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DISCRETIONARY COMMODITY ACCOUNTS: WHY THEY ARE NOT GOVERNED BY THE FEDERAL SECURITIES LAWS

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In the spring of 1974, Monte Mordaunt and his mother were solicited to invest approximately \$47,000 in accounts¹ to be traded in commodity futures contracts² by Incomco, a futures commission merchant (FCM).³ The

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1. *See* Mordaunt v. Incomco, No. 3-75-68 (D. Idaho Sept. 8, 1978) *rev'd* 686 F.2d 815 (9th Cir. 1982), *cert. denied*, ___U.S.___, 105 S. Ct. 801 (1985) (discretionary accounts in commodity futures are not investment contracts subject to federal securities laws).

2. A commodity futures contract is a standardized agreement to buy or sell a fixed quantity of a commodity. The Commodity Exchange Act ("CEA" or "Act"), 7 U.S.C. §§ 1-26, defines "commodity" as including "all services, rights and interests in which contracts for future delivery are presently or in the future dealt." 7 U.S.C. § 2 (1982). Thus, any financial instrument or other interest can be a "commodity."

If a futures contract based on that instrument is traded on an exchange designated by the Commodity Futures Trading Commission, the contract is subject to the Act's regulatory scheme. Commodity futures contracts may lawfully be traded only through the facilities of a board of trade, *i.e.*, commodity exchange, which has been designated by the CFTC as a "contract market" for the particular commodity. *See* 7 U.S.C. §§ 6(a), 6h, and 7 (1982). The price of the commodity deliverable under a futures contract is set by open and competitive bidding in a designated trading area (often called a "pit" or "ring") on the floor of the contract market. Whenever a bid and offer made in the pit correspond, a contract is formed. *See generally* *Leist v. Simplot*, 638 F.2d 283, 287 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982); *United States v. Dial*, 757 F.2d 163, 164-65 (7th Cir. 1985) (both discussing the mechanics of futures trading).

3. Futures commission merchants (FCMs) (commodity brokers) must register with the Commission and are subject to record keeping, minimum financial and other customer protection requirements. *See, e.g.*, 7 U.S.C. §§ 2, 6d(1), 6f(2), and 6g (1982); 17 C.F.R. §§ 1.10, 1.17-1.39 and 1.55 (1985).

trading arrangement the Mordaunts established with Incomco is commonly called a "discretionary" or "managed" account, under which the customer gives his FCM sole authority to make all trading decisions.⁴

Since futures trading is risky and requires knowledge of complex and technical factors,⁵ many small public investors in this rapidly growing industry⁶ elect to rely on such a discretionary trading arrangement. For example, a recent sample survey of the growing number of "public" (individual, non-commercial) participants in futures markets found that from 35 to 40 percent of these customers in the stock index,⁷ treasury bond, and corn futures markets trade through discretionary accounts.⁸

In 1974, Congress responded to the need for better regulation of this growing industry by expanding the coverage of the Commodity Exchange Act (CEA or Act) to cover futures contracts traded in any "services, rights and interests".⁹ At the same time, Congress created the Commodity Futures Trading Commission (Commission or CFTC) as an independent federal

4. See *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274, 275 (7th Cir.), cert. denied, 409 U.S. 887 (1972) (broker's discretion used to trade account for customer's benefit and profit); In the Matter of Robert Halmier [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,160, at 20,977 n.6 (CFTC 1976) (broker authorized to execute orders without prior consent of customer for each order); cf. *Bowley v. Stotler & Co.*, 751 F.2d 641, 645 (3d Cir. 1985) (whether broker has *de facto* control over account does not depend on whether account is labeled discretionary). See generally Note, *Discretionary Commodity Account as "Securities": Applying the Howey Investment Contract Test to a New Investment Medium*, 67 GEO. L. J. 269, 269-71 (1978) [hereinafter cited as *New Investment Medium*]; Note, *Federal Regulation of Discretionary Commodity Accounts*, 32 HASTINGS L.J. 871, 872 n.7 (1981); Note, *Discretionary Commodity Accounts: Are they Securities and Does it Really Matter?*, 38 WASH. & LEE L. REV. 843, 843-44 (1981).

5. See, e.g., 17 C.F.R. § 1.55. See also 43 Fed. Reg. 31888 (July 24, 1978) (risks inherent in futures trading); 50 Fed. Reg. 5382 n.14 and cases cited therein (Feb. 8, 1985) (risks and mechanics of futures trading must be explained).

6. In 1974, when the Mordaunts opened their discretionary accounts, 27.7 million futures contracts were traded. Futures Industry Association, *Volume of Futures Trading 1958-1983*. By 1984, volume had grown to over 149 million futures contracts. Futures Industry Association, *Futures Contracts Traded*, December, 1984. The 1984 level was approximately 40 times greater than that of 1958 (3.8 million). Futures Industry Association, *Volume of Futures Trading 1958-1983*. The general public has become increasingly active in futures trading as the volume of futures contracts traded has surged. S. REP. No. 384, 97th Cong., 2d Sess. 19 (1982).

7. Contracts of sale for future delivery of broad-based stock indices are commonly known as "stock index futures." In 1982, the CFTC and Securities and Exchange Commission (SEC) reached a jurisdictional agreement whereby the CFTC would be the sole regulator of stock index futures and options on stock index futures while the SEC would be the sole regulator of options on securities and securities indices. See *SEC and CFTC Jurisdictional Agreement: Proposed Legislation*, [1981-1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,096 (Joint Explanatory Statement) (Feb. 2, 1982). This agreement was in effect ratified by Congress in 1982 when it enacted 7 U.S.C. § 2a (1982). See *Mallen v. Merrill Lynch, Pierce, Fenner & Smith*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,601 (N.D. Ga. March 28, 1985) (discussing jurisdictional agreement over stock index futures).

8. See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, COMMODITY FUTURES TRADING COMMISSION AND SECURITIES AND EXCHANGE COMMISSION, *A STUDY OF THE EFFECTS ON THE ECONOMY OF TRADING IN FUTURES AND OPTIONS* at V 7-16 (December 1984).

9. Commodity Futures Trading Commission Act of 1974, § 201, 7 U.S.C. § 2 (1976). In

regulatory agency to administer the Act, including a reparations program for resolving customers' claims against their commodity brokers.¹⁰ Under what is now Section 2(a)(1)(A) of the Act, Congress gave the newly established Commission "exclusive jurisdiction" over "accounts, agreements . . . and transactions involving" commodity futures.¹¹

Notwithstanding this apparently preemptive provision, a number of dissatisfied commodity customers have brought suit under state and federal securities laws.¹² The *Mordaunt* case is illustrative.¹³ In May 1975, the Mordaunts cancelled their discretionary trading account agreements with Incomco after they had incurred losses amounting to \$27,385.03 and had paid Incomco commissions totalling \$20,190.00.¹⁴ In October 1975, the Mordaunts sued Incomco for fraud under Securities and Exchange Commission (SEC) Rule 10b-5¹⁵ and provisions of the Idaho Securities Act,¹⁶ alleging that, because their profits depended on the skill and efforts of Incomco in predicting the market, their accounts were investment contracts.¹⁷ The Mordaunts characterized their accounts as "investment contracts" because investment contracts are "securities" and therefore are subject to federal and state securities laws.¹⁸ Without addressing the implications of Section 2(a)(1)(A) of the CEA, the district court accepted the Mordaunts' contentions and awarded damages based on its finding that Incomco's investment solicitation was false and misleading in violation of SEC Rule 10b-5.¹⁹

The Court of Appeals reversed.²⁰ It reasoned that a common enterprise must be present for an investment contract to exist and that the prosperity of the third party must hinge on the success or failure of the investor in

addition to futures contracts traded in any "services, rights and interests," the Act also applies to option transactions involving commodities subject to regulation under the Act, except for options on foreign currencies which are traded on national securities exchanges. 7 U.S.C. § 2 and 6c(b)-(f) (1982). Futures trading, which previously was restricted to a handful of agricultural markets, expanded rapidly in response to the Act's development of new futures and options markets for precious metals, foreign currencies, and U.S. government securities. Commodity Futures Trading Commission Annual Report 1984 at 15. In addition, in 1982 Congress permitted Commission-designated exchanges to trade options on futures contracts. 7 U.S.C. § 6c(c) (1982).

10. 7 U.S.C. § 18 (1982). *See, e.g.*, *Myron v. Hauser*, 673 F.2d 994, 1001 (8th Cir. 1982) (describing reparations procedure); 17 C.F.R. Part 12 (1984) (rules relating to reparations proceedings).

11. 7 U.S.C. § 2 (1982).

12. *See, e.g.*, notes 94-95 and text accompanying notes 107-143.

13. *Mordaunt v. Incomco*, No. 3-75-68 (D. Idaho Sept. 1978) *rev'd* 686 F.2d 815 (9th Cir. 1982), *cert. denied*, ___U.S.____, 105 S. Ct. 801 (1985).

14. No. 3-75-68, slip op. at 4, 686 F.2d at 817.

15. 17 C.F.R. § 240.10b-5 (1985) (prohibits fraud in connection with purchase or sale of securities).

16. IDAHO CODE §§ 30-1402, -30-1462 (1980) (governs regulation of securities, including prohibition against fraud).

17. 686 F.2d at 816.

18. The term "security" is defined in Section 2(1) of the 1933 Securities Act, and Section 3(a)(10) of the 1934 Securities Exchange Act to include, *inter alia*, any investment contract. 15 U.S.C. § 77b(1) (1982); 15 U.S.C. § 78c(10) (1982). *See Tcherepnin v. Knight*, 389 U.S. 332, 335-36 and 338 (1967).

19. *Id.* at 4.

20. 686 F.2d 815 (9th Cir. 1982), *cert. denied*, ___U.S.____, 105 S. Ct. 801 (1985).

order to have a common enterprise.²¹ Since Incomco's prosperity did not hinge on the success or failure of the Mordaunts' investments, the Court of Appeals found that the accounts were not "investment contracts" subject to the federal securities laws.²² The Court of Appeals did not consider, however, whether Section 2(a)(1) of the CEA requires that causes of action for damages arising from discretionary accounts be brought under the federal commodities laws rather than securities laws.²³ Recently, the Supreme Court denied the Mordaunts' petition for a writ of certiorari.²⁴ Three Justices dissented, however, and suggested in their dissenting opinion, without any reference to Section 2(a)(1)(A), that discretionary commodity futures accounts may qualify as securities under certain circumstances.²⁵

This article examines whether federal securities laws may ever apply to discretionary commodity futures accounts, in light of Section 2(a)(1)(A).²⁶ The analysis begins with a look at the case law in 1974, when Congress

21. 686 F.2d at 817. See also *infra* text accompanying notes 33-36.

