Commodity Futures Account Protection

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LEGISLATIVE PROPOSAL

COMMODITY FUTURES ACCOUNT PROTECTION

Probably no subject we write about is more difficult to explain, or to understand, than trading in commodity futures. That's because you're selling or buying something you'll probably never see, at a place you can't be, for delivery at a time yet to come.¹

When a Futures Commission Merchant² (FCM) becomes insolvent and ceases to function, his customers may suffer serious financial losses. The purpose of this proposal is to demonstrate the need for customer protection and to propose a mechanism by which such insurance might best be provided.

The relationship between the FCM and his customer is one of reciprocal rights and duties. It is a multifaceted relationship, and many of the questions involved have been extensively litigated. Baer and Saxon summarized the broker's duties to his margin customer as follows:³

1. At once to enter into the contract on the exchange for the sale or purchase of the commodity according to instructions from the customer.⁴

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² "Futures commission merchant" is defined as: individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, 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.

Commodity Futures Trading Commission Act of 1974, § 2, 7 U.S.C. § 2 (Supp. V 1975). Essentially, a futures commission merchant (FCM) is a broker whom a customer will call to place an order to buy or to sell futures contracts.


⁴ The contract discussed here is a futures contract. This is a contract to buy and receive or to sell and deliver a commodity during a specified future month; the terms of the contract are specified by the exchange upon which the contract is traded. S. ANGRIST, SENSIBLE SPECULATING IN COMMODITIES 201 (1972).
(2) To carry the contract for the benefit of the customer so long as the margin is kept good, or until notice is given by either party that the transaction is to be closed out.

(3) To advance all money required beyond the margin required of the customer.

(4) To deliver such contract to the customer when required by him, upon receipt of the advances and commissions accruing to the broker.6

Reciprocally, the customer agrees:

(1) To pay the margin required.

(2) To keep good such margin according to the fluctuations of the market.

(3) To take the contract executed on the exchange, whenever required by the broker, and to pay the difference between the sums advanced by himself and the amount paid by the broker. In addition, of course, the customer is always bound to pay the commissions.7

Although the broker or FCM is essentially a middleman, facilitating trades between sellers and buyers, it bears substantial burdens under the margin system.8 Brokerage houses often main-

5. A margin is a sum of money deposited by the trader with the FCM, and by the FCM with the clearinghouse. The margin acts not as a down payment, as in securities trades, but rather as a performance bond. Such payments bind the seller and the buyer, respectively, to deliver and to pay in full. The clearinghouse holds the margin required on each contract. The trader delivers margin amounts to his FCM; the FCM “marks to market” and delivers appropriate amounts to the clearinghouse. Frequently, the FCM will hold money, securities, or previously realized profits for a customer in an account where the amount remains available to cover margin requirements.


7. Id.

8. FCMs are members of the various exchanges. Baer and Saxon illustrated the burdens placed upon exchange members:

Exchange members, who deal directly with one another, act as principals. The member who executes an order on the exchange for his customer is the principal in the transaction so far as the member, from whom he buys or to whom he sells, is concerned. He is also the principal so far as the clearing house is concerned.

Id. at 301 (footnotes omitted). In discussing the clearinghouse, one Guide states:

Should an individual customer of a Commission House become unable to fulfill either his financial or delivery obligation to the Clearing House, the obligation must be assumed by the carrying Commission House member itself, using its own funds to make up any customer deficit, if necessary. That is why brokers insist that margin calls, once made, be answered promptly and in full. It is also the reason why the commodity account agreement of each Commission House gives the broker the right to liquidate any position
tain large commodity accounts through which they trade for their own accounts. Like any of their customers, they stand to bear significant losses through speculation. An FCM remains liable on its customer's open contracts even though the customer defaults. Thus, several large customer defaults may render the FCM insolvent. Other events may render brokers insolvent, including fraudulent transactions, the broker's inability to compete with larger FCMs, and ordinary market forces.

In the event of an FCM insolvency, traders dealing through such an FCM stand to suffer severe financial injury by losing their margin deposits and by losing control over open positions on futures contracts and over options.

Commodity futures markets expose speculators to serious risks. These risks, however, inhere in the speculativeness of futures transactions and are understood and accepted by all traders. They are "bargained for"; traders consider these risks in evaluating the likelihood of their success in any particular transaction. Yet the risk of broker insolvency, and the disastrous financial consequences of such insolvency, is not a "bargained for" risk. These risks heighten the danger in a commodity futures trade. Since the markets prosper through increased trading, such risks should be eliminated

of his customer, and without recourse, in the event margin calls are not promptly met.


9. One problem plaguing the Commodity Futures Trading Commission (CFTC) is "dual trading." Dual trading concerns only a specific type of FCM, the futures floor trader. Futures traders may trade for their own accounts as well as for their customers' accounts. This "dual trading" capability is often considered to be the mechanism by which price distortions are caused, by clever manipulation of clients' buy, sell, or stop orders by collusive and unscrupulous floor traders who take positions for themselves opposite to those of their customers.

10. One study concluded that 75% of all speculators lost money. Of those who profited, 84% made less than $1000. See B. Stewart, AN ANALYSIS OF SPECULATIVE TRADING IN GRAIN FUTURES 57 (USDA Technical Bulletin No. 1001, 1949).

Thomas Hieronymus conducted a similar study, which indicated that 65% of all speculators lost money, and that 50% of those who profited made less than $1000. See T. Hieronymus, Economics of Futures Trading 258-63 (2d ed. 1977). A third study indicated that an average of 26% of all traders end the year with a profit. R. Teweles, C. Harlow, & H. Stone, THE COMMODITY FUTURES GAME 296-98 (2d ed. 1974).

11. See note 8 supra.

12. The term "traders" here refers to all those individuals, partnerships, or corporations who purchase or sell commodity futures contracts or options. This, of course, includes most customers of an FCM.
to encourage more speculators to enter the markets.\textsuperscript{13} These risks may be eliminated at a cost which is relatively low compared to the possible benefits of such elimination.\textsuperscript{14} Dangers to both investors and the economy necessitate this protection.\textsuperscript{15} The problem of FCM insolvency is not merely theoretical: Two such insolvencies have occurred within the last four years in New York alone.\textsuperscript{16} The J.S. Love bankruptcy\textsuperscript{17} was precipitated by improper conduct on the part of Love’s trading associates. The accounts had not been properly segregated,\textsuperscript{18} nor had the recordkeeping met the re-

