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COMMODITIES LAW AND PREDISPUTE ARBITRATION CLAUSES

*Howard Schneider**

The 1974 amendments¹ to the Commodity Exchange Act² (the Act) created the Commodity Futures Trading Commission (CFTC) and extensively revised an Act which, until then, dealt primarily with United States grown agricultural commodities³ traded on contract markets.⁴ The significant changes included expansion of the commodities regulated,⁵ exclusive CFTC jurisdiction over such regulated commodities,⁶ broad regulatory power for the CFTC,⁷ and the creation of customer dispute resolution procedures.⁸

By granting the CFTC sweeping regulatory authority, Congress established an Agency with significant power. That power was designed to regulate an industry which had flourished in the years just prior to the 1974 amendments,⁹ and which had come to

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1. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified at 7 U.S.C. §§ 2-22 (Supp. V 1975)).

2. 7 U.S.C. §§ 1-22 (1970 & Supp. V 1975).

3. The commodities previously regulated, enumerated in the Act, included: wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Irish potatoes, wool, wool tops, fats and oils, cottonseed meal, cottonseed, peanuts, soybeans, and soybean meal. *Id.* § 2 (1970) (amended 1974).

4. A contract market is defined as "a board of trade designated by the [CFTC] as a contract market under the Commodity Exchange Act." 17 C.F.R. § 1.3(h) (1977).

5. The Commodity Exchange Act (the Act) provides that, in addition to the enumerated commodities, *see* note 3 *supra*, "commodity" includes "all other goods and articles . . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in . . ." 7 U.S.C. § 2 (Supp. V 1975).

6. 7 U.S.C. § 2 (Supp. V 1975).

7. *See, e.g., id.* § 6c(b) (commodity option regulatory authority); *id.* § 7a(12) (prior approval of contract market rules); *id.* § 12a(7) (power to alter contract market rules); *id.* § 12a(9) (emergency power); *id.* § 13a-1 (injunctive power).

8. *Id.* §§ 7a(11), 18. *See* text accompanying notes 10-13 *infra*.

9. *See* 119 CONG. REC. 41,335 (1973), indicating a substantial increase in the number of contracts traded just prior to 1974, as compared to earlier years. Statistics cited in the course of congressional debates indicated:

This year, the volume of futures contracts was approximately 268 billion dollars on regulated commodities alone, and estimates before the Committee on Agriculture indicate that we can expect that volume will rise, in the near future, to over half a trillion dollars volume. This, of course, represents a

expect greater public participation in the markets.

Public participation in commodities markets produced a normal number of controversies between the public participant—the customer—and the commodity professional. The manner in which these disputes were resolved, however, apparently created congressional concern which, in turn, translated itself into at least two statutory provisions for dispute resolution: section 5a(11), requiring contract markets to create a “fair and equitable procedure” for the settlement of customer claims and grievances,¹⁰ and section 14, requiring the CFTC to establish “reparations” tribunals for the adjudication of customer complaints.¹¹ Both sections are customer-

substantial increase over these same transactions during the past several years.

Id. at 41,331 (remarks of Rep. Poage).

10. Commodity Exchange Act § 5a(11), 7 U.S.C. § 7a(11) (Supp. V 1975).

This section requires contract markets to:

[p]rovide a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof: *Provided*, That (i) the use of such procedure by a customer shall be voluntary, (ii) the procedure shall not be applicable to any claim in excess of \$15,000, (iii) the procedure shall not result in any compulsory payment except as agreed upon between the parties, and (iv) the term “customer” as used in this paragraph shall not include a futures commission merchant or a floor broker

See also 17 C.F.R. §§ 180.1-6 (1977), promulgated to implement § 5a(11) of the Act, *see* 41 Fed. Reg. 27,520 (1976).