22. *Id.*

23. 686 F.2d at 817. In *Mordaunt v. Incomco*, Incomco contended, apparently based on the exclusive jurisdiction provision in Section 2(a)(1) of the CEA, as amended in 1974, that the CEA precluded a private right of action under the federal securities laws. *Id.* at 816. The Court of Appeals rejected this contention based on *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 382-87 (1982). *Id.* In *Curran*, the Supreme Court held that the 1974 amendments to the CEA did not extinguish an implied private cause of action for persons injured by violations of the Act. 456 U.S. at 382-87.

24. ___ U.S. ___, 105 S.Ct. 801 (1985).

25. ___ U.S. ___, 105 S.Ct. at 801-03. The dissenting opinion in the denial of the petition for certiorari in *Mordaunt* assumed that "[t]he SEC has in the past taken the position that discretionary commodities futures contracts are securities." *Id.* at 802. Following the denial of the petition for certiorari, the Solicitor General on behalf of the SEC submitted a letter to the Clerk of the Supreme Court which suggested that the dissenting Justices delete the reference to the SEC's position on discretionary accounts. Letter from Rex E. Lee, Solicitor General, United States Department of Justice, to Honorable Alexander L. Stevens, Clerk, Supreme Court of United States at 2 (January 25, 1985) (on file with the Washington and Lee Law Review) [hereinafter cited as Letter from Rex E. Lee]. The Solicitor General said "it has not been the [SEC's] position that an ordinary discretionary account, where the broker tailors the trading to the individual customer and is compensated only by sales commissions, is a security." *Id.* at 1. The dissenting Justices in *Mordaunt* had cited *SEC v. Continental Commodities Corp.* and *In re Carlson* in support of their statement concerning the SEC's position. 105 S. Ct. at 801-03; *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974); *In re Carlson*, 13 SEC DOCKET 1104 (Dec. 12, 1977). The Solicitor General said that these two cases concerned naked options, not discretionary accounts. Letter from Rex E. Lee at 1. The Solicitor General suggested that the federal securities laws applied in those cases because the customers "were dependent on the brokerage firms' managerial efforts to produce the revenues needed to honor the firms' obligations to customers under the option contracts." *Id.* at 2. The authors have been advised that Justice White has since modified his dissenting opinion to read: "The SEC in the past seems to have taken the position that discretionary commodities futures contracts are securities." (Emphasis added). Letter from Henry C. Lind, Supreme Court Reporter of Decisions, to Maureen A. Donley-Hoopers (Sept. 19, 1985) (on file with the Washington and Lee Law Review).

26. See *infra* text accompanying notes 30-150.

enacted Section 2(a)(1).²⁷ The article discusses the legislative history of this provision, with emphasis on the clauses that give the CFTC "exclusive jurisdiction" and that preserve causes of action.²⁸ The article then examines the judicial response to this provision and concludes that the application of federal securities laws to discretionary commodities accounts should occur less frequently as courts become more aware of the Act and its legislative history.²⁹

I. THE LEGISLATIVE HISTORY OF SECTION 2(a)(1)(A) WITH RESPECT TO DISCRETIONARY ACCOUNTS

A. Case law before enactment of Section 2(a)(1)(A)

Before the Commodity Futures Trading Commission Act of 1974,³⁰ there was substantial judicial disagreement over whether a discretionary commodities account was an investment contract and therefore a security³¹ subject to the federal securities laws.³² Courts consistently assumed that they should apply the now classic standard formulated by the Supreme Court in *SEC v. W. J. Howey Co.*³³ for determining whether an offering is an investment contract. In *Howey*, the court stated, "[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a

27. See *infra* text accompanying notes 30-44.

28. See *infra* text accompanying notes 45-91.

29. See *infra* text accompanying notes 92-150.

30. Pub. L. 93-463, 88 Stat. 1389-1416 (1974).

31. See *supra* note 18.

32. Courts were in general agreement prior to the enactment of the CFTC Act of 1974 that a particular commodity futures contract was not an investment contract. See *Continental Commodities Corp.*, 497 F.2d at 520 n.9 (particular commodity futures contract is not a security); *Berman v. Dean Witter & Co., Inc.*, 353 F. Supp. 669, 671 (C.D.Cal. 1973) (same); *Schwartz v. Bache & Co. Inc.*, 340 F. Supp. 995, 998-99 (S.D.Iowa 1972) (same); *Berman v. Orimex Trading, Inc.*, 291 F. Supp. 701, 702 (S.D.N.Y. 1968) (same); *Sinva, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359, 360-67 (S.D.N.Y. 1966) (same). See also *Golding v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 385 F. Supp. 1182, 1183 (S.D.N.Y. 1974) (same); *Glazer v. National Commodity Research & Statistical Services, Inc.*, 388 F. Supp. 1341, 1344 (N.D. Ill. 1974), *aff'd*, 547 F.2d 392 (7th Cir. 1977) (same); *Stuckey v. duPont Glore Forgan Inc.*, 59 F.R.D. 129, 131-32 (N.D. Cal. 1973) (same); *Commercial Iron & Metal Co. v. Bache & Co., Inc.*, 478 F.2d 39, 42 (10th Cir. 1973) (same); *Mallen v. Merrill Lynch, Pierce, Fenner & Smith*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,601 at 30,573 (N.D. Ga. March 28, 1985) (individual contract for delivery of a commodity has never been considered a security).

33. 328 U.S. 293 (1946). *SEC v. W.J. Howey Co.* involved the sale of individual units of orange trees that were conveyed by deed to the purchaser, in conjunction with a service contract under which the seller (or a company other than the company controlled by the seller) cultivated, harvested and marketed the orange crop, and remitted the profits to the investor. *Id.* at 295-96. Although oranges, trees, and land are not ordinarily "securities," the Court held that the offering involved a "security" within the meaning of the Securities Act of 1933 because it was an "investment contract." *Id.* at 300.

person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . . ."³⁴ This test subsumes within it three elements: first, the existence of an investment of money; second, that the scheme functions as a common enterprise; and third, that profits of the enterprise are derived solely from the efforts of others.³⁵ The crucial and most controversial factor in pre-1974 cases concerning the application of federal securities laws to discretionary commodities accounts was whether the second element of the *Howey* test—a “common enterprise”—existed.³⁶

One line of pre-1974 cases, following the reasoning in *Milnarik v. M-S Commodities, Inc.*,³⁷ held that a discretionary commodities account is not a security.³⁸ In *Milnarik*, the Court said that *Howey's* “common enterprise” factor required a pooling of interests or a pro rata sharing of profits (otherwise known as “horizontal commonality”), and that discretionary commodities accounts do not possess such commonality and therefore are not investment contracts.³⁹ Consequently, the court found that the account was not subject to the registration requirements of Section 5 of the Securities Act of 1933.⁴⁰

Other courts prior to 1974 found that discretionary commodities accounts were investment contracts based on the “vertical commonality” test set forth in *SEC v. Glenn W. Turner Enterprises*.⁴¹ In that case, the Ninth Circuit held that the “common enterprise” element of the *Howey* test was satisfied

34. *Id.* at 298-99.

35. *See* Continental Commodities Corp., 497 F.2d at 521; *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 477 (5th Cir. 1974) (both discussing *Howey* investment contract test).

36. *See* *Mallen v. Merrill Lynch, Pierce, Fenner & Smith*, 2 COMM. FUT. L. REP. at 30,573 (N.D. Ga. March 28, 1985); LOSS, FUNDAMENTALS OF SECURITIES REGULATION 255 (1983) (cases are in disarray over kind of “common enterprise” required); Note, *Securities Regulation-Investment Contracts and the Common Enterprise Requirement*, 43 MO. L. REV. 779, 781 (1978) (split among courts primarily resulted from disagreement over meaning of “common enterprise”); *see also* 58 A.L.R. FED. 616, 627-41 (1982) (summarizing cases which have applied *Howey* test to discretionary accounts).

37. 457 F.2d 274, 276-79 (7th Cir. 1972).

38. *See* *Wasnowic v. Chicago Board of Trade*, 352 F. Supp. 1066, 1069 (M.D. Pa. 1972) (discretionary commodities trading account is not a security), *aff'd mem.*, 491 F.2d 752 (3d Cir. 1973), *cert. denied*, 416 U.S. 994 (1974); *Stuckey v. duPont Glore Forgan Inc.*, 59 F.R.D. 129, 131 (N.D. Cal. 1973) (same); *Arnold v. Bache & Co. Inc.*, 377 F. Supp. 61, 64-65 (M.D. Pa. 1973) (same); *see also* *Stevens v. Woodstock, Inc.*, 372 F. Supp. 654, 657 (N.D. Ill. 1974) (same); *Glazer v. Nat'l Commodity Research & Statistical Services, Inc.*, 388 F. Supp. 1341, 1344 (N.D. Ill. 1974), *aff'd*, 547 F.2d 372 (7th Cir. 1977) (same).

39. 457 F.2d at 276-79.

40. *Id.* at 275; *see* 15 U.S.C. § 77e (1982) (registration requirements of Section 5 of Securities Act of 1933).

41. 474 F.2d 476, 482 n.7 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). *See* *Marshall v. Lamson Bros. & Co.*, 368 F. Supp. 486, 488-90 (S.D. Iowa 1974) (discretionary commodities

by vertical commonality—a one-to-one relationship “in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties.”⁴² Under this approach, dominance of the enterprise by the investment manager provided sufficient commonality without requiring a pro rata distribution of profits.⁴³

It was in this atmosphere of conflicting case law regarding the application of federal securities laws to discretionary commodities accounts that Congress enacted the Commodity Futures Trading Commission Act of 1974 (“CFTC Act of 1974”).⁴⁴

B. *The legislative history of Section 2(a)(1)(A)*

In contrast to the approaches in which some courts fit commodities trading within the Securities Act, Congress attacked abuses in commodities trading by amending the CEA through the enactment of the Commodity Futures Trading Commission Act of 1974.⁴⁵ Before the CFTC Act of 1974, the Commodity Exchange Act was administered by the Commodity Exchange

trading account is a security); *Johnson v. Arthur Espey, Shearson, Hammill & Co.*, 341 F. Supp. 764, 765 (S.D.N.Y. 1972) (same); *Berman v. Orimex Trading, Inc.*, 291 F. Supp. at 702 (same); *Anderson v. Francis I. duPont & Co.*, 291 F. Supp. 705, 709 (D. Minn. 1968) (same); *Maheu v. Reynolds & Co.*, 282 F. Supp. 423, 426 (S.D.N.Y. 1967) (same). *See also* *Koscot Interplanetary, Inc.*, 497 F.2d at 478 (pyramid selling scheme is a security); *Commerical Iron & Metal Co., Inc.*, 478 F.2d at 42 (dictum) (discretionary account can be a security even though contracts in the account are not securities); *Booth v. Peavey Co. Commodity Services*, 430 F.2d 132, 133 (8th Cir. 1970) (allowing churning claim under federal securities laws where broker controlled account).