\begin{itemize}
  \item \textsuperscript{13} The commodity futures markets serve an essential economic function, permitting farmers, producers, and other persons whose livelihoods depend on the production or sale of commodities to “hedge,” and thus to protect themselves against declining markets. A farmer may enter the market and short (sell) wheat at a known price a year or more before it is grown. He can thus calculate his prospective profits without fear of a decline in the price of wheat by the time it is ready for sale. On the other hand, the hazards involved in production of commodities and in concomitant price fluctuations may yield windfall profits for producers or growers. The “hedger” exchanges this possibility of windfall profits for the security of a known price. The speculator, on the other hand, assumes all the risks and possible windfalls of wide price fluctuations. Without speculators willing to accept these risks, producers would be unable to hedge. Increased speculation and trading increases the liquidity of the market. Liquidity enables hedgers to enter or leave the market at will.
  \item \textsuperscript{14} See proposal at text accompanying notes 104-110 infra.
  \item \textsuperscript{15} For a contrary opinion, see the recent report of the CFTC. CFTC, \textsc{Report to Congress Concerning Commodity Futures Account Insurance} (1976), reprinted in part in \textsc{[1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,235 (1976)} [hereinafter cited as \textit{CFTC Report}]. For a critique of this Report, see discussion at notes 51-76 infra and accompanying text.
  \item \textsuperscript{17} On March 1, 1976, permanent injunctions against J.S. Love & Associates Consultants, Inc., and James Spencer Love, Jr. were issued and an order appointing a temporary receiver for the companies was issued on consent. Permanent injunctions on consent against Leonard Irwin Freedman and Melvin Cantor were issued on March 3, 1976 and against Arlene Karian on March 10, 1976. On April 9, 1976, after the first day of the hearing held on the CFTC’s motion for a preliminary injunction, Charles Lemieux consented to the entry of an order of permanent injunction. On March 11, 1976 the companies filed voluntary petitions in bankruptcy in this Court, and on April 13, 1976, Paul Krohn, Esq. was appointed trustee for each company by Bankruptcy Judge John Galgay. \textit{CFTC v. J.S. Love & Assocs. Options, \textsc{[1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,198, at 21,100 n.1 (S.D.N.Y. 1976)}.
  \item \textsuperscript{18} An FCM must:
  \begin{itemize}
    \item treat and deal with all money, securities, and property received by such [FCM] to margin, guarantee, or secure the trades or contracts of any customer of such [FCM], or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled
  \end{itemize}
\end{itemize}
quirements of regulation 1.32. As of this writing, many of Love’s customers still have not recovered much of their money. Paul Krohn, the trustee in bankruptcy, was still attempting to untangle the accounts held by Love in a single “omnibus” account in London. In the Weis bankruptcy, the accounts of commodity futures customers have been used to reimburse securities customers. This inequitable situation resulted from the imbalance caused by the Securities Investor Protection Corporation (SIPC), which has no counterpart intended to protect the interests of commodity futures customers.

The overextension of credit by banks, which resulted in numerous bank failures, in large part precipitated the Great Depression. Public confidence in banking institutions had been se-

with the funds of such commission merchant . . .


19. An accounting of such segregated amounts “shall be computed by each [FCM] as of the close of the market each business day.” 17 C.F.R. § 1.32 (1977).


22. This bankruptcy and liquidation was brought about pursuant to the Securities Investor Protection Act of 1970, § 6, 15 U.S.C. § 78ff (1970). Amounts directly traceable to commodity futures customers’ accounts were used solely in satisfaction of commodity customers’ claims. The “single and separate fund” of customers’ property, however, was used exclusively to satisfy the claims of securities customers. The basis for this decision was the definition of “customer” given in the Securities Investor Protection Act of 1970. See generally note 89 infra. The court stated that trading in commodity futures, “when done by those not in the business of producing or dealing in such commodities, but rather by those who seek to profit merely by dealing in the paper futures, is speculation rather than investment.” Weis Sec., Inc., [1975-1977 Transfer Binder] COMM. Fut. L. REP. (CCH) ¶ 20,108, at 20,789 (S.D.N.Y. 1975).


24. Representative Steagall stated the case more aptly in discussion on the floor of the House of Representatives on May 20, 1933:

Agriculture is prostrate. Industry is crushed. Trade and commerce, both domestic and foreign, have been paralyzed. Bank credit has been destroyed. Confidence has vanished and hope has been deferred until the hearts of the struggling masses are sick. These conditions culminated in the complete collapse of the banking system of the Nation . . . .

verely damaged. To aid in the recovery of the banks, Congress passed the Federal Depositor’s Insurance Act. This Act created the Federal Depositor’s Insurance Corporation, which was designed:

to strengthen the banking structure, to establish adequate capital requirements, to provide more effective regulation and supervision, to eliminate dangerous and unsound practices, and to confine banks of deposit to legitimate functions and to separate them from affiliates or other organizations which have brought discredit and loss of public confidence.

Representative Steagall stated on the House floor: “President Roosevelt in his inaugural address spoke the truth when he declared that fear is the underlying cause of our present economic difficulty. We must banish this fear if we are to put an end to the depression. The one indispensable remedy is insurance of bank deposits.”

Thus, should a bank become insolvent, its investors’ deposits are insured. The Federal Savings and Loan Insurance Corporation provides equivalent protection for savings and loan institutions. Similarly, the Securities Investor Protection Act of 1970 (the SIPA) created the Securities Investor Protection Corporation to protect securities investors’ properties in brokerage bankruptcies.

Commodity futures customers need similar protection. A

27. Id. at 3840.
31. SIPC’s success has exceeded all expectations. The New York Times noted:

Stockbrokers are apparently doing so well these days that the Securities Investor Protection Corporation—set up a few years ago to help customers of brokers in trouble—may reduce broker assessments to a bail-out fund, the agency reported yesterday.

Hugh F. Owens, chairman, said that, because broker liquidations had fallen in the last few years, the S.I.P.C. fund now stood at about $106 million. He said that once the fund reached $150 million, or such other amount determined to be in the public interest, the agency “may lower assessments.” Mr. Owens said that at the present rate the fund could reach $150 million within two years.

workable formula for the implementation of such protection is detailed below.

**The Need for Protection**

As the introductory quotation implies, few prospective traders are familiar with the mechanics of commodity futures contracts.\(^3^2\) Still fewer are familiar with the intricate workings of markets and exchanges. One of the few facts generally known about the markets is that every trade carries a high degree of risk. Studies conducted within the past decade indicate that between 65% and 75% of all traders ultimately lose money;\(^3^3\) small traders lose disproportionately more.\(^3^4\) The additional risk of broker insolvency increases the overall risk of loss, but it is not "bargained for" by traders. To elucidate the need for the proposed protection, it will be useful to explore some of the problems likely to arise in the event of an FCM insolvency. We shall assume that the FCM has ceased conducting business and executing orders.\(^3^5\)

*Hypothetical A*: Customer S holds an open position on a contract to buy grain. The current price of that contract is less than the price he paid for it, and the prospects look grim. S wishes to take an opposite position on the same contract and thus "close out" his trade.\(^3^6\)

This is a typical situation confronting a commodity futures contracts trader. In our example, S wishes to sustain a known loss now instead of holding his contract open, risking a greater loss. However, since the FCM has ceased executing orders, S cannot secure the execution of his order. He is trapped in a situation in which he may suffer substantial losses.\(^3^7\) Since, unlike the securities inves-