11. Commodity Exchange Act § 14, 7 U.S.C. § 18 (Supp. V 1975). This section provides in part:

(a) **Petition**

Any person complaining of any violation of any provision of this chapter or any rule, regulation, or order thereunder by any person registered under section 6d, 6e, 6j, or 6m of this title may, at any time within two years after the cause of action accrues, apply to the [CFTC] by petition, which shall briefly state the facts, whereupon, if, in the opinion of the [CFTC], the facts therein contained warrant such action, a copy of the complaint thus made shall be forwarded by the [CFTC] to the respondent, who shall be called upon to satisfy the complaint, or to answer it in writing, within a reasonable time to be prescribed by the [CFTC].

(b) **Investigation and hearing.**

If there appear to be, in the opinion of the [CFTC], any reasonable grounds for investigating any complaint made under this section, the [CFTC] shall investigate such complaint and may, if in its opinion the facts warrant such action, have said complaint served by registered mail or by certified mail or otherwise on the respondent and afford such person an opportunity for a hearing thereon before an Administrative Law Judge designated by the [CFTC] in any place in which the said person is engaged in business: *Provided*, That in complaints wherein the amount claimed as damages does not exceed the sum of \$2,500, a hearing need not be held and

oriented¹² and remedial in nature.¹³

This article outlines the manner in which predispute arbitration clauses became an issue of serious concern to the CFTC, analyzes the regulation promulgated to settle the issue, and discusses whether that regulation is likely to be upheld. Next, the article examines the cases which have confronted the issue and attempts to ascertain if it is possible to harmonize those decisions.

INDUSTRY PRACTICE

Public access to the nation's commodities markets is largely effected through firms called "futures commission merchants"¹⁴ (FCMs); in securities terminology, broker-dealers. A commodity customer deals with an account executive employed by the FCM in much the same manner as a securities customer deals with a registered representative employed by his broker. The customer usually telephones the account executive, or is solicited by the account executive, and places an order for the purchase or sale of a futures contract. The account executive telephones the order to the exchange floor where a floor broker¹⁵ executes the order for the

proof in support of the complaint and in support of the respondent's answer may be supplied in the form of depositions or verified statements of fact.

See also 17 C.F.R. §§ 12.1-.102 (1977), promulgated to implement § 14 of the Act.

12. E.g., 7 U.S.C. § 7a(11) (Supp. V 1975), pertaining to customer claims and grievances against a member of a contract market and not vice versa; *id.* § 14, pertaining only to violations by a registered person, that is, a commodities trading professional, not by a registered person, against a customer.

13. See H.R. REP. NO. 975, 93d Cong., 2d Sess. 22 (1974). Both § 5a(11), 7 U.S.C. § 7a(11) (Supp. V 1975), and § 14, 7 U.S.C. § 18 (Supp. V 1975), provide commodities customers with remedies unavailable prior to the 1974 amendments.

14. Futures commission merchants (FCMs) are defined as:

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

(2) shall include any person required to register as a futures commission merchant under the Act by virtue of Part 32 of this chapter [*i.e.*, options dealers].

17 C.F.R. § 1.3(p) (1977).

15. A floor broker is defined as "any person who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market." *Id.* § 1.3(n).

FCM. The FCM is advised of the purchase or sale, and confirms the trade to the customer.

If the customer has not previously traded with the particular FCM, he will be asked to complete certain printed forms to open an account. The FCM forms generally require the customer to provide information about himself, including relevant financial data. These forms also establish a contractual relationship between the customer and the FCM. Matters of particular importance to the FCM, such as margin payments and, significantly for these purposes, dispute settlement procedures, are covered in the contract.

As a result of the cost and length of most civil litigation, FCMs found arbitration to be the most acceptable and economical resolution of the customer disputes which inevitably arose. Thus, as in the kindred securities industry, it soon became commodities industry practice to insist on the resolution of disputes by arbitration in one forum or another.¹⁶ In their printed forms, FCMs required that anyone opening an account agree in advance to settle a dispute relating to the account by arbitration.¹⁷ This has been called,¹⁸ for lack of a better name, a predispute arbitration clause.¹⁹ Nearly all FCMs followed this practice.