42. 474 F.2d at 482 n.7.

43. *See* *Glenn W. Turner Enterprises, Inc.*, 474 F.2d at 482 (commonality depends on efforts and success of those seeking investment); *Lamson Bros. & Co.*, 368 F. Supp. at 489 (pooling among investors is helpful but not essential to commonality); *Maheu*, 282 F. Supp. at 429 (discretionary joint account may be investment contract even if funds are not pooled).

44. The confusion over discretionary accounts has not been limited to commodities accounts. Similar confusion exists as to whether a discretionary account for the trading of securities is an “investment contract” and therefore itself a security. *See* *Savino v. E.F. Hutton & Co., Inc.*, 507 F. Supp. 1225, 1235-39 (S.D.N.Y. 1981); *Jenny v. Shearson, Hammill & Co., Inc.*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,911, at 90,633 (S.D.N.Y. March 20, 1981); *Troyer v. Karcagi*, 476 F. Supp. 1142, 1147 (S.D.N.Y. 1979); *Alvord v. Shearson Hayden Stone, Inc.*, 485 F. Supp. 848, 852-53 (D. Conn. 1980) (all holding that discretionary stock and stock option accounts are securities); *see also* *Sennett v. Oppenheimer & Co.*, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,834, at 90,155-90,156 (N.D.Ill. Oct. 15, 1980); *Darrell v. Goodson*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,349, at 97,325 (S.D.N.Y. April 10, 1980); *Holtzman v. Proctor, Cook & Co., Inc.*, 528 F. Supp. 9, 15-16 (D.Mass. 1981) (all holding that discretionary stock accounts are not securities). *Cf.* *Morduant*, 105 S.Ct. at 802 (White, J., dissenting) (conflict is not limited to discretionary commodities futures contracts).

45. *Mallen v. Merrill Lynch, Pierce, Fenner & Smith*, 2 COMM. FUT. L. REP. (CCH), ¶ 22,601 at 30,573 (N.D. Ga. March 28, 1985).

Authority, a part of the Department of Agriculture, and applied only to transactions in certain agricultural commodities.⁴⁶ In substantially amending the CEA in 1974, Congress expanded the definition of "commodity" to include "all services, rights, and interests in which contracts for future delivery are presently or in the future dealt,"⁴⁷ thereby subjecting all futures contracts to the CEA. Congress also created an independent federal regulatory agency, the CFTC, to administer and enforce the Act's provisions.⁴⁸

In addition to creating the CFTC and making the CEA applicable to all futures transactions, Congress attempted to correct perceived deficiencies in the old regulatory scheme, including confusing, inconsistent, and duplicative application of state laws and federal securities laws to commodity matters.⁴⁹ Congress addressed these deficiencies by enacting "the first complete overhaul of the Commodity Exchange Act since its inception," to provide a new and "comprehensive regulatory structure."⁵⁰ Congress made clear that the

46. 7 U.S.C. § 1 *et seq.* (1970).

47. 7 U.S.C. § 2 (1976). As the court in *Mallen* recently stated, the 1974 amendments to the CEA "expanded the concept of a commodity beyond the edible to the intangible." 2 COMM. FUT. L. REP. at 30,573.

48. 7 U.S.C. §4a (1976). Congress intended that the CFTC be "comparable in stature and responsibility to the Securities and Exchange Commission." 120 CONG. REC. 34,996 (1974) (statement of Senate Agriculture and Forestry Committee Chairman Herman E. Talmadge).

49. See, e.g., H.R. REP. NO. 975, 93d Cong., 2d Sess. 36-49 (1974); S. REP. NO. 1131, 93d Cong., 2d Sess. 18-19 (1974); H.R. REP. NO. 963, 93d Cong., 2d Sess. 10, 40-58 (1974). In presenting a bill to amend the CEA, Chairman Poage suggested:

[T]he time is now upon us for a significant change in the parameters of Federal authority over the exchanges. Already, many State laws are exercising jurisdiction over these same markets to fill what had become a vacuum of regulation. *Varied and often conflicting regulation such as this could become a burden on commerce, if it is not already.* With States seeking additional authority, litigants challenging self-regulatory judgments, a weak system of Federal regulation, several recent examples of abuse within the present futures structure and the exchanges . . . it is incumbent on Congress to act, and act expeditiously through meaningful, thoughtful change that is well reasoned and sure.

119 CONG. REC. 41,333 (1973) (emphasis added).

50. H.R. REP. NO. 975, 93d Cong., 2d Sess. 1 (1974). Among the many other amendments to the Commodity Exchange Act in 1974 were provisions that: (1) granted exclusive regulatory jurisdiction to the Commission (§201); (2) recognized new categories of commodity professionals—commodity trading advisors, commodity pool operators and associated persons—and required their registration (§§202, 204 and 205); (3) authorized specific Commission rulemaking authority over registrants who are not members of exchanges (§214); (4) authorized administrative reparation proceedings (§106); (5) required commodity exchanges to establish fair and equitable arbitration procedures for claims against their members (§209); (6) authorized Commission injunctive actions (§211); (7) required the Commission to consider the anticompetitive nature of rules it approves (§107); (8) granted Commission review of exchange disciplinary actions (§216); and (9) authorized the creation of new self-regulatory associations (§301). With respect to options, in 1974, Congress continued the 1936 prohibition in effect for options involving agricultural commodities (7 U.S.C. §6c(a)(B) (1976)) but vested exclusive authority in the Commission to determine whether to permit the offer and sale or trading of options in the

purposes underlying the jurisdictional and other provisions were "to fill all regulatory gaps" and "to avoid unnecessary, overlapping and duplicative regulation."⁵¹

Section 2(a) of the Commodity Exchange Act, as amended by Section 201 of the Commodity Futures Trading Commission Act of 1974, provides in pertinent part:

That the [Commodity Futures Trading] Commission shall have *exclusive jurisdiction* with respect to *accounts*, agreements . . . and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to Section 5 of this Act or any other board of trade, exchange or market. . . .⁵²

Section 201 of the CFTC Act of 1974 goes on to state that "*except as hereinabove provided*" the jurisdiction of the Securities and Exchange Commission and other agencies as to other matters is preserved.⁵³

1. Exclusive jurisdiction

The legislative history of Section 2(a)(1)(A) suggests that Congress intended to prevent any application of the federal securities laws to commodities accounts.⁵⁴ Although an early proposal appeared to preserve existing SEC jurisdiction, that view was expressly rejected. The Commodity Futures Trading Commission bill, H.R. 13113, originally passed by the House, provided that

the Commission shall have exclusive jurisdiction of transactions dealing in, resulting in, or relating to contracts of sale of a com-

newly-regulated commodities. 7 U.S.C. §§2, 4a and 6c(b) (1976). If the Commission determined to permit the marketing of these commodity options, the Commission was empowered to establish the terms and conditions governing the offer and sale of these options. 7 U.S.C. §6c(b) (1976).

51. 120 CONG. REC. 34,736 (1974) (remarks of House Agriculture Committee Chairman Robert Poage); 120 CONG. REC. 34,997 (1974) (remarks of Sen. Talmadge). Cf. H.R. REP. NO. 1383, 93d Cong., 2d Sess. 35 (1974) (CFTC jurisdiction is exclusive and supercedes state and federal agencies); S. REP. NO. 1194, 93d Cong., 2d Sess. 35 (1974) (same).

52. 7 U.S.C. §2 (1982) (emphasis added). Senator Talmadge explained that the words "any other board of trade, exchange or market" were included in Section 2(a)(1) of the CEA to give the Commission jurisdiction over futures contracts bought and sold in the United States but executed on foreign exchanges. 120 CONG. REC. 34,997 (1974). Section 2(a)(1) was renumbered Section 2(a)(1)(A) in 1982.

53. 7 U.S.C. §2 (1982). In addition to the caveat preserving the jurisdiction of the SEC and other agencies "except as hereinabove provided," Section 2(a)(1)(A) also contains a "savings" clause which preserves "the jurisdiction conferred on courts of the United States or any State." *Id.* See *infra*, text accompanying notes 72-84 (discussion of courts' jurisdiction over commodities accounts).

54. See *infra*, text accompanying notes 55-91.

modity for future delivery, traded or executed on a domestic board of trade or contract market or on any other board of trade, exchange, or market: *And provided further, that nothing herein* contained shall supersede or limit the jurisdiction at any time conferred on the Securities Exchange Commission. . . .⁵⁵

If enacted, this Bill would have provided for exclusive Commission jurisdiction over all futures transactions but, because of the proviso, the bill would nevertheless have permitted an inference that Congress intended that the SEC would continue to have jurisdiction over commodity transactions so long as the transaction was also a security.⁵⁶

The Senate, however, adopted a significant change in Section 201 which the Conference Committee subsequently accepted.⁵⁷ The Senate Agriculture and Forestry Committee held hearings on H.R. 13113 and the Senate bills, during which the president of a commodities brokerage testified about the conflict in decisions among federal courts regarding whether managed account agreements between commodity traders and their brokers in which the traders confer discretion upon brokers were securities subject to the Securities Act of 1933 and the Securities Exchange Act of 1934.⁵⁸ Witnesses

55. H.R. 13113, 93d Cong., 2d Sess. §201 (1974) (emphasis added).

56. SEC v. American Commodity Exchange, Inc., 546 F.2d 1361, 1368 (10th Cir. 1976). One witness testified during hearings on the 1974 commodity futures legislation:

Section 201 of the House bill, which deals with the jurisdiction of the Commission, does not end the confusion in both Federal and State law as to who should regulate the futures trading industry. . . . The SEC interprets some aspects of futures trading as within the broad definition of a security under the Securities Act of 1933. The committee will be doing a great favor to the industry and the American public if it would change the jurisdictional provisions of section 201 to insure that if any transaction relates to a futures contract and is regulated by the Commission, these rules and regulations are preemptive of State regulations to the contrary and are exclusive of other Federal regulations.