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32. Observe the title of the article cited note 1 supra.
33. See note 10 supra.
34. See also article cited note 1 supra.
35. This occurred in J.S. Love & Assocs. Options, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,198 (S.D.N.Y. 1976). All order execution ceased, a temporary receiver was appointed, and customers were unable to contact their FCM. Many of the letters sent by discouraged customers to Judge Galgay's court are on file in the Southern District of New York. The tone of these letters is unequivocal desperation.
36. One closes out a trade by executing an order exactly opposite to one previously executed through the same FCM. Thus, if S were long 10 contracts of May wheat, S would close out by shorting 10 contracts of May wheat through the same FCM. The result is a paper profit or loss; the trader is relieved of any obligation either to deliver or to accept delivery of the wheat.
37. The trader is trapped only in the sense that he does not know, and may have great difficulty discovering, the current status of his contracts. If the exchange
tor, the commodities trader holds an executory contract, it may be impossible for S to predict the possible extent of his loss. The loss sustained by a securities investor is limited to the value of his securities; the loss sustained by a commodity futures speculator is theoretically limitless.\textsuperscript{38} An observer might suggest that S immediately contact another FCM and take the opposite position through him. Unfortunately, unless the opposing trades are conducted through the same FCM, the trade will never be closed out.\textsuperscript{39} The uncertainty concerning the present status of one’s account may result in traders taking positions “opposite” to formerly “open” accounts that may already have been closed out by the exchange.\textsuperscript{40}

\textit{Hypothetical B:} Customer S holds an open position on a contract to buy grain. The current price of that contract is greater than the price he paid for it. S wishes to close out his position and take his profit.

This is another very common situation, albeit not as common as that in hypothetical A. S wishes to take certain profit now rather than speculative profit later. Since his FCM has ceased to execute orders, he cannot close out his position. The trader is trapped in a volatile market that may radically reverse itself, causing him serious losses before he can close out.

\textit{Hypothetical C:} An FCM becomes insolvent and cannot meet his financial obligations. According to the general rules of the

\textsuperscript{38} For example, S “shorts” or sells 10 contracts of May wheat. He expects the price of May wheat to drop, at which time he will buy 10 contracts and close out. Due to unforeseen circumstances, the price of May wheat triples within three days. S cannot close out without taking substantial losses, the extent of which was entirely unforeseeable. The extent of the loss depends on the fluctuation in price; the price might have increased tenfold. Consider the prices of sugar, cocoa, coffee, and oranges in recent months. Note that one may “short” securities with equivalent inestimable losses.


\textsuperscript{40} There are several situations in which an exchange may close out an open account. One such account is the insolvency of the FCM. COMM. FUT. L. REP. (CCH) ¶ 317(4)(a) (1974). The exchange needs this authority because a customer who does not know whether his account is open or closed cannot cover his position.

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clearinghouses, the first step in dealing with the insolvency is to liquidate "all contracts open on the failed member’s books." 41 Customer S wishes to maintain his newly profitable open positions.

In light of the foregoing discussion, this presents a significant problem. The customer may be unaware of the mandated procedure or uncertain whether the clearinghouse has followed it.

_Hypothetical D_: S, holder of an option to purchase a particular contract for a certain price, wishes to exercise his option. Since his FCM has become insolvent, he cannot do so.

A futures option 42 is very time-sensitive property. A newly purchased option may become valuable in two months, in two minutes, or never. It may remain valuable for two minutes or two months. Thus, an order to exercise an option must be executed swiftly. Where an insolvent FCM has ceased to execute orders, S’s option may quickly become valueless or may expire.

_Hypothetical E_: Trader S has placed a "stop loss" order 43 with his FCM. This type of order requires the FCM to close the customer out when the market price for a particular contract reaches a prescribed level. S has thus attempted to minimize the possible negative consequences of a particular trade.

Here the problem of failure to execute becomes even more pronounced. A trader places a "stop loss" order to prevent the type of

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41. Id.
42. A "futures contract" is a bilateral executory contract to buy and receive or to sell and deliver a commodity during a specified future month with the terms of the contract specified by the futures exchange on which the contract is traded. A "futures option" consists of the right to purchase or to sell a futures contract at a specified price at any time prior to expiration of the option. The amount paid for the option is known as a "premium." If, at some time prior to expiration, the market price of the underlying futures contract exceeds the price specified in the option, a "call" or buy option may be exercised. For example, if S holds an option to buy a May wheat contract for $10 and the price of a May wheat contract rises to $12, S will exercise the option and buy the contracts at $10. S will then sell the contracts on the market at $12. His net gain will be $2 per contract less the premium he paid for the option.
43. A "stop" order is defined as: an order placed at a limit above the prevailing market price in the case of a buy stop, or below the existing level in the case of a sell stop, that will not be executed until the stop price has been reached. . . . When such an order is placed, an existing position will be liquidated only if there is a price movement adverse to the position.

_MERRILL LYNCH, PIERCE, FENNER & SMITH INC., HANDBOOK FOR COMMODITY SPECULATORS_ 10 (1975).
entrapped that may occur when the market begins to dive or climb. In this case it has done him no good.

_Hypothetical F:_ Trader S holds a "discretionary account"\(^4^4\) with an FCM. If the FCM has ceased to function, the discretionary account may suffer due to lack of proper management.

In addition to the difficulties raised by these hypotheticals, significant problems arise in relation to "good-til-canceled" orders,\(^4^5\) "good-the-week" orders,\(^4^6\) "limit" orders,\(^4^7\) "market-if-touched" orders,\(^4^8\) and various other orders that remain dormant until the market moves in a specified manner.

These dangers inhere in any broker insolvency regardless of the cause of insolvency. Thus, the protection sought for customers of insolvent FCMs must protect the accounts of _all_ FCMs without regard to cause. Financial mismanagement by a firm or its employees, failure to segregate funds and futures, and other "fault" causes should be included in this coverage. Exceptions may be made in exceptional circumstances, such as where the customer is a wrongdoer, or where the customer held a substantial proprietary interest in the brokerage.

Early in 1974, Congress considered providing some type of account insurance for commodity futures traders. Section 417 of the Commodity Futures Trading Commission Act of 1974\(^4^9\) required the Commodity Futures Trading Commission (CFTC) to submit to Congress, not later than June 30, 1976, a report on the feasibility and desirability of such insurance. No report was submitted by the CFTC until August 1976. In essence, the report reiterated the 1974 statute, stating:

\(^4^4\) A "discretionary account" gives the FCM power of attorney to trade the customer's account as the FCM deems profitable.

\(^4^5\) A "good-til-canceled" order is an order to buy or to sell which remains effective until it is filled by the FCM or canceled by the customer. If the FCM is inoperative, circumstances requiring the execution of the order may arise and pass without execution.

\(^4^6\) A "good-the-week" order remains effective for a week. It will not be executed if the FCM has ceased to function.

\(^4^7\) A "limit" order permits the broker to buy for not more than, or sell for not less than, a stated price.

\(^4^8\) A "market-if-touched" order is an order to buy or to sell at the market immediately if an execution takes place at a certain price stated in the order. S. ANGRIST, _Sensible Speculating in Commodities_ 198-206 (1972) provides an excellent glossary which defines these and other technical terms relating to commodity futures.

In order to determine whether an insurance program should be established, it is necessary to analyze such matters as:

— the incidence of FCM insolvencies;
— the adequacy of exchange trust funds;
— the cost of the program;
— the amount of coverage that should be afforded;
— how the program would be financed and administered;
— the amount of reserves that should be available to the program;
— who should be a member;
— whether private insurance would be feasible; and
— whether commodity account insurance could be integrated with the securities account insurance provided by the Securities Investor Protection Corporation.  