16. Some standard predispute arbitration clauses adopt the contract market as the arbitration forum, but many select the American Arbitration Association or the New York Stock Exchange.

17. See generally 41 Fed. Reg. 6120 (1976).

18. See, e.g., *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. 1231 (D.D.C. 1977); 41 Fed. Reg. 42,942 (1976).

19. A typical predispute arbitration agreement utilized by FCMs, as described in *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. 1231, 1232 n.2 (D.D.C. 1977), states:

Any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange as I may elect, except that any controversy arising out of or relating to transactions in commodities or contracts relating thereto, whether executed or to be executed within or outside of the United States shall be settled by arbitration in accordance with the rules then obtaining of the Exchange (if any) where the transaction took place, if within the United States, and provided such Exchange has arbitration facilities or under the rules of the American Arbitration Association as I may elect. If I do not make such an election by registered mail addressed to you at your main office within five days after demand by you that I make such an election, then you may make such election.

THE ISSUE IN CONTEXT OF THE ACT

As a result of the 1974 amendments to the Act, a commodities customer has three forums for settlement of a controversy relating to his commodities trading activities: a civil action in state or federal court, a reparations proceeding before a CFTC administrative law judge, or an arbitration conducted under the auspices of the contract market or another body, such as the American Arbitration Association or the New York Stock Exchange.²⁰

Generally, judicial procedures are formal, lengthy, and expensive; however, they provide extensive discovery mechanisms and appeal procedures. Reparation proceedings conducted by an expert administrative tribunal resolve disputes more quickly than judicial proceedings, and more formally than most arbitrations. Arbitrations are informal, inexpensive hearings which provide little pretrial discovery or posttrial appeal.

Notwithstanding the enactment of the 1974 amendments, as a result of the industry practice referred to above, if a commodities customer had signed a predispute arbitration clause, the FCM community felt that he had agreed to settle all issues between him and his FCM by arbitration in accordance with the procedures outlined in the FCM form contract. If that customer, however, sought reparations against the FCM under the new procedure provided in section 14, citing a violation of the Act as the basis of the controversy, he could be excluded from that congressionally mandated forum by the predispute arbitration clause. The customer, likewise, could be contractually barred from benefitting by section 5a(11), unless the parties had contractually agreed to the particular contract market arbitration forum.²¹ Finally, if the customer sued in court, whether pursuant to a private right of action under the Act²² or pursuant to a common law theory of damages, such a remedy might be unavailable because he had forfeited that right by agreeing to a predispute arbitration clause.

The CFTC believed that it had a congressional directive to deal with customer dispute resolution.²³ The Commission was

20. See notes 10 & 11 *supra* and accompanying text. If there has been no prior agreement selecting the forum, the attorney for a commodities customer will, quite naturally, choose the forum most advantageous to his client.

21. See note 10 *supra* and accompanying text.

22. See, e.g., *Goodman v. H. Hentz & Co.*, 265 F. Supp. 440 (N.D. Ill. 1967).

23. See 41 Fed. Reg. 42,942, 42,944 (1976), in which the CFTC stated: "The legislative history of the Act indicates that Congress 'expected the Commission to

faced, however, with the industry practice, the effect of which would have blocked access to reparations tribunals as provided in section 14 of the Act. To alleviate this roadblock, the CFTC exercised its general rulemaking power²⁴ and promulgated a regulation which required FCMs to modify substantially the concept embodied in predispute arbitration clauses.

CFTC REGULATION 180.3

Regulation 180.3²⁵ addresses the issue of predispute arbitration clauses; it provides that no such clauses may be entered into with a commodities customer, effective on and after November 29, 1976, unless: (1) the customer is not required to sign the predispute arbitration clause as a condition of doing business with the commodities professional;²⁶ (2) the customer separately endorses the clause if it is part of a broader agreement;²⁷ (3) the customer reserves his right to reparations, and, accordingly, maintains an unqualified right to demand reparations for forty-five days after the FCM has notified the customer that it intends to arbitrate the dispute;²⁸ (4) the contract contains a statement of the customer's

publish regulations' 'to implement and coordinate' reparations and other dispute settlement procedures 'and their utilization and availability for resolution of disputes.' " (footnote omitted).