Commodity Futures Trading Commission Act of 1974: Hearings on S.2485, S.2578, S.2837 and H.R. 13113 Before the Senate Committee on Agriculture and Forestry, 93d Cong., 2d Sess. 541 (1974) (remarks of John Clagett, President of Association of Commodity Exchange Firms, Inc.) [hereinafter cited as *1974 Senate Hearings*]. Cf. *Review of Commodity Exchange Act and Discussion of Possible Changes: Hearings Before the House Committee on Agriculture*, 93d Cong., 1st Sess. 121 (1973) (statement of Reed Clark on behalf of New York Coffee & Sugar Exchange, Commodity Exchange and New York Cocoa Exchange).

Although the House bill on its face appeared to maintain the application of federal securities law to commodity futures, the House Committee Report indicated that this was not its intent. See H.R. REP. NO. 975, 93d Cong., 2d Sess. 28 (1974) (stating that other agencies' retention of jurisdiction did not extend to transactions involving designated contract markets and that the CFTC's exclusive jurisdiction would include securities subject to futures trading on a contract market). See generally Johnson, *The Commodity Futures Trading Commission Act: Preemption as Public Policy*, 29 VAND. L.R. 1, 12 (1976).

57. H.R. REP. NO. 1383, 93d Cong., 2d Sess. 35 (1974); S. REP. NO. 1194, 93d Cong., 2d Sess. 35 (1974).

58. *1974 Senate Hearings*, supra note 56, at 715 (remarks of Harold J. Heinold, President, Heinold Commodities). Urging Congress to resolve the "difference of opinion concerning managed accounts," this witness asked, "Having created the regulatory program, and formed

also told the Senate Committee of the need to "change the jurisdictional provisions" of the House bill to ensure that the CFTC's authority with respect to commodity-related investment contracts including discretionary commodity trading accounts would be plenary and exclusive.⁵⁹

Following its consideration of the testimony and the suggested amendments provided by interested parties,⁶⁰ the Committee revised the exclusive jurisdiction provision in H.R. 13113 by adding an express reference to the Commission's jurisdiction over "accounts" and other futures-related transactions.⁶¹ The Senate Committee also clarified the relationship between the Commission's exclusive jurisdiction and the jurisdiction of other agencies by adding the phrase "except as hereinabove provided" before the proviso in H.R. 13113 concerning SEC jurisdiction.⁶² The Committee explained that the phrase, "except as hereinabove provided" would make clear that "the Commission's [exclusive] jurisdiction, where applicable, supersedes State as well as Federal agencies. . . and Federal and State courts retain their jurisdiction."⁶³ This version of the bill was passed by the Senate,⁶⁴ and was

a commission with the expertise and manpower to implement that program, should not Congress vest in the new commission exclusive jurisdiction over all commodity trading accounts—managed and regular?" *Id.*

59. *Id.* at 541 (remarks of John Clagett) and 680 (remarks of Glenn W. Clark, Professor, Drake University Law School).

60. See S. REP. NO. 1131, 93d Cong., 2d Sess. 20 (1974). See also STAFF OF SENATE COMM. ON AGRICULTURE AND FORESTRY, 93d Cong., 2d Sess., COMPARATIVE ANALYSIS OF AMENDMENTS TO H.R. 13113 at 30 (Comm. Print No. 3, 1974).

61. See S. REP. NO. 1131, 93d Cong., 2d Sess. 54 (1974).

62. *Id.*

63. S. REP. NO. 1131, 93d Cong., 2d Sess. 6 (1974). The Conference Committee report adopted the identical language suggested by the Senate Committee on Agriculture & Forestry. S. REP. NO. 1194, 93d Cong., 2d Sess. 35 (1974); H.R. REP. NO. 1383, 93d Cong., 2d Sess. 35 (1974). As the court in *SEC v. Uninvest, Inc.*, said: "The key phrase in this proviso is the [phrase] . . . 'hereinabove provided' [which] do[es] limit the jurisdiction of the S.E.C. with regard to commodity futures trading. In effect, [this phrase] transfer[s] jurisdiction from the S.E.C. to the new Commodity Futures Trading Commission." 405 F. Supp. 1057, 1058 (N.D. Ill. 1975), *rem'd mem.*, 556 F.2d 584 (7th Cir. 1977). Any suggestion that this proviso "somehow negates . . . [t]he grant of exclusive jurisdiction" to the Commission "is simply invalid." *Id.*

64. 120 CONG. REC. 30,468 (1974). In contrast to the clarifying language of the Conference Committee Report, Senate Agriculture and Forestry Committee Chairman Herman E. Talmadge's remarks in presenting the committee's recommendations were confusing, for while he emphasized that the committee intended to give the Commission "exclusive jurisdiction over those areas delineated in the act," he stated that it was not intended "for the Commodity Futures Trading Commission to usurp powers of other regulatory bodies such as those of the Federal Reserve in the area of banking or the Securities and Exchange Commission in the field of securities." 120 CONG. REC. 30,459 (1974). Commentators have suggested that "[t]he better reading would be that the Chairman . . . wished simply to assure his colleagues that the SEC and other agencies would retain their 'traditional' roles which had never included the regulation of futures trading on commodity markets." Johnson, *supra* note 56, at 16-17; Van Wart, *Preemption and the Commodity Exchange Act*, 58 CHI. KENT L. REV. 657, 687 (1982).

This interpretation is supported by Senator Talmadge's acquiescence in Congress's deletion of former Section 4c of the Act, 7 U.S.C. § 6c (1970), which stated, "Nothing in this section or section 4b shall be construed to impair any State law applicable to any transaction enumerated

subsequently adopted by the Conference Committee.⁶⁵

In discussing the addition of this clarifying language to the exclusive jurisdiction provision, the Conference Report stated, "The clarifying amendments make clear that . . . the Commission's jurisdiction over futures contract markets or other exchanges is exclusive and includes the regulation of *commodity accounts*, commodity trading agreements, and commodity options. . . ."⁶⁶ The Conferees further stated that Section 2(a)(1) was intended to "preempt the field insofar as futures regulation is concerned."⁶⁷

In explaining the clarifying amendments, W. Robert Poage, chairman of the House Committee on Agriculture, said:

As passed by the House, H.R. 13113 makes clear that nothing in the Act would supersede or limit the jurisdiction of the Securities and Exchange Commission or other regulatory authorities. The Senate refined this language in an attempt to avoid unnecessary overlapping and duplicative regulation.⁶⁸

Chairman Poage assured the SEC that it would continue to regulate the stock market and was not divested of jurisdiction over "interests and rights traditionally known as securities" such as "stocks, corporate bonds, warrants and debentures."⁶⁹ However, Poage explained that to the extent that investment contracts were previously within the SEC's jurisdiction they would now

or described in such sections." *See* 120 CONG. REC. 30,464 (1974). Senator Curtis sponsored this deletion "to assure that preemption was complete." *Id.* He described the bill as granting the Commission exclusive jurisdiction "except to the extent the bill specifies that other Federal and State agencies and Federal and State courts are to retain jurisdiction . . . [and that] if any substantive State law were contrary to or inconsistent with Federal law, the Federal law would govern." *Id.* Senator Talmadge concurred with Senator Curtis, stating "I have studied the amendment[,] . . . agree with its import . . . [and] urge the Senate to adopt it." *Id.*

65. *See* H.R. REP. No. 1383, 93d Cong., 2d Sess. 8-9 (1974); S. REP. No. 1194, 93d Cong., 2d Sess. 8-9 (1974).

66. S. REP. No. 1194, 93d Cong., 2d Sess. 35 (1974) (emphasis added); H.R. REP. No. 1383, 93d Cong., 2d Sess. 35 (1974); *see* S. REP. No. 1131, 93d Cong., 2d Sess. 23 (1974) (CFTC jurisdiction supersedes state and federal agencies).

67. S. REP. No. 1194, 93d Cong., 2d Sess. 35 (1974); H.R. REP. No. 1383, 93d Cong., 2d Sess. 35 (1974). With respect to state regulation of futures contracts, the House-Senate Conference Committee stated:

[I]f any substantive State law regulating futures trading was contrary to or inconsistent with Federal law, the Federal law would govern. In view of the broad grant of authority to the Commission to regulate the futures trading industry, the Conferees do not contemplate that there will be a need for any supplementary regulation by the States.

S. REP. No. 1194, 93d Cong., 2d Sess. 35-36 (1974); H.R. REP. No. 1383, 93d Cong., 2d Sess. 35-36 (1974). Congress carried out its preference for avoiding duplicative and potentially conflicting state regulation by expressly subjecting commodity pools and commodity pool operators, for the first time, to the comprehensive regulatory scheme of the Act. *See* 7 U.S.C. §§ 2, 6l, 6n and 6o (1976).

68. 120 CONG. REC. H34,736 (1974).

69. *Id.* at H34,737.

be governed by the CFTC's jurisdiction if they related to futures contracts. Poage stated,

I further understand, however, that the Securities and Exchange Commission has jurisdiction over other types of securities, including investment contracts, and that the term investment contract includes a broad category of arrangements and contracts relating to investments. In this area, there may be some apparent overlap between the jurisdiction of the Securities and Exchange Commission and the intended jurisdiction of the Commodity Futures Trading Commission over trading in futures contracts relating, or purporting to relate to tangible commodities. It was not intended that the jurisdiction of the Securities and Exchange Commission with respect to investment contracts be superseded, except to the extent that jurisdiction is granted to the CFTC with respect to contracts for future delivery or options relating, or purporting to relate, to tangible commodities, or which are effected on a contract market designated pursuant to section 5 of the act.⁷⁰

Thus, the legislative history of Section 2(a)(1)(A) suggests that Congress considered and rejected permitting the application of the federal securities laws to commodity accounts.

2. The "savings" clause

Section 2(a)(1)(A) also provides that "[n]othing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State."⁷¹ This provision, read together with the exclusive jurisdiction clause, has been interpreted by certain courts merely to oust the SEC from jurisdiction and not to affect the jurisdiction of the courts over commodities claims brought under the securities laws.⁷² This interpretation is not supported by the legislative history of this language. Rather, the legislative history suggests that this language was added to make clear that Congress did not intend generally to preclude private rights of action under the Commodity Exchange Act.⁷³ Thus, courts may entertain commodities account claims, but only if they are brought under the CEA.

70. *Id.*

71. 7 U.S.C. §2 (1982).

72. *See* Mullis v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 492 F. Supp. 1345, 1350 (D. Nev. 1980) (CFTC exclusive jurisdiction does not preempt judicial application of securities statutes); Peavey Company v. Mitchell, [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,593, at 97,336-97,337 (W.D. Okla. Dec. 30, 1983) (same); Westlake v. Abrams, 504 F. Supp. 337, 342 (N.D. Ga. 1980) (same); *cf.* American Grain Ass'n v. Canfield, Burch & Mancuso, 530 F. Supp. 1339, 1346 (W.D. La. 1982) (discussing cases which have allowed judicial application of federal securities statutes).

73. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 388 (1982).

The House version of H.R. 13113 did not contain this clause.⁷⁴ Subsequently, various legislators raised concerns that the grant of exclusive jurisdiction to the new Commission might preclude claims brought under federal antitrust, state contract, and state commercial laws.⁷⁵ Senator Dick Clark, who had favored specific authorization of private treble damage suits under the Act, said with respect to the House bill: "Unfortunately, the House bill not only does not authorize them, but Section 201 of that bill [the exclusive jurisdiction provision] may prohibit all court actions. The staff of the House Agriculture Committee has said that this was done inadvertently and they hope it can be corrected in the Senate."⁷⁶

Similarly, antitrust suits and judicial review of CFTC decisions would be precluded under the House version of H. R. 13113. Congressman Rodino expressed concern that:

this double proviso could possibly be read as an attempt to oust even federal courts of jurisdiction. The first proviso confers "exclusive jurisdiction" on the Commission for commodity transactions. Exceptions to this exclusive jurisdiction are carved out in the second proviso without, however, referring to federal district courts. . . . [A]ntitrust laws are to apply to commodity transactions and, of course, federal courts play an instrumental role in promoting as well as protecting the national policies expressed already in the antitrust laws. Arguably, too, if jurisdiction of federal courts were to be withdrawn also, Commission decisions on commodity transactions would be non-reviewable by the judiciary, raising . . . serious questions of administrative and constitutional law.⁷⁷

74. See H.R. 13113, 93d Cong., 2d Sess. § 201 (1974).

75. See *infra* text accompanying notes 76-78.

76. 1974 Senate Hearings, *supra* note 56, at 205.

77. *Id.* at 260. See 120 CONG. REC. H34,737 (1974) (remarks of Rep. Poage); 120 CONG. REC. S30,459 (1974) (remarks of Sen. Talmadge); S. REP. NO. 73, 94th Cong., 1st Sess. 5-6 (1975). During the 1974 Senate hearings a representative of the Department of Justice commented that the House bill, read literally, could "deprive [state courts] of jurisdiction to enforce State contracts and commercial law relating to futures contracts." 1974 Senate Hearings, *supra* note 56, at 663-64 (statement of Keith Clearwaters, Deputy Assistant Attorney General, Department of Justice). He noted "the fact that no substantive provisions in the nature of contract or commercial law are included in the bill" as evidence that "the Commission was not intended to adjudicate disputes between commodities brokers and their customers over contract terms or similar matters." *Id.* He suggested revising the House bill so that "[j]urisdiction for violations of the Commodity Exchange Act would then be conferred on the Commission . . . while other adjudicatory authorities, including State and Federal courts, would not be deprived of jurisdiction to hear matters traditionally entrusted to them." *Id.* at 663. The Chairman of the Senate committee answered that he also did not believe that "the House had in mind depriving either Federal courts [of jurisdiction] in antitrust matters, or any other matter, and certainly not State courts." *Id.* at 664. The remark "any other matter" appeared to refer to the "traditional" matters mentioned by the Department representative. The Chairman of the Senate committee asked the Department representative to assist the committee's staff in revising the language of H.R. 13113 "to make clear that we don't propose to deprive Federal courts of antitrust jurisdiction, or State courts' jurisdiction." *Id.* at 664. See also *id.* at 260 (remarks of Rep. Rodino regarding preserving state courts' jurisdiction over contract and commercial matters).

As a consequence of these concerns regarding judicial jurisdiction, the Senate Committee amended the House bill to include the savings clause disclaimer language with respect to federal and state courts.⁷⁸ The Senate Committee Report did not offer an explanation of this provision's purpose.⁷⁹ The Committee's chairman, Senator Talmadge, explained on the floor, however, that the purpose of the "savings" clause for courts was to preserve parties' rights of action under the Commodity Exchange Act:

The vesting in the Commission of the authority to have administrative law judges and apply a broad spectrum of civil and criminal penalties is likewise not intended to interfere with the courts in any way. It is hoped that giving the Commission this authority will somewhat lighten the burden upon the courts, but the entire appeal process and the right of final determination by the courts are expressly preserved.⁸⁰

The enactment of Section 412 of the CFTC Act of 1974⁸¹ further confirms that Congress did not intend to sanction or preserve federal court jurisdiction under the federal securities laws over claims regarding commodities accounts.⁸² Section 412 provided that:

Pending proceedings under existing law shall not be abated by reason of any provision of this Act but shall be disposed of pursuant to the applicable provisions of the Commodity Exchange Act, as amended, in effect prior to the effective date of this Act.⁸³

78. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 386 (1982) (discussing legislative history of savings clause); *Gravois v. Fairchild, Arabatzis*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,873 (E.D. La. Nov. 9, 1978) (same); *Leist v. Simplot*, 638 F.2d 286, 314-15 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982) (same); *Jones v. B.C. Christopher & Co.*, 466 F. Supp. 213, 219 (D. Kan. 1979) (same); *Hofmayer v. Dean Witter & Co., Inc.*, 459 F. Supp. 733, 737 (N.D. Cal. 1978) (same).

79. See S. REP. No. 1131, 93d Cong., 2d Sess. 23 (1974).

80. 120 CONG. REC. S30,459 (1974). See also *Strobl v. New York Mercantile Exchange*, Nos. 84-7328, 84-7770, slip op. at 5026-28 (2d Cir. July 5, 1985) (savings clause also ensured that antitrust laws apply to commodities trading), *cert. denied*, 54 U.S.L.W. 3374 (U.S. Dec. 2, 1985).

81. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 412, 88 Stat. 1389, 1414 (1974) [hereinafter cited as "CFTC Act of 1974"].

82. Less than four months after the CFTC Act was signed into law, the Chairman of the SEC proposed an amendment to the Securities Exchange Act which would have provided: No definition of "commodity" or grant of exclusive jurisdiction to the [CFTC] contained in the [CFTC] Act of 1974 shall supersede or limit the jurisdiction of the [SEC] or the courts of the United States or of any State with respect to accounts, agreements and transactions involving a "security" within the meaning of this Title, the Securities Act of 1933, as amended, the Public Utility Holding Company Act of 1935, as amended, the Trust Indenture Act of 1939, as amended, the Investment Company Act of 1940, as amended and the Investment Advisers Act of 1940, as amended.

See Johnson, *supra* note 56, at 26-27 (emphasis added). No Congressional committee supported the SEC proposal and the provision was never enacted.

83. CFTC Act of 1974, *supra* note 81, § 412, 88 Stat. at 1414.

Senator Talmadge and Representative Poage explained that actions and investigations which were previously brought under the federal securities laws and other federal and state laws to correct abuses in connection with commodities accounts would not be abated "in order to prevent the creation of any regulatory gaps, particularly during the time between the adoption of this legislation and the full implementation of its provisions by the [CFTC]."⁸⁴

If Congress had intended for federal securities laws (and state laws) to be used concurrently with the CEA, the "regulatory gaps" which prompted enactment of Section 412 would not have existed. Construing the "savings" clause as a preservation of federal court jurisdiction under the federal securities laws would be inconsistent with Congress's apparent interest in correcting the industry complaint that federal courts were applying federal securities laws, albeit inconsistently, to discretionary commodity accounts. Instead, as the above remarks suggest, Congress intended to change the law; courts were now to apply the CEA to claims involving commodity accounts and not the laws enforced by other federal and state regulators.

3. Post-1974 legislation

The language adopted by Congress in 1974 concerning the Commission's exclusive jurisdiction over commodity accounts has not altered although Congress comprehensively reexamined and significantly amended the Act in 1978 and 1982.⁸⁵ In 1978, the Senate Committee on Agriculture and Forestry reaffirmed its support for the Commission's exclusive jurisdiction over all aspects of futures trading, stating: "[t]he basic conclusion reached in 1974 that there should be a single regulatory agency responsible for futures trading is as valid now as it was then."⁸⁶

84. 120 CONG. REC. S34,997 (1974) (remarks of Sen. Talmadge); 120 CONG. REC. H34,737 (1974) (remarks of Rep. Poage). See S. REP. NO. 1131, 93d Cong., 2d Sess. 43-44 (1974) (sets forth language enacted as section 412); H.R. REP. NO. 1383, 93d Cong., 2d Sess. 29 (1974) (same); S. REP. NO. 1194, 93d Cong., 2d Sess. 29 (1974) (same). See also SEC v. American Commodity Exch., 546 F.2d at 1368 (legislative history indicates that SEC retained jurisdiction over matters under investigation on effective date of CFTC Act of 1974); SEC v. Univest, 405 F. Supp. at 1059 (Section 412 was enacted to avoid regulatory gaps between enactment and effectiveness of CFTC Act of 1974); CFTC Interpretive Letter 77-2, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) 20,257 (Jan. 14, 1977) (SEC could seek relief for activities it was investigating on effective date of CFTC Act of 1974).

85. Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865 *et seq.* (1978); Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 *et seq.* (1982).

86. S. REP. NO. 850, 95th Cong., 2d Sess. 22 (1978); see also H.R. REP. NO. 1181, 95th Cong., 2d Sess. 12-13 (1978) (other agencies should not have authority which duplicates CFTC authority). In 1978, Congress also continued the Commission's exclusive jurisdiction over options involving commodities regulated under the Act by prohibiting generally, in the absence of Commission regulations, the offer and sale to the public of commodity options. See 7 U.S.C. § 6c(c) (Supp. V 1981). Congress also continued to express its support for preemption of state law. See, e.g., S. REP. NO. 850, 95th Cong., 2d Sess. 13 and 25-26 (1978). Congress enacted Section 6d of the Act, however, which gives states statutory standing to bring civil actions in federal district court for violations of the Act or CFTC rules. 7 U.S.C. § 13a-2 (1982). States

While Congress in 1982 made certain clarifications with respect to the Commission's jurisdiction in other areas, Congress did not tamper with the language giving the Commission exclusive jurisdiction over "accounts." In particular, Congress clarified the jurisdictional boundaries concerning commodity pools by adding language to the commodity pool provision which provides:

Nothing in this Act shall relieve any person of any obligation or duty, or affect the availability of any right or remedy available to the Securities and Exchange Commission or any private party arising under the Securities Act of 1933 or the Securities Exchange Act of 1934 governing the issuance, offer, purchase, or sale of securities of a commodity pool, or of persons engaged in transactions with respect to such securities, or reporting by a commodity pool.⁸⁷

In contrast, no similar language was added to the Act with respect to discretionary commodity accounts.⁸⁸

In 1982, Congress also inserted after the grant of exclusive jurisdiction to the CFTC in Section 2(a)(1)(A) the phrase "except to the extent otherwise provided in Section 2a of this title."⁸⁹ The new Section 2a further clarified the jurisdictional division between the CFTC and the SEC over financial instruments based on stock indices,⁹⁰ providing that the CFTC would retain

are able to seek injunctive relief, writs of mandamus, damages on behalf of their residents and other appropriate relief, except against clearinghouses, and floor brokers. 7 U.S.C. § 13a-2(1)-(3) (1982). In addition, Section 6d recognizes actions in state court for violations of any general civil or criminal antifraud statute of that state. 7 U.S.C. § 13a-2(7) (1982).