On November 1, 1976, the CFTC completed its research into this question and concluded that legislation providing insurance to futures customers is unnecessary. The two reasons given to justify this conclusion were: "a. the level of public confidence in the safety of funds appears to be relatively high, and b. the benefit-cost ratios demonstrate that insurance protection would not be cost effective."  

The first of these conclusions is subject to doubt; the second is demonstrably inaccurate. The cost of an account insurance program such as that proposed here would be minimal. The reason for the CFTC’s miscalculation as to the cost of such a program appears from the report itself. The calculations made by the CFTC were based on a “hypothetical commodity account insurance fund . . . and [were] compared to similar ratios calculated for existing government-sponsored insurance programs.”  

As this proposal

51. See CFTC REPORT, supra note 15.
52. Id. at vi.
53. Scholars who lecture on commodity futures speculation have observed: Wide publicity is given to the relatively rare but highly dramatic manipulations that cause many to conclude that speculation is not only gambling but that the game is dishonest besides. Almost any public speaker talking about commodity trading can be sure that someone in the audience will ask about “that big soybean oil scandal of a few years ago” [the Allied Crude Vegetable Oil Refining Corporation scandal] or some similar incident. R. Tewelles, C. Harlow, & H. Stone, THE COMMODITY FUTURES GAME 13 (2d ed. 1974) (footnote omitted). Professor Hieronymus also alludes to this general public cynicism, which he finds unfair and inaccurate. T. Hieronymus, ECONOMICS OF FUTURES TRADING 6-7 (2d ed. 1977).
54. CFTC REPORT, supra note 15, at v.
will demonstrate, inexpensive account insurance can be provided for commodity futures accounts because commodity futures differ fundamentally from every other type of account insured.

Because the CFTC failed to perceive this fundamental difference, its Report to Congress Concerning Commodity Futures Account Insurance (the Report) is seriously flawed. The following innovative approach to account protection cannot be compared to other existing federal insurance plans on a strict loss-reimbursement basis.55

The CFTC stated in its Report that the segregation of accounts would protect commodity speculators from loss of funds in FCM insolvency.56 The CFTC concluded that such funds would be unavailable to satisfy the claims of general creditors;57 this, it observed, “has never been challenged in an appellate court.”58 Although it is true that this conclusion has never been challenged in an appellate court, there is neither assurance that it will not be challenged, nor assurance that it will withstand challenge.

The Report claimed that additional protection is afforded by the “adjusted working capital” requirement of Commission regulation 1.17(a).59 That regulation requires an FCM to “have an adjusted working capital equal to or greater than $10,000 or the sum of a number of safety factors plus 5 percent of the FCM’s aggregate debt.”60 This minimal amount will purportedly protect the approximately 120,000 open commodity futures accounts presently held

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55. The CFTC REPORT, id., did not accurately respond to the request of § 417 of the Commodity Futures Trading Commission Act of 1974. The demand for a report was formulated after lengthy discussion in Congress regarding the advisability of account insurance. From the discussion on the Senate floor, it seems that Congress wished the CFTC to propose different types of insurance, not to issue an accountant-like analysis of the feasibility of a SIPC in the commodities area. But see CFTC REPORT, supra note 15, at 62. Dr. Clayton Yeutter, Assistant Secretary of Agriculture, articulated the general feelings of Congress regarding account insurance, stating:

[I]t seems to me some significant questions have been raised with regard to the structure of this kind of insurance entity. . . . No one disagrees with the concept. I believe that all of us feel that an insurance system would contribute to protection of the participants in the markets. The only question is how this can best be done.


56. See CFTC REPORT, supra note 15, at 6-8 & n.13.

57. See id. at 8.

58. Id. at 8 n.13.

59. Id. at 9.

60. Id. The exact text of the regulation appears at 17 C.F.R. § 1.17 (1977).
by FCMs, each account having equity ranging from minor amounts to sums far in excess of $50,000.61

The Report indicated several other proposals which would eventually be of some value to commodity futures traders. For example, an "early warning system to alert the CFTC of FCM's or commodity option dealers which are undercapitalized or do not meet segregation requirements"62 was suggested. Yet this system would be unnecessary if the act proposed here were enacted.63 The proposed act encompasses the goals of this mechanism in its overall scheme.

The Report contained some general misconceptions regarding commodity futures options. For example, the Report observed: "If options dealers are thus regulated [and required to segregate customer funds], the potential for future customer losses due to insolvencies should be reduced to frequencies similar to those for FCM's under regulation."64 This observation is inaccurate. Open futures contracts may be closed by an exchange in the event of FCM insolvency without undue difficulty. While the risks involved are great, at least some protection is afforded the contract holder. An option, on the other hand, may become extremely profitable before it expires; an insolvency prevents the exercise of options, and thus results in the loss of the full value of all options held. A contract does not necessarily become worthless if neglected; an op-

61. See CFTC REPORT, supra note 15, at 67-68.
62. Id. at 10. Evidently satisfied with its Report, the CFTC seems to have abandoned investigation of possible insurance plans. On June 16, 1977, the CFTC proposed a new rule "to insure adequate customer protection, to insure the integrity of the futures market system, to increase regulatory efficiency, and to facilitate the development of a registered futures association." 42 Fed. Reg. 31,740 (1977). The proposed rule would create an early warning system which would require FCMs to report to the CFTC in the event that certain financial situations arose. In addition, the CFTC proposed to increase the FCMs' minimum financial requirements. The early warning system is a good first step, but it is inadequate. The CFTC does not detail the response it would give upon receipt of an early warning. Presumably, it would simply observe that FCM more closely. Incidents such as the Love, Weis, and Goldstein, Samuelson bankruptcies, however, would inevitably occur; how the CFTC proposes to deal with such cases remains unclear. While preventive measures are to be encouraged, curative measures must be developed to deal with the next FCM insolvency. The Goldstein, Samuelson bankruptcy reputedly cost commodity traders approximately $70,000,000. Maidenberg, When the Commodity Pitchman Calls, Hang Up, N.Y. Times, May 22, 1977, § 3, at 3, col. 1. It is doubtful that the measures proposed by the CFTC suffice to deal with the problem posed by Goldstein, Samuelson.
63. See text accompanying notes 104-110 infra.
64. CFTC REPORT, supra note 15, at 18 (citation omitted).
tion automatically becomes worthless when the period for its exercise expires. Such basic misconceptions undermine the validity of the CFTC Report: A thorough analysis of the economic feasibility of the proposed program would likely indicate a favorable "benefit-cost ratio," evidently the Commission’s primary measure of the value of a program.

