 40 of CEA as statutory basis of consent decree).

<sup>190</sup> 655 F.2d at 782; see note 175 *supra*.

<sup>191</sup> 655 F.2d at 782.

<sup>192</sup> *Id.* at 781; see note 185 *supra*. The words "willfully" and "knowingly" evince a scienter requirement. See *Gordon v. Shearson Hayden Stone, Inc.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,977 (CFTC Apr. 10, 1980).

<sup>193</sup> 655 F.2d at 782.

<sup>194</sup> *Id.* at 783. In *Premex*, the court noted that the defendants erred in citing § 40 of the Commodity Exchange Act as the statutory basis underlying issuance of the decree. *Id.* at 782 n.3; see note 189 *supra*. The court pointed out that the CFTC had charged the defendants with a violation of rule 30.03(b), regulating fraud in connection with transactions in precious metals. 655 F.2d at 782 n.3; see 17 C.F.R. § 31.03(b) (1981) (CFTC rule 30.03 now designated as 31.03); 655 F.2d at 783 n.5 (text of CFTC rule 31.03). CFTC rule 30.03(b) then, and not § 40 of the CEA, formed the basis of the consent decree. 655 F.2d at 783.

<sup>195</sup> 655 F.2d at 781; see note 181 *supra* (text of paragraph A(2) of consent decree).

<sup>196</sup> 655 F.2d at 782; see note 175 *supra* (leverage contracts).

<sup>197</sup> 17 C.F.R. § 31.03(b) (1981); see note 194 *supra*.

<sup>198</sup> 655 F.2d at 783 n.3. Compare *id.* at 781 (paragraph A(2) of consent decree) with 17 C.F.R. § 31.03(b) (1981) (language of CFTC rule 30.03(b)).

language evincing a scienter requirement.<sup>199</sup> The court distinguished language of rule 30.03 from certain antifraud provisions of the CEA which contain language concerning willful behavior requiring proof of scienter.<sup>200</sup> The court noted that the CFTC, in adopting rule 30.03, specifically stated that proof of scienter is not necessary to establish violations of the rule.<sup>201</sup> Additionally, the Seventh Circuit recognized that a scienter requirement would run contrary to the CFTC mandate encouraging broad interpretation of rules to effectuate the remedial purposes of the CEA.<sup>202</sup> The court concluded that since rule 30.03, as the regulatory basis of the decree, did not require proof of scienter,<sup>203</sup> violations of the consent decree did not require proof of scienter.<sup>204</sup>

The Seventh Circuit also examined relevant securities law precedent to determine whether a civil contempt violation required proof of scienter.<sup>205</sup> Premex argued that under *Ernst & Ernst v. Hochfelder*<sup>206</sup> and *Aaron v. SEC*<sup>207</sup> liability for civil violations of consent decrees may only attach upon proof of scienter.<sup>208</sup> The Seventh Circuit rejected Premex's argument on the grounds that *Hochfelder* and all similar actions under section 10(b)<sup>209</sup> of 1934 Act<sup>210</sup> are private actions for damages.<sup>211</sup> Since the plaintiff, CFTC, is a federal agency charged with enforcement of commodities law,<sup>212</sup> the Seventh Circuit viewed the *Premex* action as a public enforcement action.<sup>213</sup> The Seventh Circuit noted that public enforcement actions, unlike private actions such as *Hochfelder*, do not require proof of scienter.<sup>214</sup>

The court also reasoned that even if the language in paragraph A(1)<sup>215</sup> of the consent decree was similar to the language of rule 10b-5 requiring proof of scienter,<sup>216</sup> Premex allegedly had violated paragraph

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<sup>199</sup> 655 F.2d at 783.

<sup>200</sup> *Id.*; see 7 U.S.C. §§ 6b(B)-(D), 6o (1976 & Supp. III 1979) (provisions of CEA requiring scienter).

<sup>201</sup> 655 F.2d at 783 n.5.

<sup>202</sup> *Id.* at 783; see 7 U.S.C. § 12a (1976 & Supp. III 1979) (statement of CFTC mandate for rule interpretation); notes 3 & 5 *supra* (remedial purposes of CEA).

<sup>203</sup> 655 F.2d at 783.

<sup>204</sup> *Id.*

<sup>205</sup> *Id.*

<sup>206</sup> 425 U.S. 185 (1976); see note 68 *supra*.

<sup>207</sup> 446 U.S. 680 (1980); see note 113 *supra* (discussion of *Aaron v. SEC*).

<sup>208</sup> 655 F.2d 783.