87. 7 U.S.C. § 6m(2) (1982).

88. Additionally, in 1982, Congress required a person associated with a commodity trading advisor who solicits "a prospective client's *discretionary account*" to register with the Commission. 7 U.S.C. §6k(3) (1982) (emphasis added). Congress also clarified the parameters of exclusive Commission jurisdiction vis-a-vis the states. Congress amended Section 6d to allow states to proceed in state courts against persons registered under the Act, except for floor brokers or registered futures associations, for violations of the antifraud provisions of the Act and CFTC rules. 7 U.S.C. § 13a-2(8) (1982). Congress also authorized states to apply any of their laws or regulations to activities which are not subject to the Commission's comprehensive regulatory powers and to persons engaged in activities requiring registration or designation by the Commission who have not been so registered or designated. 7 U.S.C. §16(e) (1982). Activities subject to the Commission's comprehensive regulatory powers include exchange-traded futures, foreign futures (except as specified by the Commission), authorized commodity options and regulated leverage transactions. See 7 U.S.C. §§ 2 and 16(e) (1982).

In addition, Congress repealed the 1936 ban on agricultural options and permitted the Commission to establish a pilot program in the trading of options in the domestic agricultural commodities that had been regulated under the Act prior to 1975, subject to certain conditions. 7 U.S.C. §6c(e) (1982). And with respect to non-agricultural options, Congress added a new Section 4c(f) which provides that:

Nothing in this chapter shall be deemed to govern or in any way be applicable to any transaction in an option on foreign currency traded on a national securities exchange. 7 U.S.C. § 6c(f) (1982).

89. 7 U.S.C. § 2 (1982).

90. See *supra* note 7 (explaining term "stock index futures").

exclusive jurisdiction over “accounts, agreements . . . and transactions involving” stock index futures, while the SEC would have sole jurisdiction over options on securities and securities indices.⁹¹

II. POST 1974 CASES CONSIDERING WHETHER FEDERAL SECURITIES LAWS APPLY TO DISCRETIONARY COMMODITIES ACCOUNTS

Since the 1974 amendments, many courts have continued to apply the *Howey* investment contract test⁹² to discretionary commodity accounts without considering whether Section 2(a)(1)(A) moots the question.⁹³ Most of these decisions hold that commodities accounts do not satisfy that test and hence are not securities.⁹⁴ The Fifth Circuit and several district courts in other circuits, however, have held that discretionary trading accounts are “investment contracts” as defined in *Howey* and therefore are securities for purposes of the federal securities acts.⁹⁵

91. 7 U.S.C. § 2a (1982) (emphasis added).

92. See *infra* notes 94-95 (cases in which courts have continued to apply *Howey* test). See also Note, *Continuing Confusion in the Definition of a Security: The Sale of Business Doctrine, Discretionary Trading Accounts, and Oil, Gas and Mineral Interests*, 40 WASH. & LEE L. REV. 1255, 1275-77 (1983); Note, *Discretionary Trading Accounts in Commodity Futures are not Securities Absent Horizontal Commonality*, 60 WASH. U.L.Q. 675, 677 (1982).

93. As early as 1977 the CFTC's General Counsel interpreted Section 2(a)(1) to make it “beyond serious dispute that the Commodity Futures Trading Commission has *exclusive jurisdiction* with respect to all accounts, agreements and transactions involving commodity futures contracts, *both discretionary and non-discretionary*, and that the exclusivity of its jurisdiction is not affected by whether the account, agreement or transaction might otherwise be viewed as a ‘security.’ ” Interpretive Letter No. 77-2, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,257, at 21,371 (Jan. 14, 1977) (emphasis added). The CFTC did not, however, participate in any litigation on this issue until 1984. See Memorandum of CFTC as *amicus curiae*, *Kupke v. Shearson/American Express*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,757 (M.D. Fla. Oct. 10, 1985) (order dismissing federal securities claims regarding discretionary commodities accounts).

94. For cases holding that discretionary commodities accounts are not investment contracts under a “horizontal commonality” approach, see *Salcer v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 682 F.2d 459, 460 (3d Cir. 1982); *Curran v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 622 F.2d 216, 222-24 (6th Cir. 1980), *aff'd*, 456 U.S. 353 (1982); *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96, 101 (7th Cir. 1977); *Berman v. Bache, Halsey, Stuart, Shields*, 467 F. Supp. 311, 319-20 (S.D. Ohio 1979). Cases reaching the same result under a “vertical commonality” approach include *Meyer v. Thomas & McKinnon Auchincloss Kohlmeyer, Inc.*, 686 F.2d 818, 819 (9th Cir. 1982), *cert. denied*, 460 U.S. 1023 (1983); *Mordaunt v. Incomco*, 686 F.2d at 817; *Brodt v. Bache & Co., Inc.*, 595 F.2d 459, 462 (9th Cir. 1978); *In re Federal Bank & Trust Co., Ltd.*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,255, at 29,329-29,330 (D.Oregon June 4, 1984); and *Blacker v. Shearson Hayden Stone, Inc.*, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,459, at 93,661 (Fla. Dist. Ct. App. May 16, 1978).

95. See *Rasmussen v. Thomas & McKinnon Auchincloss Kohlmeyer, Inc.*, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,203, at 96,589 (5th Cir. Dec. 12, 1979); *Continental Commodities Corp.*, 497 F.2d at 520-22; *Moody v. Bache*, 570 F.2d 523, 526 (5th Cir. 1978); *Taylor v. Bear Stearns & Co.*, 572 F. Supp. 667, 671-72 (N.D.Ga. 1983); *Westlake v. Abrams*, 565 F. Supp. 1330, 1340 (N.D.Ga. 1983); *Christensen Hatch Farms, Inc. v. Peavey*

*SEC v. Continental Commodities Corporation*⁹⁶ is most often relied upon in post-1974 decisions finding securities laws applicable to discretionary commodities accounts. *Continental Commodities* concerned "naked" options on commodity futures contracts. Naked options are options that the writer does not cover by either owning the underlying futures contracts or escrowing a portion of the customer payments to acquire the contracts.⁹⁷ The SEC did not assert that the accounts involved in *Continental Commodities* were discretionary or that they were securities.⁹⁸ Rather, the SEC contended that the naked commodity options were securities "since it was the defendants' object to retain money owed to their customers as capital for use in the defendants' business."⁹⁹ Nevertheless, the Fifth Circuit found that the accounts themselves were investment contracts because they were discretionary and met the elements set forth in *Howey* under a vertical commonality analysis.¹⁰⁰ In *Continental Commodities* the Fifth Circuit had no reason to consider Section 2(a)(1) because the case was decided before the effective date of the Commodity Futures Trading Commission Act of 1974. Thus, the CFTC had not yet received its grant of exclusive jurisdiction over commodities accounts.¹⁰¹ Moreover, the futures contracts that were the subjects of the options in *Continental Commodities* were on commodities not covered by the CEA until 1975.¹⁰²

In addition to *Continental Commodities*, courts often cite *Moody v. Bache*¹⁰³ in support of the application of federal securities laws to discretion-

Co., 505 F. Supp. 903, 907 (D. Minn. 1981); *Walsh v. International Precious Metals Corporation*, 510 F. Supp. 867, 872 (D.Utah 1981) (dictum); *Molis v. P.G. Commodities Assoc.*, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,725, at 94,863 (S.D.N.Y. Dec. 29, 1978); *Rochkind v. Reynolds Securities, Inc.*, 388 F. Supp. 254, 257 (D.Md. 1975); *Scheer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,086, at 97,855 (S.D.N.Y. April 30, 1975). *Cf. Popham, Haik, Schnobrich, Kaufman & Doty, Ltd. v. Newcomb Securities Co.*, 751 F.2d 1262, 1265 (D.C.Cir. 1985) (noting conflicting results in application of *Howey* to discretionary commodity accounts); *Clayton Brokerage Co. of St. Louis, Inc. v. Stansfield*, 582 F. Supp. 837, 840 (D.Colo. 1984) (dictum) (commodity account is a security if investor does not have control over it).

96. 497 F.2d 516 (5th Cir. 1974).

97. *See id.* at 519.

98. *See generally*, Brief for Appellant, *SEC v. Continental Commodities Corp.*, 497 F.2d 516 (5th Cir. 1974).

99. *Id.* at 8. *See also supra* note 25 (differentiating SEC's position on naked options from SEC's position on discretionary accounts).

100. 497 F.2d at 520-23. *See supra* text accompanying notes 41-43.

101. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 418, 88 Stat. 1415-16 (1974). The exclusive jurisdiction provision did not apply to conduct that occurred before April 21, 1985, the effective date of the 1974 amendments. *SEC v. American Commodity Exchange*, 546 F.2d 1361, 1367 (10th Cir. 1976). *See SEC v. Univest*, 405 F. Supp. 1057, 1059 (N.D. Ill. 1975), *rem'd mem.* 556 F.2d 584 (7th Cir. 1977).

102. The options in *Continental Commodities* were on futures contracts in silver, sugar, coffee, platinum, plywood and cocoa. 497 F.2d at 518, n.5. In the 1974 amendments, Congress expanded the list of commodities subject to the Act to include those commodities. *See supra* text accompanying notes 47-48.

103. 570 F.2d 523 (5th Cir. 1978).

ary commodities accounts. *Moody v. Bache* also held that a commodities account was an "investment contract" under the vertical commonality test. Although this case was decided more than three years after the enactment of Section 2(a)(1), *Moody* also was not governed by the Act because *Moody* was pending on the Act's effective date.¹⁰⁴ Congress provided in Section 412 of the 1974 Act that the 1974 CEA amendments would not govern such pending proceedings. Furthermore, as in *Continental Commodities*, the conduct at issue in *Moody* occurred in 1973, before the effective date of the 1974 amendments.