24. 7 U.S.C. § 12(a)(5) (Supp. V 1975). See text accompanying note 33 *infra*.

25. 17 C.F.R. § 180.3(a) (1977) provides:

(a) The use by customers of the dispute settlement procedures established by contract markets pursuant to the Act or this Part or of the arbitration or other dispute settlement procedures specified in an agreement under paragraph (b)(3) of this section shall be voluntary. The procedures so established shall prohibit any agreement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

The regulation prohibits an FCM from entering into "any agreement or understanding with a customer in which the customer agrees, prior to the time the claim or grievance arises, to submit such claim or grievance to any settlement procedure," *id.* § 180.3(b), except in compliance with the requirements of *id.* § 180.3(b)(1)-(5), see text accompanying notes 26-30 *infra*.

26. 17 C.F.R. § 180.3(b)(1) (1977) provides: "Signing the agreement must not be made a condition for the customer to utilize the services offered by the futures commission merchant, floor broker or associated person."

27. *Id.* § 180.3(b)(2) provides: "If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and other provisions specified in this section."

28. *Id.* § 180.3(b)(3) provides:

The agreement may not require the customer to waive the right to seek

rights printed in boldface type,²⁹ and (5) if the forum for arbitration specified is other than a contract market under section 5a(11), the forum complies with minimum standards established by the CFTC in connection with contract market arbitration procedures.³⁰

VALIDITY OF THE REGULATION

The regulation, as an interpretation of a statute by the Agency entrusted with its enforcement, is entitled to great weight.³¹ The

reparations under section 14 of the Act and Part 12 of these regulations. Accordingly, the customer must be advised in writing that he or she may seek reparations under section 14 of the Act by an election made within 45 days after the futures commission merchant, floor broker or associated person notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the futures commission merchant, floor broker or associated person notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (i.e. do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexisting arbitration agreement.

29. *Id.* § 180.3(b)(4) provides:

The customer agreement must contain cautionary language, printed in large boldface type, to the following effect:

WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) RECOGNIZES THE BENEFITS OF SETTLING DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name]. See 17 CFR 180.1-180.6.

BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT AT A LATER DATE TO PROCEED PURSUANT TO SECTION 14 OF THE COMMODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES YOU WILL BE NOTIFIED IF [name] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC YOU WILL STILL HAVE 45 DAYS IN WHICH TO MAKE THAT ELECTION.

30. *Id.* § 180.3(b)(5) provides: "If the agreement specifies a forum for settlement other than a procedure established pursuant to section 5a(11) of the Act or this Part, the procedures of such forum must comply with the requirements of § 180.5." The minimum standards established in 17 C.F.R. § 180.5 (1977) require these procedures to be "voluntary" and "fair and equitable," as provided in *id.* §§ 180.2-.3.

31. *See, e.g.,* Power Reactor Dev. Co. v. International Union of Electrical,

industry practice confronting the CFTC and the mandate to establish an effective reparations procedure³² required that the Agency promulgate a rule enabling commodities customers to use the reparation procedures established by Congress and implemented by the CFTC. Section 8a(5) confers authority on the CFTC "to make and promulgate such rules and regulations as, in the judgment of the [CFTC], are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of [the Act]."³³ In light of the background stated above, there can be little question that the regulation is "reasonably necessary."

Most FCMs viewed regulation 180.3 as an unwarranted interference by the CFTC with the contractual agreement between the FCM and its customer.³⁴ Insubstantial arguments of unconstitutionality aside,³⁵ the main argument against regulation 180.3 was that, if left to the courts, predispute arbitration clauses in commodities customer contracts would not be invalidated for two significant reasons: First, legislative³⁶ and judicial³⁷ policies favor arbitration; second, there is a lack of an express statutory provision in the Act comparable to that in the Securities Act of 1933,³⁸ precluding the waiver of statutory rights. The Securities Act nonwaiver provision was a basis of the Supreme Court decision in *Wilko v. Swan*³⁹ which struck down a similar predispute arbitration clause

Radio and Mach. Workers, 367 U.S. 396, 408 (1961) (citing *Norwegian Nitrogen Prods. Co. v. United States*, 288 U.S. 294, 315 (1933)).