<sup>209</sup> 15 U.S.C. § 78j(b) (1976); see notes 65-67 *supra*.

<sup>210</sup> 15 U.S.C. §§ 78a-78kk (1976); see notes 6-12 *supra* (relation between commodities and securities acts).

<sup>211</sup> 655 F.2d at 783.

<sup>212</sup> 7 U.S.C. §§ 2, 4a (1976 & Supp. III 1979); see notes 6-8 *supra*.

<sup>213</sup> 655 F.2d at 783.

<sup>214</sup> *Id.*; see *Aaron v. SEC*, 446 U.S. 680, 691 (1980) (Blackmun, J., concurring) (no scienter required for public enforcement actions); note 113 *supra*.

<sup>215</sup> 655 F.2d at 781; see note 175 *supra* (paragraph A(1) of consent decree).

<sup>216</sup> 15 U.S.C. § 78j(b) (1976).

A(2) of the decree.<sup>217</sup> The language of paragraph A(2) prohibiting false or omitted statements of material fact was identical to the language of sections 17(a)(2) and (3)<sup>218</sup> of the 1933 Act.<sup>219</sup> The Supreme Court in *Aaron* held that under sections 17(a)(2) and 17(a)(3) scienter is not a necessary element of proof to enjoin violations of the provisions.<sup>220</sup> The Seventh Circuit concluded, therefore, that even under the securities law, the language of paragraph A(2) did not require proof of scienter to constitute a violation of the decree.<sup>221</sup>

Concluding that the district court properly held Premex in contempt,<sup>222</sup> the Seventh Circuit last considered whether the contempt was civil or criminal in nature.<sup>223</sup> Premex asserted that the alleged violation was one of criminal contempt that requires proof of intentional action to violate.<sup>224</sup> Stressing that the nature of the relief requested determines whether an action is one for civil or criminal contempt, the Seventh Circuit rejected the defendant's claim.<sup>225</sup> The court pointed out that while a criminal contempt action vindicates court authority, a civil contempt action is remedial in nature and designed to enforce an order or compensate for losses.<sup>226</sup> Since the CFTC requested and received compensatory relief,<sup>227</sup> the court concluded that the nature of the relief was not punitive and that the contempt action was a civil violation.<sup>228</sup>

The *Premex* decision is one of first impression combining the express statutory protections of the CEA with contempt as a method of judicial redress. The power of the court in sustaining a civil contempt charge for violations of injunctions or consent decrees is to secure the benefits of the decree for aggrieved parties.<sup>229</sup> The Supreme Court has stated that because the purpose of a civil contempt citation is remedial, the intent of the defendant in violating the decree is unimportant.<sup>230</sup> A majority of federal and state courts have held that civil contempt actions do not require proof of intent.<sup>231</sup> The Seventh Circuit's decision in

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<sup>217</sup> 655 F.2d at 784.

<sup>218</sup> 15 U.S.C. §§ 77q(a)(2), 77q(a)(3) (1976) (§§ 17a(2) and (3) of 1933 Act).

<sup>219</sup> 15 U.S.C. §§ 77a-77aa (1976).

<sup>220</sup> 446 U.S. at 695.

<sup>221</sup> 665 F.2d at 784.

<sup>222</sup> *Id.* at 781, 784.

<sup>223</sup> *Id.* at 784.

<sup>224</sup> *Id.*

<sup>225</sup> *Id.*; see note 169 *supra*.

<sup>226</sup> 655 F.2d at 785; see note 169 *supra*.

<sup>227</sup> 655 F.2d at 785.

<sup>228</sup> *Id.*

<sup>229</sup> See Dobbs, *supra* note 167, at 235; *Intent Element*, *supra* note 169, at 861.

<sup>230</sup> *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 191 (1949).

<sup>231</sup> See *NLRB v. Fairview Hosp.*, 473 F.2d 1217, 1219 (7th Cir. 1972) (no intent required for civil contempt); *NLRB v. San Francisco Typographical, Local 21*, 465 F.2d 53, 62 (9th Cir. 1972) (same); *Hodgson v. A-Ambulance Serv., Inc.*, 455 F.2d 372, 380 (8th Cir. 1972) (same); *NLRB v. Crown Laundry & Dry Cleaners, Inc.*, 437 F.2d 290, 295 (5th Cir. 1971) (same); *NLRB v. Mastro Plastic Corp.*, 261 F.2d 147, 153 (2d Cir. 1958) (same).