An important inconsistency lies at the core of the CFTC’s Report. The Report concedes that “[t]he existing environment in the commodities industry can be boiled down to the fact that, in spite of regulation, a certain risk of loss exists because of fraudulent behavior on the part of FCM’s.” The Report does not define “existing environment.” It explains, however, that the fraudulent behavior of FCMs is subject to fines and penalties, “powerful deterrent[s] to fraudulent behavior.” The “existing environment” to which the Report alludes is precisely the condition it later denies: Commodity futures markets in general, and FCMs in particular, are plagued by a general and abiding lack of public confidence. By its own terminology, the Report exposes this prevalent attitude as more than just a problem; it is, rather, an existing environment in the commodities industry.

The CFTC’s assurances that fines and penalties will deter fraudulent behavior on the part of FCMs are misplaced. The individual who seeks automobile theft insurance is undaunted by the knowledge that criminal sanctions may deter theft; one purchases insurance for the simple reason that thefts, and indeed frauds, occur with regularity regardless of the sanctions.

Senator Robert J. Dole observed that “[t]he bankruptcy or insolvency of a futures commission merchant, while a very infrequent

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65. The “benefit-cost ratio,” which indicates the prospective profitability of a program, is the main topic of the CFTC Report. Following a basic introduction of 22 pages, the Report analyzes account insurance on the basis of this “benefit-cost ratio.” See CFTC REPORT, supra note 15, at 23-62.

66. See generally id. passim.

67. Id. at 59 (emphasis added).

68. Id.

69. Professor Mark R. Greene has stated that:

[A] basic purpose of insurance is to reduce the degree of risk perceived by the customer. To the extent that negative mental attitudes concerning this risk are relieved—a powerful deterrent to action is removed . . . . There are many examples of insurance in which annual losses are almost miniscule (e.g., title insurance), but in which the financial guarantees are significant devices to facilitate business transactions due to the risk reduction factor.

occurrence, can jeopardize large sums held for customers by that broker. [A Federal Insurance Corporation established to protect commodity accounts] would minimize risks of loss to customers and thereby encourage trading.”

Furthermore, the Subcommittee on Special Small Business Problems has concluded that such an insurance plan would protect, if not enhance, the economy:

[S]ome form of protection is necessary as the bankruptcy or insolvency of a futures commission merchant, while an infrequent occurrence, can place in jeopardy large sums of money held for customers by that firm and any such losses could lead to a serious loss of public confidence and subsequent further deterioration of the futures markets.

The subcommittee also noted that “the concern over losses is magnified because of the closely intertwined nature of the industry as if one firm goes, it could easily have a domino effect and topple other firms which were doing business with it.”

Testifying at public hearings on behalf of the Chicago Board of Trade, Philip F. Johnson stated that public confidence was an important factor in considering account protection, and that such protection is needed.

The Chicago Board of Trade Clearing Corporation, the New York Cocoa Exchange, Inc., and various other concerns supported implementation of an insurance plan.

Finally, only twice in the sixty-nine page CFTC Report does the CFTC address the potential value such a program might yield to society. While the Report stresses the “costs to society of such an insurance fund,” it largely ignores the potential advantages of such protection. The costs to society include only the minimal

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72. Id. at 61.

73. CFTC Report, supra note 15, at 40, 43.

74. Id. at 40.

75. Id. at 31.

76. Concerning the value of these social benefits, the Report observed: “Trying to measure these benefits is like trying to measure the benefit one individual American receives because of the existence of the Strategic Air Command.” CFTC Report, supra note 15, at 31. That these benefits are difficult to measure is a poor
transaction fees necessary to establish the initial fund. However, these fees are borne not by society, but only by commodity futures traders. The benefits to society, on the other hand, are potentially great. If, therefore, trading in futures is to be encouraged, an insurance plan such as that proposed would make speculation more attractive to otherwise hesitant individuals. Simply stated, the insurance plan would benefit the economy and thus society.

Before expounding the proposed plan, it is helpful to examine an alternative solution raised in the CFTC's August report.

INTEGRATION WITH SIPC

The Securities Investor Protection Act of 1970\(^7\) seems analogous to the type of protection here suggested. It will be shown, first, why integration of a commodity account insurance plan would be inappropriate, and second, why this type of plan is impracticable in the commodities area.

The initial report issued by the Advisory Board to the CFTC posed the question "whether commodity account insurance could be integrated with the securities account insurance provided by the Securities Investor Protection Corporation."\(^7\) The logic behind this suggestion seems ineluctable: Securities brokerages are often FCMs as well; securities investors are often commodity speculators as well; the SIPC has operated successfully for some time;\(^7\) commodity futures, like securities, are an investment vehicle.

However, like the securities market, the futures market is "[i]n some respects . . . unique, and its problems and practices require original solutions."\(^8\) Five reasons militate against such integration and in favor of the creation of an independent protection corporation for commodity accounts.

First, the Commodity Futures Trading Commission Act of 1974\(^8\) created the Commodity Futures Trading Commission, and gave that Commission exclusive jurisdiction to regulate and control

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78. See note 50 supra.
79. See note 31 supra.
trading in commodity futures. Congress manifestly expressed its intent to place all such matters within the sole discretion of the CFTC. The Securities Investor Protection Act of 1970 conferred numerous powers on the Securities Exchange Commission (SEC). Giving the SEC such control over commodity futures might violate congressional intent in establishing an autonomous agency.

Second, the CFTC devotes its full resources to the regulation of commodity futures trading. Hence the expertise required to formulate and oversee a customer account protection mechanism lies peculiarly within the domain of the CFTC.

Third, the requisite legislation can be drafted precisely to suit the needs of commodity futures accounts. Integration with SIPC would likely result in an inoperable patchwork system.

Fourth, the fund from which SIPC compensates securities customers constitutes a sum of assessments collected from member securities brokerages pursuant to the Securities Investor Protection Act of 1970. It would be unfair to those contributors to subject the fund to liabilities incurred through FCM insolvencies since FCMs have never contributed to the fund. Rather, a discrete fund comprised of similar assessments against FCMs constitutes a more appropriate source of protection.

Fifth, a separate corporation could better protect the interests of commodity futures customers in insolvencies in which the FCM had also been a securities broker. Bankruptcy proceedings are often adversarial in nature, and in cases in which the interests of futures customers and securities customers collide, a completely separate entity could best represent the interests of futures customers. In this manner, potential conflicts of interest are avoided; accusations of prejudice on the part of SIPC in favor of securities customers are eliminated. Weis Securities, Inc., conclusively demonstrates that the needs of futures customers and those of securities customers frequently diverge and occasionally clash. Weis

82. Id. § 2.
84. For examples of these grants of power, see 15 U.S.C. §§ 78bbb, 78ccc(e)(1), 78ddd(c)(1) (1970). In addition, three of the seven directors of SIPC are selected “from among persons who are associated with, and representative of different aspects of, the securities industry.” 15 U.S.C. § 78ccc(c)(2)(C)(i) (1970).
85. SIPC assesses a percentage of the gross commission revenues of each of its members. These revenues comprise a fund from which insurance for customer losses is provided. 15 U.S.C. § 78ddd(a)-(i) (1970).
underscores the need for protecting commodity futures accounts.\textsuperscript{87} 

The very existence of SIPC operates to the disadvantage of commodity futures customers. \textit{Weis}, decided October 23, 1975, reveals the present predicament of commodity customers: SIPC protects securities investors at the expense of all other creditors, including commodity traders.\textsuperscript{88} In \textit{Weis} a brokerage house that dealt in both securities and commodity futures became insolvent. The commodity futures customers attempted to secure the protection provided by SIPC to "customers."\textsuperscript{89} The court defined "customers" to include only securities investors, and proceeded to characterize commodity traders as "simply creditors of the general estate."\textsuperscript{90} The zealous efforts of the SIPC have thus operated to the detriment of commodity futures customers.