Consequently, the court in *Continental Commodities* and *Moody v. Bache* neither considered nor had reason to consider the impact of the 1974 amendments, since both suits were brought before the effective date of the exclusive jurisdiction provision.¹⁰⁵ Nevertheless, several courts have relied on *Continental* and *Moody* as precedent for holding that Section 2(a)(1) does not preclude judicial application of the federal securities laws to discretionary commodities accounts.¹⁰⁶

A few courts, however, have considered the impact of the 1974 amendments and have nevertheless applied federal securities laws to discretionary commodities accounts. One such case is *Mullis v. Merrill Lynch, Pierce, Fenner & Smith*,¹⁰⁷ in which the United States District Court for the District of Nevada sustained a private action alleging fraud in the handling of a commodities account under SEC regulation 10b-5.¹⁰⁸

In *Mullis*, without any discussion of the relevant legislative history,¹⁰⁹ the court interpreted the "savings" clause in Section 2 as distinguishing between agency jurisdiction and court jurisdiction, thus permitting the courts to retain jurisdiction under federal securities laws. The court recognized that Section 2(a)(1) precludes the SEC from regulating "securities whose dominant feature is participation in trading futures."¹¹⁰ But the court found that "a

104. CFTC Act of 1974, Pub. L. No. 93-463, § 418, 88 Stat. 1415-16 (1974). The plaintiff in *Moody* filed suit on September 27, 1973, nearly one and one-half years before the 1974 amendments became effective. See Complaint, *Moody v. Bache*, CA-3-7725 (N.D. Tex. 1983).

105. *Mallen v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,601 at 30,574 (N.D. Ga. March 28, 1985).

106. See *Westlake v. Abrams*, 504 F. Supp. at 342 (grant of exclusive jurisdiction to CFTC does not prevent courts from applying federal securities laws to a security used for trading commodity futures); *American Grain Ass'n.*, 530 F. Supp. at 1346 (same); see also *Peavey Company v. Mitchell*, [1983-1984 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 99,593, at 97,337 (W.D. Okla. Dec. 30, 1983) (CFTC exclusive jurisdiction is limited to matters involving regulation of commodity futures industry). *Contra Gravois v. Fairchild, Arabatzis*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,872-22,875 (E.D. La. Nov. 9, 1978) (1974 amendments to CEA preclude application of federal securities laws to discretionary commodities accounts).

107. 492 F. Supp. 1345 (D. Nev. 1980).

108. *Id.*; see 17 C.F.R. §240.10b-5 (1984).

109. See 492 F. Supp. at 1350.

110. *Id.*

grant of exclusive jurisdiction to the commodity agency to regulate commodity transactions" did not necessarily preempt "judicial application of security statutes to a security used for trading commodity futures."¹¹¹ Although the court stated that jurisdiction was preserved only with respect to claims brought under securities statutes,¹¹² it nevertheless permitted a claim under an SEC regulation.

A desire for customer protection appears to have motivated the *Mullis* decision.¹¹³ This is shown by the court's willingness to allow a customer to avoid a preexisting arbitration agreement under the *Wilko v. Swan*¹¹⁴ doctrine which the court held precluded arbitration of the claim brought under the SEC's antifraud regulation 10b-5.¹¹⁵ (In *Wilko v. Swan*, the Supreme Court held on the basis of section 14 of the 1933 Securities Act that a person who signs a pre-dispute arbitration agreement does not waive his right to seek judicial redress under that Act).¹¹⁶ The *Mullis* court also assumed no private right of action existed under the CEA.¹¹⁷ This assumption also may have

111. *Id.* (emphasis added). The court appeared to base its conclusion that Congress had not precluded courts from applying securities statutes to securities used for trading commodity futures on the "savings clause" in Section 2(a)(1) and on a statement in the Senate Report which stated that "Federal and State courts retain their jurisdiction." See 492 F. Supp. at 1350 (quoting S. REP. No. 1131, 93d Cong., 2d Sess. 6 (1974)). Conspicuously absent from the court's description of the legislative history of Section 2(a)(1), however, is any reference to Section 412 of the 1974 Act or the remarks by Congressman Rodino, Senator Talmadge and others that indicate that the savings clause was not intended to create or preserve federal court jurisdiction under the federal securities laws for commodities account claims. See *supra* text accompanying notes 72-84.

112. 492 F. Supp. at 1350.

113. See *E.F. Hutton & Co., Inc. v. Shank*, 456 F. Supp. 507, 512 (D.Utah 1976) (courts applying federal securities laws to discretionary accounts are motivated by a desire to give commodities investors the same protections as stock market investors).

114. 346 U.S. 427 (1953).

115. *Mullis*, 492 F. Supp. at 1361. Whether the *Wilko v. Swan* doctrine even applies to SEC rule 10b-5 and other claims under the Securities Exchange Act of 1934 might be questioned in light of *Dean Witter Reynolds, Inc. v. Byrd*, ___ U.S. ___, 105 S.Ct. 1238 (1985). In *Byrd*, the Supreme Court held that the *Wilko v. Swan* doctrine does not prevent arbitration of pendent arbitrable claims. ___ U.S. at ___, 105 S. Ct. at 1241. The Court expressly declined to resolve whether *Wilko v. Swan* applies to claims under the Securities Exchange Act of 1934 or regulations issued thereunder. ___ U.S. at ___, 105 S. Ct. at 1240, n.1. See also *infra* note 118 (some courts prior to *Byrd* precluded arbitration of all claims if securities claims were also asserted).

116. 346 U.S. at 434-35; 15 U.S.C. § 77n (1982) (Section 14 of 1933 Securities Act).

117. 492 F. Supp. at 1358. *Mullis* held that the savings clause in Section 2(a)(1)(A) of the CEA, which the court used as the basis for permitting federal securities law claims in that case, did not indicate a Congressional intent to preserve a previously implied right of action under the CEA. 492 F. Supp. at 1356. The Supreme Court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran* specifically overruled that view, finding that the saving clause in Section 2 was "direct evidence of legislative intent to preserve the implied private remedy federal courts recognized under the CEA." 456 U.S. 353, 386 (1982). See *Gravois v. Fairchild, Arabatzis*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,872 (E.D. La. Nov. 9, 1978). The enactment of Section 22, 7 U.S.C. §25 (1982), which explicitly provides for a private right of action, further undermines *Mullis*'s rationale. See *Kupke v. Shearson/American Express*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,757 at 31,155 (M.D. Fla. Oct. 10, 1985) (enactment of Section 22 effectively mooted concerns expressed by *Mullis* and other courts).

played a role in the court's finding a cause of action under the federal securities laws.¹¹⁸

In *Westlake v. Abrams*,¹¹⁹ the United States District Court for the Northern District of Georgia, agreeing with *Mullis* only in part, held that Section 2(a)(1)(A) does not preclude application of the federal securities laws to commodity options, although it does preclude the application of SEC regulations such as 10b-5.¹²⁰ The court held that there was no cause of action under Section 10 of the 1934 Securities Exchange Act because that provision only makes it unlawful to use a manipulative or deceptive device in violation of SEC regulations and such regulations cannot, by virtue of Section 2(a)(1) of the CEA, be applied by the courts to commodity instruments.¹²¹ Thus the *Westlake* court dismissed the 10b-5 claim. However, the *Westlake* court permitted the plaintiff to seek relief under Section 12 of the 1933 Securities Act,¹²² which provides relief against sellers of unregistered securities and under federal securities laws establishing "controlling person" liability.¹²³

118. 492 F. Supp. at 1349-51. Even if a cause of action under the CEA had been recognized the *Mullis* court might have stayed arbitration under the "intertwining doctrine" which precluded the arbitration of other federal and state claims in actions where securities claims based on the same set of facts were also asserted. See, e.g., *Smokey Greenhaw Cotton Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 720 F.2d 1446, 1448 (5th Cir. 1983) (applying intertwining doctrine); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Haydu*, 675 F.2d 1169, 1172-73 (11th Cir. 1982) (same). This doctrine was rejected, however, by the Supreme Court in *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. at 1241-44.

119. 504 F. Supp. 337 (N.D. Ga. 1980).

120. *Id.* at 345. The court in *American Grain Ass'n. v. Canfield, Burch & Mancusco* followed the reasoning of *Westlake* in deciding that a cooperative pool was subject to the *Howey* investment contract analysis. 530 F. Supp. 1339, 1346 (W.D. La. 1982). The only federal securities law invoked by the *American Grain* plaintiff, however, was Section 10 of the 1934 Securities Exchange Act, 15 U.S.C. §78, which permits actions against any manipulative or deceptive device in violation of SEC regulations. *Id.* Therefore, the *American Grain* court, following *Westlake*, dismissed the case. 530 F. Supp. at 1346.

121. 504 F. Supp. at 346. See *American Grain Ass'n.*, 530 F. Supp. at 1346.

122. 15 U.S.C. §771 (1982).

123. See Section 15 of the Securities Act of 1933, 15 U.S.C. §77o (1982) and Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78t(a) (1982). The *Westlake* court doubted that there was a cause of action under the CEA. 504 F. Supp. at 340. *But see Westlake*, 565 F. Supp. at 1336 and 575 F. Supp. 58, 59 (N.D.Ga. 1983) (reinstating claims after *Curran*). The court expressed concern that "should those causes of action [under the federal securities laws] be extinguished, [the plaintiff] may have lost any avenue of recovery against an aider and abettor or controlling person. . . ." *Westlake*, 504 F. Supp. at 345. In 1982, however, Congress added aiding and abetting as a basis of liability in private actions under the CEA. See 7 U.S.C. §§ 13c(a) and 26 (1982). Moreover, certain standards of liability are available under the CEA that are not available under the federal securities laws. For instance, while there is no "controlling person" liability provision under the CEA for private actions, there is a "respondeat superior" liability provision in the CEA which does not have an analogue in the federal securities laws. 7 U.S.C. §4 (1982); see Note, *Securities-Investment Contracts-Discretionary Trading Accounts*, ARIZ. ST. L. J. 797, 807 (1979) (CEA adequately protects discretionary account holders).

The reasoning in *Westlake* leads to an anomalous result.¹²⁴ In *Westlake*, the court allowed the plaintiff to seek damages based on the firm's failure to register the account as a security with the SEC, even though under the court's own theory the SEC did not have the authority to require or administer registration.¹²⁵ The *Westlake* court reasoned that Section 2(a)(1) does not preclude judicial (as opposed to regulatory) application of the securities laws to commodities accounts.