32. See text accompanying note 23 *supra*.

33. Commodity Exchange Act § 8a(5), 7 U.S.C. § 12a(5) (Supp. V 1975).

34. See 41 Fed. Reg. 42,942, 42,944 (1976).

35. FCMs argued that the regulation unconstitutionally impaired the obligation of contracts, see U.S. CONST. art. I, § 10, constituted an *ex post facto* law, see *id.*, and violated the due process clause of the fifth amendment, see *id.* amend. V. However, the impairment of contracts provision of the Constitution limits the states, not the federal government; the *ex post facto* prohibition relates to criminal law; it is an established constitutional principle that private contracts can be amended by governmental action where the regulation is reasonably necessary to effect a statutory purpose, see generally *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934); *O'Gorman & Young, Inc. v. Hartford Fire Ins. Co.*, 282 U.S. 251 (1931).

36. See Federal Arbitration Act, 9 U.S.C. §§ 1-208 (1970).

37. See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974). See generally Address by Chief Justice Burger, National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice (Apr. 7, 1976).

38. 15 U.S.C. § 77n (1970). This section provides: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the [Securities and Exchange] Commission shall be void."

39. 346 U.S. 427 (1953).

used in the securities industry.⁴⁰

The CFTC opposed the position taken by the FCMs. The CFTC contended that, despite the legislative and judicial policies favoring arbitration, predispute arbitration clauses should not be permitted to frustrate the remedial provisions of the Act.⁴¹ The Agency reasoned that predispute arbitration clauses were so pervasive that they would have the effect of precluding customers from benefiting by the 1974 amendments, particularly those relating to reparations. Thus, the Agency argued, courts would be bound to give effect to the remedial provisions contained in the Act; even the conflicting provisions in the Federal Arbitration Act favoring arbitration should not preclude judicial application of the remedial provisions of the 1974 amendments.

The courts which have considered whether predispute arbitration clauses can be used to prevent a reparations proceeding have thus far agreed with the CFTC. In *Shearson Hayden Stone Inc. v. Miles*⁴² and *Bache Halsey Stuart, Inc. v. French*,⁴³ FCMs sought to stay reparation proceedings instituted by commodities customers who had alleged violations of the Act by the FCMs.⁴⁴ In each case, the FCM moved to compel arbitration under predispute arbitration clauses.⁴⁵ Both courts denied the motions on the grounds that courts should not stay administrative proceedings absent a showing of irreparable harm; initiating a reparations proceeding was held

40. The Court in *Wilko v. Swan, id.*, stated:

Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment. On the other hand, it has enacted the Securities Act to protect the rights of investors *and has forbidden a waiver* of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act.

Id. at 438 (emphasis added) (footnote omitted).

41. 41 Fed. Reg. 42,942, 42,944-45 (1976).

42. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,223 (N.Y. Sup. Ct. 1976).

43. 425 F. Supp. 1231 (D.D.C. 1977).

44. *Id.* at 1232-33; *Shearson Hayden Stone Inc. v. Miles*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,223, at 21,203 (N.Y. Sup. Ct. 1976).

45. *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. at 1232-33; *Shearson Hayden Stone Inc. v. Miles*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,223, at 21,203 (N.Y. Sup. Ct. 1976).

not to be irreparable harm.⁴⁶ The essential holding of the cases is that, since the Federal Arbitration Act contains no provision permitting a judicial stay of an administrative action,⁴⁷ the customer's right to reparations could not be supplanted by a predispute arbitration clause.