*Premex* is consistent with the majority approach to the requirements of civil contempt.<sup>232</sup>

The court's holding that *Premex*'s civil contempt violation did not require proof of scienter is sound in light of the remedial purposes of both the CEA and the consent decree.<sup>233</sup> The language and structure of the CEA indicates that Congress intended to establish a broad remedial program to insure fair trade in commodities.<sup>234</sup> Since rule 30.03 was the basis for the language of the consent decree,<sup>235</sup> the Seventh Circuit correctly characterized the violation of the decree as civil contempt, recognizing that the proscriptions of the rule are remedial and not criminal.<sup>236</sup>

The Seventh Circuit's assessment of whether rule 30.03 requires scienter corresponds with the CFTC's approach to scienter in construing similar antifraud provisions.<sup>237</sup> In finding that no scienter requirement existed in rule 30.03, the court properly considered the absence of willful language in the rule and the legislative history underlying the rule's enactment.<sup>238</sup> The court also critically distinguished securities law in accordance with CFTC and congressional policy, encouraging careful application of securities law to commodity problems.<sup>239</sup>

The *Premex* court, however, overlooked a fundamental issue in determining the scienter requirements for civil violations of a consent decree. The question of whether civil contempt of a consent decree requires intentional conduct does not depend on the requirements of the underlying charge.<sup>240</sup> Rather, the intent necessary to prove contempt violations depends solely on the nature of the contempt involved.<sup>241</sup>

The violator's intent in the act of contempt distinguishes civil from criminal contempt.<sup>242</sup> In civil contempt cases, the requirement of intentional conduct is unnecessary.<sup>243</sup> Since the purpose of civil contempt cases is remedial, the contemnor's state of mind in violating the court order is not important.<sup>244</sup> In criminal contempt cases, the contemnor's

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<sup>232</sup> See note 231 *supra*.

<sup>233</sup> See Dobbs, *supra* note 167, at 235 (civil contempt violations based on remedial design of relief).

<sup>234</sup> See notes 3-8 *supra* (discussing structure and purpose of CEA); Rainbolt, *supra* note 3, at 18-20.

<sup>235</sup> 655 F.2d at 783.

<sup>236</sup> *Id.*

<sup>237</sup> 655 F.2d at 782-86; see *Gordon v. Shearson Hayden Stone, Inc.*, 2 COMM. FUT. L. REP. (CCH) ¶ 21,016, at 23,976 (CFTC Apr. 10, 1980); text accompanying notes 49-87, 139-48 (discussion of Gordon's method of statutory analysis to determine scienter requirement).

<sup>238</sup> 655 F.2d at 783.

<sup>239</sup> See notes 140-41, 155 *supra*.

<sup>240</sup> Dobbs, *supra* note 167, at 236. Classification of contempt proceedings, whether criminal or civil, is determined by the sentence and nature of the proceedings and not the act of contempt. *Id.*; see note 169 *supra*.

<sup>241</sup> Dobbs, *supra* note 167, at 236.

<sup>242</sup> See *id.* at 262; Moskovitz, *supra* note 169, at 793.

<sup>243</sup> Dobbs, *supra* note 167, at 263.

<sup>244</sup> *Id.*; see *Intent Element*, *supra* note 169, at 861-63.

state of mind is important.<sup>245</sup> The sanctions for criminal contempt punish the contemnor directly, so proof of scienter or lack thereof in committing the contempt is a component of criminal contempt actions.<sup>246</sup> Once the Seventh Circuit determined that the Premex's violation was civil and not criminal contempt, therefore, the court could have held that scienter was unnecessary to sustain the civil contempt charge. In this way, the *Premex* court could have avoided lengthy examination of the scienter requirements of rule 30.03 since scienter is not an element of civil contempt.

The sanctions of the CEA are nonpunitive.<sup>247</sup> Thus, consent decrees stemming from provisions of the CEA will require remedial redress.<sup>248</sup> Contempt of a decree based upon CEA provisions or CFTC rules will be civil contempt, and therefore, will not require scienter. The Seventh Circuit's decision in *Premex* illustrates a reasoned approach to incorporation of the remedial purposes of the Commodities Exchange Act with notions of civil contempt.

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<sup>245</sup> Dobbs, *supra* note 167, at 262-63.

<sup>246</sup> *Id.*

<sup>247</sup> See notes 7-8, 165 *supra* (sanctions of CEA). Section 13a provides that the CFTC may refer criminal violations of the Commodity Exchange Act to the Justice Department for resolution. 7 U.S.C. § 13a (1976 & Supp. III 1979).

<sup>248</sup> See 7 U.S.C. § 13a (1976 & Supp. III 1979).