\textbf{SIMILARITY TO SIPC}

Although a commodity futures account protection program should be separate from SIPA, many of the mechanisms provided in that Act may be remodeled to suit the needs of commodity fu-

\textsuperscript{87} In \textit{Weis Sec., Inc.}, \textit{id.}, both securities customers and commodity futures customers sought to recover various monies. Part of the money sought was from the "single and separate fund" held by the broker to cover the margins of his customers. SIPC protected securities customers; futures customers protected themselves. \textit{Id.} Since Congress conferred broad protective powers on SIPC, it came as no surprise that the commodities customers were defeated. Yet to confer this privileged status on a particular group of investors is irrational. Had SIPC been empowered to defend futures customers as well, the conflict of interest questions generated would have posed vexatious problems.


\textsuperscript{89} The Securities Investor Protection Act of 1970 states in pertinent part: "[C]ustomers" of a debtor means persons (including persons with whom the debtor deals as principal or agent) who have claims on account of \textit{securities} received, acquired, or held by the debtor from or for the account of such persons (I) for safekeeping, or (II) with a view to sale, or (III) to cover consummated sales, or (IV) pursuant to purchases, or (V) as collateral security, or (VI) by way of loans of \textit{securities} by such persons to the debtor, and shall include persons who have claims against the debtor arising out of sales or conversions of such \textit{securities}, and shall include any person who has deposited cash with the debtor for the purpose of purchasing \textit{securities}, but shall not include any person to the extent that such person has a claim for property which by contract, agreement, or understanding, or by operation of law, is part of the capital of the debtor or is subordinated to the claims of creditors of the debtor.

\textsuperscript{90} \textit{Weis Sec., Inc.}, \textit{1975-1977 Transfer Binder} COMM. FUT. L. REP. (CCH) ¶ 20,108 (S.D.N.Y. 1975).
tures accounts. To understand the differences between the Securities Investor Protection Act and the proposed legislation, one must first understand the basic structure of the SIPC. Thus, a brief outline of the SIPA may prove helpful.

The Securities Investor Protection Act of 1970 created the Securities Investor Protection Corporation, an independent body comprised of members. Every broker, dealer, or member of a national securities exchange is a member of the SIPC. Annually, each member contributes an assessment consisting of a fixed percentage of commissions earned in the course of business. All assessments collected are added to a fund to be used to compensate all securities customers injured by broker insolvency.

When the SEC or any self-regulatory organization, that is, an exchange, becomes aware of facts leading to the belief that any broker or dealer is approaching financial difficulty, it must notify SIPC immediately. If SIPC determines that such broker or dealer has "failed or is in danger of failing to meet its obligations to customers" or that a court has found the broker or dealer insolvent, SIPC applies to a court for a decree providing that SIPA should apply. The court then stays all other proceedings against the debtor and appoints a trustee "for the liquidation of the business of the debtor."

The purposes of such liquidation are specified in the Act:

(1) as promptly as possible after such appointment and in accordance with the provisions of this section—
   (A) to return specifically identifiable property to the customers of the debtor entitled thereto;
   (B) to distribute the single and separate fund, and (in advance thereof or concurrently therewith) pay to customers moneys advanced by SIPC, as provided in subsection (f) of this section;
(2) to operate the business of the debtor in order to complete

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92. Id. § 78ccc(a).
93. Id. § 78ccc(a)(2)(A)-(B).
94. Id. § 78ddd.
95. Id. The protection provided, however, covers only the first $50,000 of the account. Id. § 78ff(f)(1).
96. Id. §§ 78eee(a)(1)-(2).
97. Id. § 78eee(a)(2).
98. Id.
99. Id. § 78eee(b)(2)-(3).
open contractual commitments of the debtor pursuant to subsection (d) of this section;
(3) to enforce rights of subrogation as provided in this chapter; and
(4) to liquidate the business of the debtor.100

Thus, under SIPC, securities held by the debtor for the customer's account are delivered directly to the customer. In addition, the single and separate fund of the broker, consisting of all property received, acquired, or held by or for the account of customers is then ratably divided among the customers.

At this point, the difficulty in applying SIPA to commodity futures accounts manifests itself. A security represents a fractional interest in a corporation. It constitutes property, and securities investors would gladly receive such specifically identifiable property from the insolvent debtor. A commodity futures contract, on the other hand, is an executory contract which speculators buy or sell in the hope of profitably "unloading" later. Few traders participating in daily trading ever intend to make or take delivery on the contracts in which they deal.101 Thus, while a securities customer might be quite pleased to receive his shares of stock, a futures trader would be horrified to receive a contract which requires him to sell and deliver 10,000 bushels of wheat.

THE PROBLEM

Thus far, this proposal has indicated the need for protection for commodity futures accounts and has illustrated the mechanism by which securities accounts are protected. The best type of protection for any individual, a type which SIPC utterly fails to provide, is a system by which all expectations of the customer are satisfied. SIPC does not function immediately. Given the laborious procedures inherent in the SIPA, many months may elapse between insolvency and the customers' recovery. A plan that would satisfy the immediate needs of the customer would be far superior. By preventing damage, losses would be averted and expenses minimized.

Assuming, then, that commodity futures accounts would be

100. Id. § 78ff(a).
101. Physical delivery of the underlying commodity takes place on very few futures contracts. See T. Hieronymus, Economics of Futures Trading 42 (2d ed. 1977).
best protected by meeting the customers' expectations, these expectations must be determined precisely.

The services performed by the FCM for the customer have been divided into four types. First, the FCM provides the customer with a contact with which he can deal personally. Second, the FCM guarantees the customer's contracts to the clearinghouse, makes and takes delivery of the commodities, and pays money upon delivery or offset. Third, the FCM serves as custodian of the customer's funds and renders a regular accounting of profits, losses, and balances. Fourth, the FCM provides the customer with information.  

The most important service, however, is that the FCM provides the best possible order execution. A very important component of good order execution is speed. Given the rapid fluctuations in going prices for different commodities, it is essential that trades be executed when ordered, not five or ten minutes later when the going price may have shifted drastically.

While the price of a security may also fluctuate daily, the degree of fluctuation is rarely as great as that in the price of commodity futures. Moreover, securities ownership is generally of greater duration; a "short-term" investment might extend to the better part of one year. On the other hand, a "round turn" in the futures market, a trade in which a contract is bought and then sold, or sold and then bought, may be opened and closed within five minutes; millions of dollars may be gained or lost within a few minutes. Such rapid transactions are the rule rather than the exception.

One specialized type of trader unknown to the securities market is the "day trader," one who carries no open positions overnight. As this discussion emphasizes, the FCM qualities most important to commodity futures traders are the speed and reliability with which it executes orders.