The FCMs' second contention was that the Act did not specifically prohibit a waiver of statutory rights in a manner comparable to the Securities Act provision cited in *Wilko v. Swan*.⁴⁸ The CFTC contended that *Wilko* and its progeny were grounded more in the remedial, nonwaivable nature of the rights afforded securities customers under the Securities Act than on any express statutory provision. The CFTC reasoned that because of the remedial provisions of the Act, a court would likely hold that these rights could not be waived by a commodities customer even without an express statutory provision. Moreover, the CFTC believed that industry practice created a situation in which there was lack of an informed consent by the customer to waiver of his remedial rights.⁴⁹ Thus far, no court has addressed the issue of informed consent in this context.⁵⁰ Nevertheless, in light of the industry-wide practice requiring predispute arbitration clauses, the in-

46. *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. at 1234-35; *Shearson Hayden Stone Inc. v. Miles*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,223, at 21,209 (N.Y. Sup. Ct. 1976).

47. Basically, this reasoning upholds the concept of requiring an exhaustion of administrative remedies before resort to the courts may be obtained. This theory of exhaustion of administrative remedies is explained in *Renegotiation Bd. v. Banner-craft Clothing Co.*, 415 U.S. 1, 20-25 (1974); *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938).

48. 346 U.S. 427 (1953). See text accompanying notes 38-40 *supra*.

49. The CFTC stated in the notice accompanying promulgation of regulation 180.3:

The Commission is convinced that, as a legal matter, courts would strike down pre-dispute arbitration agreements currently in effect in the commodities business since such clauses have the effect of negating the remedial provisions of sections 5a(11) and 14 of the Act and are signed in an atmosphere which imports a lack of informed consent on the part of certain unsophisticated customers under circumstances which may well be viewed by courts as the imposition of a contract of adhesion to the detriment of such customers.

41 Fed. Reg. 42,942, 42,944 (1976). The CFTC further stated: "Certain commodity customers who are unsophisticated are compelled to sign such agreements under conditions which suggest a lack of informed consent and the imposition of a contract of adhesion on them to their detriment." *Id.* at 42,945 (footnote omitted).

50. *But see Tamari v. Bache & Co.*, COMM. FUT. L. REP. (CCH) ¶ 20,505, at 22,092-94 (7th Cir. Oct. 19, 1977) (Swygert, J., dissenting).

formed consent argument would be fertile grounds for customer-initiated litigation.

Several cases, however, have considered the argument in *Wilko* which emphasized the remedial nature of the Securities Act despite the lack of an express statutory provision relating to non-waiver, and have split on its efficacy. In *Milani v. ContiCommodity Services, Inc.*,⁵¹ a commodities customer brought suit in federal court alleging violations of the Act. The FCM moved to enforce a predispute arbitration clause. The court held, similarly to the *Wilko* theory advocated by the CFTC, that the Act's policy of protecting investors overrode the predispute arbitration clause.⁵² In addition, *French*,⁵³ and to a lesser extent, *Miles*,⁵⁴ support the CFTC *Wilko* theory as grounds for denying the FCM motion to compel arbitration.

However, at least two recent cases which considered the CFTC *Wilko* theory rejected it and upheld the predispute arbitration clause. In *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,⁵⁵ a customer sued in the Southern District of New York, alleging that his FCM had violated the Act. The FCM moved to stay the court proceeding and to compel arbitration under a predispute arbitration clause. The court held that the commodities field lacks special circumstances, as contrasted with the antitrust⁵⁶ or civil rights⁵⁷ fields, which would justify abandonment of the policy favoring arbitration.⁵⁸ The court stressed that Congress sanctioned arbitration as one method of acceptable commodities dispute resolution in section 5a(11).⁵⁹ Furthermore, the court stated that the

51. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,227 (N.D. Cal. 1976).

52. *Id.* at 21,225. See also *Tamari v. Bache & Co.*, COMM. FUT. L. REP. (CCH) ¶ 20,505, at 22,092-94 (7th Cir. Oct. 19, 1977) (Swygert, J., dissenting).

53. *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. 1231 (D.D.C. 1977).

54. *Shearson Hayden Stone Inc. v. Miles*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,223 (N.Y. Sup. Ct. 1976).