The *Westlake* court's view is difficult to reconcile with Congress's goals in enacting Section 2(a)(1).¹²⁶ For example, Congress probably did not intend to allow private parties to invoke the federal securities laws for their private benefit when it barred the SEC from doing so on the public's behalf.¹²⁷ Rather, as noted,¹²⁸ Congress added "accounts" to the provision for exclusive Commission jurisdiction to correct the problem identified by representatives of the futures industry that in private litigation courts were in some instances applying the securities laws to commodities accounts.¹²⁹

Most courts that have considered the impact of Section 2(a)(1), however, have concluded that it precludes the application of federal securities laws to commodities instruments or accounts.¹³⁰ The United States District Court for the District of Utah was the first court to reach this result, in *E. F. Hutton & Co. v. Shank*.¹³¹ The *Shank* court permitted a private action under the CEA and enforced an arbitration agreement, dismissing the argument that the federal securities laws should be applied to commodities accounts because the CEA allegedly does not provide comparable protections.¹³² The court held that, because of the grant of exclusive jurisdiction to the CFTC, "it would fly in the face of express Congressional intent" to construe the

124. See *Hofmayer v. Dean Witter & Co.*, 459 F. Supp. 733, 737 (N.D. Cal. 1978) (if SEC jurisdiction is superceded private actions under federal securities laws also must be barred).

125. 504 F. Supp. at 344-46.

126. See *supra* text accompanying notes 54-85.

127. See *Johnson*, *supra* note 56, at 35. Indeed, nothing in the legislative history suggests that private actions under the securities laws are to be treated differently from actions brought by the SEC. *Hofmayer v. Dean Witter & Co.*, 459 F. Supp. 733, 737 (N.D. Cal. 1978).

128. See *supra* text accompanying note 61.

129. See *supra* text accompanying notes 54-85.

130. See *Mallen v. Merrill Lynch, Pierce, Fenner & Smith*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,601 at 30,578 (N.D. Ga. March 28, 1985); *Trustman v. Merrill Lynch, Pierce, Fenner & Smith*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,490, at 30,166 (C.D. Cal. Jan. 24, 1985); *Gonzalez v. Paine, Webber, Jackson & Curtis, Inc.*, 493 F. Supp. 499, 504 (S.D.N.Y. 1980); *Fairchild, Arabatzis & Smith, Inc. v. Prometco (Produce & Metals) Co., Ltd.*, 470 F. Supp. 610, 614 (S.D.N.Y. 1979); *Hofmayer v. Dean Witter & Co.*, 459 F. Supp. 733, 736-37 (N.D. Cal. 1978); *Gravois v. Fairchild, Arabatzis*, [1977-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706, at 22,874 (E.D. La. Nov. 9, 1978); *Bartels v. International Commodities Corp.*, 435 F. Supp. 865, 869 (D. Conn. 1977); *E. F. Hutton v. Shank*, 456 F. Supp. 507, 513 (D. Utah 1976); see also *Kupke v. Shearson/American Express*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,757 (M.D. Fla. Oct. 10, 1985) (order dismissing federal securities claims); cf. *Marshall v. Green Giant Co.*, No. 4-83-578 (D. Minn. June 26, 1984).

131. 456 F. Supp. 507 (D. Utah 1976).

132. *Id.* at 513-14.

requirements of *SEC v. W. J. Howey Co.*¹³³ “so as to include discretionary accounts within the bailiwick of the securities acts and the SEC.”¹³⁴

In addition, the *Shank* court concluded that the protections against fraudulent conduct given to investors under the federal commodities and securities laws were comparable.¹³⁵ The court rejected the argument that the CEA is inferior because it, unlike the Securities Act of 1933 as construed in *Wilko v. Swan*,¹³⁶ permits arbitration to be compelled. To the contrary, in compelling arbitration in *Shank*, the court stated,

[T]his court concludes that it would be anomalous to hold that a commodities account was a security for purposes of permitting an investor to avoid an arbitration provision, while holding for all other purposes that Congress did not intend that a commodities account be a security subject to the provisions of the securities acts and the regulations of the SEC.¹³⁷

Similarly, other courts have concluded that whether a discretionary account is a security is no longer relevant.¹³⁸ In *Gravois v. Fairchild, Arabatzis*,¹³⁹ the United States District Court for the Eastern District of Louisiana said:

The unambiguous language of Section 2 makes clear that transactions involving commodity futures, commodity options and discretionary accounts that deal solely in commodity futures all fall within this exclusive grant of jurisdiction. [citations omitted] The purpose of this provision was “. . . to avoid unnecessary overlapping and duplicate regulation” between the CFTC and the SEC. [citations omitted] [I]t is clear that, where applicable, the CEA now preempts both the SEC and state regulatory jurisdiction.¹⁴⁰

And in *Hofmayer v. Dean Witter & Co., Inc.*,¹⁴¹ the United States District

133. See *supra* text accompanying notes 33-34.

134. 456 F. Supp. at 513.

135. *Id.*

136. See *supra* text accompanying notes 114-116 (discussing *Wilko v. Swan*).

137. 456 F. Supp. at 513-14. The *Shank* court's decision to compel arbitration is consistent with CFTC policy, which sanctions arbitration agreements and encourages binding arbitration as a means for settling disputes that may arise in connection with commodity futures and options accounts. Pre-dispute arbitration agreements have been held to be consistent with the purposes of the CEA. See *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1181 (2d Cir. 1977) (ordering arbitration of alleged CEA violations pursuant to preexisting agreement). The CFTC has promulgated rules concerning arbitration that are designed to encourage arbitration, while assuring that customers do not unknowingly or involuntarily waive rights and remedies available under the Act. See Part 180 of the CFTC's Rules, 17 C.F.R. Part 180 (1984) and 41 Fed. Reg. 27,520 (1976) (notice of proposed arbitration rules).

138. See *supra* note 130.

139. [1978-1980 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,706 (E.D. La. Nov. 9, 1978).

140. *Id.* at 22,873.

141. 459 F. Supp. 733, 737 (N.D. Cal. 1978).

Court for the Northern District of California concluded that “[E]ven if the *discretionary commodity trading account is assumed to be a security*, the exclusive jurisdiction provision of the 1974 Act precludes application of the securities laws to this action.”¹⁴²

Recently, the United States District Court for the Northern District of Georgia in *Mallen v. Merrill Lynch, Pierce, Fenner & Smith*¹⁴³ followed this reasoning in dismissing a customer’s state and federal securities claims in connection with a discretionary account for trading stock index futures.¹⁴⁴ In doing so, the court rejected those cases that have held that the jurisdictional provisions and the savings clause in the 1974 CEA amendments created a distinction between agency and court jurisdiction, thereby preserving a private right of action under the federal securities laws, even where the underlying transaction is a commodity.¹⁴⁵ The court found that the “savings” clause in the 1974 CEA amendments was intended to protect then pending SEC investigations and ongoing court proceedings, to protect state court jurisdiction over contract claims forming the basis of a futures contract, and to preserve private rights of action in federal court under the commodities laws.¹⁴⁶

The *Mallen* court recognized the paradox of subjecting individuals and corporations to regulation by the CFTC under the CEA, to suit by the CFTC or states in a *parens patriae* capacity under the CEA,¹⁴⁷ and to arbitration and reparations claims under the CEA, while also subjecting them to suit by private investors under the securities acts without the interpretative regulations promulgated thereunder.¹⁴⁸ The court noted that judicial application of federal securities laws to commodities accounts “would force careful brokers to see that the investment vehicle is registered as if it were regulated by the SEC at the same time that the board of exchange is seeking approval as a

142. *Id.* (emphasis added). See *Bartels v. International Commodities Corp.*, 435 F. Supp. 865, 868-69 (D. Conn. 1977) (holding that since the 1974 amendments SEC has no power to regulate commodity options and that since SEC jurisdiction is preempted, no private liability actions based on SEC rules or regulations such as Rule 10b-5 can exist). See also *Gonzalez v. Paine Webber Jackson & Curtis, Inc.*, 493 F. Supp. 499, 504-05 (S.D.N.Y. 1980); *Fairchild, Arabatzis & Smith v. Prometco, Ltd.*, 470 F. Supp. 610, 614 (S.D.N.Y. 1979); *Kupke v. Shearson/American Express*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,757 (M.D. Fla. Oct. 10, 1985) (all discussing impact of Section 2(a)(1)).

143. 2 COMM. FUT. L. REP. (CCH) ¶ 22,601 (N.D. Ga. March 28, 1985).

144. *Id.* at 30,578; cf. *Kupke v. Shearson/American Express*, 2 COMM. FUT. L. REP. (CCH) ¶ 22,757 at 31,155 (M.D. Fla. Oct. 10, 1985) (dismissing federal securities claims regarding discretionary commodities accounts based on *Mallen*).

145. See 2 COMM. FUT. L. REP. (CCH) at 30,574 and 30,576. The *Mallen* court found cases which continue to apply securities law to commodities transactions inconsistent with the Supreme Court’s holding in *Curran* that the savings clause was added merely to clarify that the previous provisos on regulatory jurisdiction did not remove all jurisdiction from federal courts. *Id.* at 30,577. The *Mallen* court noted that the minority in *Curran* had found that the substantive provision of the CEA remained the source of a litigant’s rights. *Id.*, citing *Curran*, 456 U.S. at 406.

146. 2 COMM. FUT. L. REP. at 30,576-30,577.

147. See 7 U.S.C. § 13a-2 (1982).

148. *Mallen*, 2 COMM. FUT. L. REP. at 30,578.

contract market under actual regulation by the CFTC.”¹⁴⁹ In the court’s view, this dual system of regulatory compliance caused by allowing federal securities claims was antithetical to the Congressional purpose in creating the CFTC. The dual system also defeated Congress’s purpose because in enacting the 1974 amendments to the CEA, Congress intended to avoid a duplicative or contradictory regulatory structure.¹⁵⁰

III. CONCLUSION

The legislative history of the 1974 and subsequent amendments to the Commodity Exchange Act suggest that Congress did not intend for federal securities laws to apply to discretionary commodity futures accounts after 1974. Accordingly, the rationale for the continued application of federal securities laws may indeed be reliance on historical judicial precedent which is no longer valid, combined with the failure of litigants and courts to actively address relevant statutory authority. As courts gain a better understanding of Section 2(a)(1)(A) and its legislative history, the application of federal securities laws should occur less frequently and the issue of horizontal or vertical commonality should no longer be relevant to cases involving discretionary commodities accounts.

149. *Id.* at 30,577.

150. *Id.* at 30,578. The court in *Mallen* said that the “basic rule” of statutory construction that “the specific controls the general” makes an application of *Howey* to discretionary commodities accounts “faulty” since a *Howey* analysis applies “the most general terms” in the federal securities statutes while such an analysis ignores specific terms in the jurisdictional statutes of both the SEC and the CFTC. *Id.* at 30,577. The court paid particular attention to the 1982 amendments to the Act, which it believed “fine tuned” the description of the specific investments under each agency’s jurisdiction. *Id.*