A PROPOSAL FOR COMMODITY FUTURES ACCOUNT PROTECTION

To protect the interests of commodity futures customers in the event of an FCM insolvency, a membership corporation should be created. The proposed statute would create two alternative mech-
anisms: one for “ordinary” insolvencies and one for “emergency” situations. An “ordinary” insolvency would occur when the FCM, although insolvent, continues to execute orders for its customers until the close of trading on its last operating day, and notifies the membership corporation, the Commodity Futures Account Protection Corporation (CFAPC) of its decision to discontinue operations. An “emergency” insolvency would occur when the FCM either fails to execute orders at the opening of a trading day or discontinues trading before the close of a trading day without previously notifying the CFAPC of its intention.

The basic premise of the proposed mechanism is that the customer will escape uninjured if he can continue trading as usual. The mechanism is thus to transfer all open accounts of a defunct FCM to an operating and efficient FCM. The customer could then trade as he pleases, without the usual delay caused by insolvency proceedings. To avoid preferential assignment of accounts, open accounts could be assigned to operating FCMs on the basis of a revolving list, with no FCM to be assigned more than an additional 20% of the present number of its open accounts. Thus, if an FCM decided on Thursday afternoon that it would not open for trading on Friday, an operative of the CFAPC could assign all open accounts to new FCMs on Thursday night and permit customers to trade, as expected, early on Friday morning. In consideration for those accounts transferred, the duty to notify customers of the transfer would be imposed upon the transferee FCM.

After such transfer, a trustee would be appointed to liquidate the assets of the debtor and to satisfy creditors. An important aspect of the plan is to transfer all open accounts and margin deposits without delay.

The shortcomings of this mechanism manifest themselves in a surprise or “emergency” insolvency. In this situation, the CFAPC would not have received notice. Traders would suddenly discover that the FCM does not answer the telephone, or the like. The solution to this “emergency” problem is more complicated.

First, a telephone number would be arranged at which the CFAPC could be notified immediately in the event of an FCM closedown. Notice of the availability of this service would be given. Next, upon notice of the closedown, the CFAPC would arrange for immediate placement of an operative at the closed FCM’s place of business, with access to the FCM’s telephone.105 The operative’s

105. Each FCM would file a consent form with the telephone company to assure the CFAPC immediate access to the FCM’s line.
task would be to record and timestamp all incoming orders.\textsuperscript{106} Simultaneously, a second operative would transfer all open accounts, as in the “ordinary” procedure, to operating FCMs.

Under the “ordinary” procedure, no fund would be necessary to make customers whole. Under the “emergency” procedure, a fund would be necessary to reimburse customers. Since this fund would only be used in extraordinary cases, it would not need to be as large as the SIPC fund. Moreover, due to certain aspects of this mechanism, the fund stands to profit greatly if an emergency insolvency arises.\textsuperscript{107}

Under the “emergency” procedure, the significance of timestamping is that all orders received by the CFAPC operative would be deemed executed, if reasonable,\textsuperscript{108} at the mean price between the highest and the lowest price at which similar contracts were traded during the five-minute period subsequent to placement of the order. If no similar contract were traded within that five-minute period, the period would be extended by five-minute intervals until a meaningful figure could be ascertained.

When an order is placed and “deemed executed,” any loss or gain that the customer has realized would be charged or credited to his account. The open contract, in fact unexecuted, would then become property of the “fund.” The protection afforded any particular customer might be limited to an arbitrary amount. Fifty

\textsuperscript{106} Such timestamping is already required of each FCM doing business. The purpose of timestamping in relation to the protection mechanism is to establish a record of transactions and orders which could be examined and effected later under less hectic circumstances. The present requirement for timestamping states: “Each futures commission merchant receiving a customer’s order shall immediately upon receipt thereof prepare a written record of such order, including the account identification and order number, and shall record thereon, by time-stamp or other timing device, the date and time, to the nearest minute, the order is received.” 17 C.F.R. § 1.35(a-l)(1) (1977).

\textsuperscript{107} In deeming orders by customers executed, the fund would pay over all profits of the transactions to the customer. On trades where the trader misjudged the value of his contract, selling prematurely, the fund would absorb the profit. In essence, the fund becomes a kind of “bucket shop.” In a “bucket shop,” the brokerage itself takes the opposite position on each trade by a customer. These trades do not go through an exchange. The shop simply bets against the trader. These operations are generally illegal, but they are typically very profitable. That they are profitable derives from one of the basic statistics of the commodity futures markets: Most speculators lose money, see note 10 supra and accompanying text. Thus, this plan presents two aspects that would tend to undercut the cost analysis of the CFTC’s advisory board: The “turnover” plan would not require a fund, and the fund might prove profitable.

\textsuperscript{108} “Reasonable” here means if similar trades are being executed on the market. If no trades are being executed in a particular market because, for example, the market is limit down, the ordered trade will not be deemed executed.
thousand dollars per customer would adequately cover the losses of
the majority of customers.109

Once the new FCM gains control over the transferred ac-
counts, it might immediately begin margin calls and conduct all
other essential activities of an FCM. For the period during which
no FCM has control of the account, the fund may be used to cover
the margin calls.

The purpose of the immediate assignment of accounts is two-
fold: It affords customers complete protection while keeping the
CFAPC out of the brokerage business. To permit the CFAPC to
trade contracts would become overly burdensome; furthermore, it
is unlikely that the CFAPC could compete with the excellent order
execution offered by experienced FCMs.

THE PROPOSED STATUTE

Most of the formational, structural, and empowering sections
of the Securities Investor Protection Act of 1970 could be adapted
for use in this statute with minimal modification. Section 78ccc,
regarding the creation and powers of the SIPC, could be readily
adapted for use here; section 78ddd, regarding creation and
maintenance of the fund may also be mirrored. Similarly, sections
78ggg, 78hhh, 78iii, and 78jjj may be adapted with few changes.
Sections 78eee and 78fff, however, present the essential mech-
anisms of the SIPA; these sections must be omitted and new sec-
tions providing the proposed mechanism must be substituted.

The mechanism sections of the proposed act read as follows:

I. DETERMINATION OF THE NEED FOR PROTECTION

A. Notice to the CFAPC

If the Commodity Futures Trading Commission, any
self-regulatory organization, or any customer, creditor, or
employee of an FCM is aware of facts which lead it to
believe that any FCM is in or is approaching financial
difficulty or insolvency, or has voluntarily or involuntarily
become subject to bankruptcy proceedings, it shall im-
mediately notify the CFAPC. The FCM shall be charged

109. Cf. CFTC REPORT, supra note 15, at 67-69 (discussing commodity account
insurance).
with the duty of notifying the CFAPC before the occurrence of any of the above-named events.

B. Action by the CFAPC

The CFAPC shall immediately place the named FCM in "suspect" status. The CFAPC shall immediately designate one or more CFAPC agents to investigate the veracity of the reported facts and the severity of the financial condition of the FCM.

C. Function of the CFAPC Agent

The CFAPC agent(s) assigned pursuant to subsection IB shall immediately investigate the true financial condition of the "suspect" FCM, and either

1. determine that the customers of the suspect FCM are in need of the protection provided by this section, or
2. determine that the customers of the suspect FCM are not in need of the protection provided by this section.