55. [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,283 (S.D.N.Y. Mar. 21, 1977), *appeal docketed*, No. 77-7192 (2d Cir. Apr. 27, 1977).

56. See *Power Replacements, Inc. v. Air Preheater Co.*, 426 F.2d 980 (9th Cir. 1970); *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968).

57. See *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974).

58. *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,283, at 21,538-39 (S.D.N.Y. Mar. 21, 1977), *appeal docketed*, No. 77-7192 (2d Cir. Apr. 27, 1977).

59. *Id.* at 21,534-35.

Securities Act of 1933 is distinguishable⁶⁰ in that it grants exclusive jurisdiction to the federal district courts,⁶¹ contains a nonwaiver section,⁶² and provides a private right of action for civil liability,⁶³ these distinctions, the court reasoned, render the reasoning of *Wilko* inapplicable to the commodities area. Similarly, the Seventh Circuit, in a recent split decision, *Tamari v. Bache & Co.*,⁶⁴ held that the court would not legislate a nonwaiver provision, similar to that in the Securities Act of 1933, into the Act.⁶⁵ The dissent in *Tamari*, however, is in accord with *Milani* and the CFTC *Wilko* theory.⁶⁶

Both *Ames* and *Arkoosh v. Dean Witter & Co., Inc.*,⁶⁷ which upheld a predispute arbitration clause, refused to apply regulation 180.3. The *Ames* court would not apply the regulation retroactively, stating:

Because I believe that retrospective application of § 180.3 would serve to prejudice heretofore valid agreements entered into in the basis of existing legal authority, I decline to apply § 180.3 retroactively, which would perforce require this Court to deny the benefits of the arbitration provision set forth in the Customer's Agreement, based on language not in existence when the contract was made.⁶⁸

The *Arkoosh* court reasoned that at the time of its decision regulation 180.3 was inapplicable because it was merely proposed, not final.⁶⁹

SYNTHESIS OF THE DECIDED CASES

Regulation 180.3 is valid as to disputes which arose after its effective date of November 29, 1976. *French*, *Arkoosh*, and *Ames* imply such validity in that they cite the regulation with seeming

60. *Id.* at 21,539-40.

61. 15 U.S.C. § 77i (1970).

62. *Id.* § 77n.

63. *Id.* § 77l.

64. COMM. FUT. L. REP. (CCH) ¶ 20,505 (7th Cir. Oct. 19, 1977).

65. *Id.* at 22,088-89. *Accord*, *Romnes v. Bache & Co., Inc.*, [1977] SEC. REG. & L. REP. (BNA) A-9 (W.D. Wis. Nov. 10, 1977).

66. *Tamari v. Bache & Co.*, COMM. FUT. L. REP. (CCH) ¶ 20,505, at 22,092 (7th Cir. Oct. 19, 1977) (Swygert, J., dissenting).

67. 415 F. Supp. 535 (D. Neb. 1976).

68. *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,283, at 21,537 (S.D.N.Y. Mar. 21, 1977), *appeal docketed*, No. 77-7192 (2d Cir. Apr. 27, 1977).

69. *Arkoosh v. Dean Witter & Co., Inc.*, 415 F. Supp. 535, 541 (D. Neb. 1976).

approval; but even without these cases, there would be a strong presumption of validity in light of the CFTC's rulemaking power and its sound explanations of the necessity for the regulation.⁷⁰ However, strict adherence to the *Ames* reasoning with respect to denial of retroactive application could negate the regulation's broad impact. If *Ames* is carried to its logical conclusion, all predispute arbitration agreements entered into before the effective date of regulation 180.3 would remain in effect; only those customer agreements entered into after the effective date of the regulation would have to adhere to the requirements of regulation 180.3.⁷¹ The anomalous result would be to make the remedial provisions of section 14 available to some commodities customers while denying them to others. In any event, *Ames* is being appealed.⁷² The CFTC filed an *amicus curiae* brief supporting the plaintiff's contention, at least on the narrow ground that the regulation applies to contract clauses already in existence.⁷³

*Miles, French, and Hornblower & Weeks-Hemphill Noyes, Inc. v. Csaky*⁷⁴ indicate that, even where the dispute predates the effective date of the regulation, if a commodities customer seeks to institute a reparations proceedings under the Act, he will not be forced to arbitrate under a predispute arbitration clause.⁷⁵ *Arkoosh* is distinguishable from these cases; in *Arkoosh* no violation of the Act was claimed and therefore, reparations was not an available remedy. Thus, no real issue, such as the remedial nature of the Act for the benefit of commodities customers, was posed.

70. See text accompanying notes 31-33 *supra*.

71. See 17 C.F.R. § 180.3 (1977).

72. See *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,283 (S.D.N.Y. Mar. 21, 1977), *appeal docketed*, No. 77-7192 (2d Cir. Apr. 27, 1977).

73. The CFTC position conforms to that stated in 41 Fed. Reg. 42,942, 42,944 n.18 (1976):

[The CFTC has] carefully considered the alternative to invalidating pre-dispute arbitration agreements . . . [to limit regulation 180.3 to agreements entered into after its effective date]. However, [the CFTC] believes [*sic*] that customers who have already signed arbitration agreements may need the protection afforded by proposed § 180.3(b) as much as customers who may enter arbitration agreements in the future, and is not persuaded that the convenience of futures commission merchants and other registrants is a sufficient reason to discriminate between customers on the basis of when they signed arbitration agreements.

74. 427 F. Supp. 814 (S.D.N.Y. 1977).

75. See *id.*; *Bache Halsey Stuart, Inc. v. French*, 425 F. Supp. 1231 (D.D.C. 1977); *Shearson Hayden Stone Inc. v. Miles*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,223 (N.Y. Sup. Ct. 1976).

However, where a customer has claimed a violation of the Act, but has sought to institute a civil action for damages, as contrasted with an administrative proceeding in reparations, the decided cases have split on the validity of the predispute arbitration clause. *Milani* and, in part, the dissent in *Tamari* relied on the CFTC *Wilko* theory; *Ames* and *Tamari* denied its applicability to commodities cases. *French* and *Miles* impliedly support the *Milani* result. Both the *Milani* and *Tamari* positions are tenable; accordingly, it is difficult to determine which will prevail in the courts. However, the more time which elapses from the effective date of regulation 180.3, the less likely it becomes that a dispute will arise which will not be governed by the express provision of the regulation.⁷⁶ Thus, the *Tamari-Milani* split may remain unresolved as regulation 180.3 takes hold.

CONCLUSION**

The CFTC's impact on commodities customer predispute arbitration clauses has been significant. Congress granted commodities customers the right to resolve their disputes with commodities professionals in the remedial manner specified. The CFTC fashioned a regulation which carries out the congressional mandate, while still preserving arbitration as a feasible remedy.

Regulation 180.3 requires that the FCM provide a commodities customer with a document which permits the customer, at a minimum, to make an informed decision whether to select arbitration as a method of resolving disputes. The customer nevertheless retains the option to seek reparations in any event. This result, it is believed, fulfills the congressional mandate. Perhaps the regulation will, in the course of time, have the salutary effect of ending litigation relating to whether a customer must arbitrate. Notwithstanding the controversy surrounding the regulation, the certainty created by its promulgation will probably prove to be the regulation's greatest contribution to the field of futures regulation.

76. See *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,283, at 21,536 (S.D.N.Y. Mar. 21, 1977), appeal docketed, No. 77-7192 (2d Cir. Apr. 27, 1977).

** As this article went to press, the Second Circuit reversed the lower court's decision in *Ames*, finding that regulation 180.3 applies retroactively. *Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, COMM. FUT. L. REP. (CCH) ¶ 20,515 (2d Cir. Dec. 6, 1977). The Second Circuit concluded that retroactive application is consistent with the administrative history of the regulation and is not unconstitutional, see *id.* at 22,121-24.