D. The Finding of “No Necessity of Protection”

Should the CFAPC agent(s) assigned pursuant to subsection IB determine that the protection of this section is unnecessary, the agent shall, within forty-eight hours, apprise the CFAPC, and the suspect FCM that there is no necessity of protection. Upon such notice, the suspect FCM shall be removed from suspect status by the CFAPC.

E. The Finding of “Necessity of Protection”

Should the CFAPC agent(s) assigned pursuant to subsection IB determine that the protection of this section is necessary, the agent(s) shall immediately:

1. notify by telephone (or the fastest reliable alternative available) the CFAPC, and
2. receive and timestamp orders placed by present customers of the FCM. If the FCM is receiving, recording, and timestamping incoming orders, however, the CFAPC agent(s) need only oversee those activities. In such a case, the FCM should execute those orders if possible.
II. CFAPC ACTION UPON NOTIFICATION OF THE NEED FOR PROTECTION

A. Action upon Notification

Upon notification of a CFAPC agent’s finding, pursuant to subsection IE(1), that there exists a need for the protection afforded by this section, or upon notification of a voluntary or involuntary proceeding in bankruptcy, the CFAPC shall immediately arrange to transfer all the operating accounts of the FCM to listed operating FCMs, and transfer those accounts as soon as practicable. In no event should such transfer be delayed more than twenty-four hours after receipt of the subsection IE(1) notice.

B. Effect of Receipt and Timestamping of Orders

Orders received and timestamped pursuant to subsection IE(2) shall be deemed executed at the prevailing market price for the contract or option in question. The customer will be credited for any profit accruing or loss flowing from the transaction deemed executed at the prevailing market price. The actual open contract or unexercised option shall thereafter become the property of the fund. Customers will be compensated out of the fund for profitable trades, but in no event shall any customer receive in excess of fifty thousand dollars from the fund. Customers will be liable to the fund for losses flowing from deemed executed unprofitable trades.

C. Orders Deemed Executed

1. Profits or losses to be paid to or collected from customers by the fund shall be calculated as follows:
   Each order received shall be timestamped. Each order will be deemed executed at the mean price between the highest and lowest price at which similar contracts were traded during the five-minute period subsequent to placement of the order. If no similar contract was traded within that five-minute period, such period shall be extended by five-minute intervals until a figure can be ascertained. In no event shall the calculation of this figure carry into a later trading day.
2. The contract shall be "deemed closed" upon the deemed execution of a closing order. Profits or losses shall be calculated as if the trades had actually been executed. No commissions shall be exacted upon such trades.

III. DISPOSITION OF ACQUIRED CONTRACTS AND OPTIONS BY THE CFAPC

Contracts and options deemed executed pursuant to subsections IIB and IIC shall become the property of the fund under subsection IIB. The CFAPC may maintain an open trading account with a private FCM for purposes of disposing of acquired contracts and options. Under no circumstances shall the fund be used for speculative trading except as provided under this section. All profits accrued or losses sustained pursuant to such trades shall be paid directly into or out of the fund.

IV. THE POSTING OF BONDS AND THE RELEASE OF COMMODITY ACCOUNTS

In the event that a court of competent jurisdiction takes jurisdiction over the assets and accounts of an FCM, such court shall, upon motion by the CFAPC, permit the release of all futures and options accounts to the CFAPC upon the posting of a bond or assurance of an amount deemed necessary by the court. The CFAPC shall treat accounts so acquired as the terms of this section provide.\(^{110}\)

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110. If the mechanism of this proposed statute is unacceptable to Congress, another simpler mechanism might be offered. This mechanism would consist of only five basic provisions:

1. creation of the CFAPC;
2. provision for notice to the CFAPC as provided in proposed subsection IA;
3. provision for automatic closeout of all open contracts;
4. provision for transfer of all option contracts to operating FCMs;
5. provision for posting bond to secure release of accounts from a court exercising jurisdiction over them, as provided in proposed subsection IV.

In this way, Congress might provide traders with an agency to represent them and a mechanism to afford them protection. Under this mechanism, there would be no fund and, therefore, no inhibitive costs. No actual "insurance" would be provided, but at least some minimal protection would be afforded. This statute might easily be drafted from the statute proposed above. It would be identical to the one proposed with the exception of subsections IIB, IIC, and § III.
INTERFERENCE WITH SIPC

Section 78eee(a)(1) of the Securities Investor Protection Act of 1970 triggers the SIPC mechanism whenever SIPC becomes aware of "facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty." SIPC then applies to a court of competent jurisdiction for "a decree adjudicating that customers of such member are in need of the protection provided by this chapter." Upon filing a section 78eee(a)(2) application, "the court to which application is made shall have exclusive jurisdiction of the debtor involved and its property wherever located." If an FCM were also a securities brokerage, the insolvency triggering the proposed act would also trigger SIPC. Under the present Securities Investor Protection Act of 1970, SIPC would be able to paralyze the CFAPC by applying to an appropriate court, eliminating CFAPC jurisdiction. Section IV of the proposed statute would alleviate this situation by allowing the CFAPC to post a bond and release the accounts. The proposed mechanism would thus alleviate conflict with the SIPC without reducing the efficacy of either body.

It is conceivable that, under adversarial bankruptcy proceedings, SIPC and CFAPC might conflict. This is particularly likely in the insolvency of an FCM which also operates as a securities broker. But, as illustrated above, this adversarial role of the CFAPC would fill a present void. SIPC preserves assets for the protection of securities customers; as Weis illustrates, this preservation operates to the detriment of commodity futures customers. The CFAPC might generate some friction in such matters, but this should be encouraged, not thwarted. Each corporation would represent and protect its respective special interest group. In this way, justice would best be served.

CONCLUSION

The goals of the CFTC are simple and straightforward. They include the maintenance of consistently rational, stable, and orderly supply and demand markets, and the prevention of fraud in

112. Id.
113. Id. § 78eee(a)(2).
114. Id. § 78eee(b)(2).
115. See discussion at notes 86-90 supra and accompanying text.
advertising, marketing, or executing futures transactions. An ancillary goal of the CFTC must be to raise the level of public confidence in the commodity futures industry. The November 1976 Report to Congress by the CFTC\textsuperscript{116} indicated that “the level of public confidence in the safety of funds appears to be relatively high.”\textsuperscript{117} This is simply not the case. In 1973, for example, thirty million people held securities of one kind or another; only half a million people traded in futures during that same year.\textsuperscript{118} Some of this difference can be attributed to the more speculative nature of the commodities markets. Much of it, however, reflects the lack of public confidence in the markets, merchants, and exchanges. An insurance or protection program such as that proposed here will go far to instill greater public confidence, and thus to encourage greater public participation in, the commodity futures markets.

\textit{Jack M. Platt*}

\begin{itemize}
  \item[116.] CFTC REPORT, supra note 15.
  \item[117.] Id. at vi.
  \item[118.] \textit{Fraud in the Futures?}, Barron’s, May 28, 1973, at 11, col. 1.
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\end{itemize}