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No Squeezing, No Cornering: Some Rules for Commodity Exchanges

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NO SQUEEZING, NO CORNERING:
SOME RULES FOR COMMODITY EXCHANGES

The "temporary emergency rules" promulgated under the Commodity Futures Trading Commission Act of 1974 authorize commodity exchanges to take various measures to prevent commodity futures market manipulation. However, these rules may be ineffective if the commodity exchanges have discretion over their enforcement. For decades, commodity exchanges had the means to prevent various types of market manipulation, but often ignored the problem or imposed penalties for completed conduct.

1. 17 C.F.R. § 1.41(f) (1978) provides in part:
In the event of an emergency, a contract market, by a two-thirds vote of its governing board, may place into immediate effect a temporary emergency rule to deal with the emergency without prior Commission approval . . . :

   (3) A temporary emergency rule may provide for, or may authorize the contract market . . . to undertake actions necessary or appropriate to meet the emergency, including, but not limited to, such actions as:
   (i) Limiting trading to liquidation only, in whole or in part, or limiting trading to liquidation only except for new sales by parties who have the commodity to deliver pursuant to such sales;
   (ii) Extending or shortening the expiration date for trading in contracts;
   (iii) Extending the time of delivery;
   (iv) Changing delivery points;
   (v) Ordering the liquidation of contracts, the fixing of a settlement price or the reduction in positions;
   (vi) Ordering the transfer of contracts, and the money, securities, and property securing such contracts, held on behalf of customers by a member of the contract market to another member, or other members, of the contract market willing to assume such contracts or obligated to do so;
   (vii) Extending, limiting or changing hours of trading;
   (viii) Suspending trading; and
   (ix) Modifying or suspending any provision of the rules of the contract market.

Id. (emphasis added).
4. See notes 113-114 infra and accompanying text.
5. See text accompanying notes 26-29 infra.
This Note examines those forms of market manipulation amenable to preventive regulation, focuses on the inequities of judicial resolution of manipulation, and proposes a course of action to protect commodity market operation from the inconsistent approaches previously taken by commodity exchanges.

**FUNCTIONS OF THE EXCHANGE**

A commodity exchange is a marketplace through which contracts are made for the future delivery of a specified quantity and grade of a particular commodity. Each contract must be confirmed by a cash deposit called a “margin,” after which a “clearinghouse” is substituted as buyer from the seller and as seller to the buyer. Thereafter, each of the contracting parties is obligated only to the clearinghouse.

A commodity futures contract must either be satisfied by acceptance or delivery of the actual commodity during the delivery month, or liquidated by entering into an exactly opposite and equal offsetting contract through the same broker, in the same future, prior to the specified delivery date. Approximately ninety-

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6. Delivery is usually permitted during any one of 12 successive calendar months. In some markets the outside limit may be 18 months in the future. J. BAER & O. SAXON, COMMODITY EXCHANGES AND FUTURES TRADING 140-41 (1949). See generally T. HIERONYMUS, ECONOMICS OF FUTURES TRADING 40-41 (2d ed. 1977). The seller has the entire trading month that is specified in the contract to make delivery. J. BAER & O. SAXON, supra, at 141. However, the seller must give the buyer notice of impending delivery at least one business day in advance. 1 COMM. FUT. L. REP. (CCH) 6335 (1979).


8. The volume of trading and duration of the contract make a direct contract between two individuals impractical. Exchanges have developed corporations to reconcile and assure the financial integrity of futures transactions. J. BAER & O. SAXON, supra note 6, at 164, 168, 182. See generally 1 COMM. FUT. L. REP. (CCH) § 315 (1974); T. HIERONYMUS, supra note 6, at 45.

9. When a futures contract is satisfied by delivery, delivery is effectuated by seller’s tender and buyer’s acceptance of a warehouse receipt covering a specified quantity and grade of a particular commodity stored in a designated warehouse approved by the exchange. The full cash contract price must then be paid. T. HIERONYMUS, supra note 6, at 37, 46.

10. For example, a standard corn contract involves the purchase or sale of 5000 bushels of corn. If a trader had bought one contract of corn for May delivery (“May corn”), that trader would have to accept delivery of the warehouse receipts for 5000 bushels of corn before the end of May or liquidate by selling one contract of May corn (through the same broker who had executed the buy contract) prior to the end of May. Likewise if a trader had sold ten contracts of May corn (involving 50,000 bushels) that trader would have to deliver the warehouse receipts for 50,000 bushels of corn before the end of May or liquidate by buying ten contracts of May corn through the same broker who had executed the sell contract, before the end of May.
nine percent of futures contracts are offset by opposite transactions before the delivery date. Profits or losses are determined by the difference between each party’s buy price and sell price minus the broker’s commission. A trader who fails to offset or deliver is in default on the contract. Commodity futures trading serves several economic functions. Farmers use futures contracts to spread the sale of seasonal crops over many months, alleviating the uncertainty of supply and demand and resulting price fluctuations at the end of a harvest season. In addition, a commodity producer or a dealer in the actual or “cash” commodity who has not yet made a cash sale may want protection from a decline in price before the sale is complete. This producer or dealer will “hedge” actual inventory against any uncertainties involved in the production and sale of commodities and the concomitant price fluctuations can produce both windfall profits and devastating losses. The hedger exchanges the possibility of windfall profits for the security of a fixed price. Hedging enables a commodity producer or dealer to calculate prospective profits without the danger of a price change by the time the actual commodity is delivered or received. The following illustrates how hedging protects a farmer:

Suppose you are a corn producer in Iowa and you expect to have a crop that will yield 50,000 bushels of corn. In June, you check futures prices for September and see that corn for that month is quoted at $3.00 a bushel. This


13. Exchanges have varying regulations regarding default. Generally, if the buyer defaults, the seller has the right to sell the commodity in the open market and charge any losses to the buyer. If the seller defaults, the value of the commodity is determined by a board on the exchange and the seller is charged a penalty, usually 5 to 10% of the commodity's value as determined by the board. See T. Hieronymus, supra note 6, at 37. See also 5 FTC REPORT, supra note 11, at 187.


price would provide you with a fair profit if you could be sure of getting it when your crop is ready for delivery.

Here's how you can make sure of getting that price:

- Since each corn contract calls for 5,000 bushels, you sell 10 September futures contracts.

Now, no matter whether corn prices go up or down, you are assured of your fair profit when you sell your 50,000 bushels.

- If prices should drop from $3.00 a bushel to $2.70, you would receive $15,000 less for your crop than you wanted.

But on your 10 futures contracts, you would make a profit of $1,500 per contract, or $15,000. So the net result would be the same as if corn prices had remained steady at $3.00 a bushel.

The same is true if prices rise by 30¢ a bushel. You would receive $15,000 more for your crop but you would have a loss in the futures market of $15,000. So again, the net result is the same as if the $3.00 a bushel price had stayed steady.

Hedging need not change your usual business procedures unless you want to change them. You would probably not deliver your crop to the Chicago futures market to meet your obligation. You would simply offset your futures contract by buying 10 September contracts and you would sell your production in the same way you normally sell it.

On the other hand, if you were a corn dealer and you had forward commitments to sell at $3.00, you would do the opposite of what the producer did to obtain protection in the futures market. You would:

- Buy 10 contracts of September corn at $3.00. If prices should rise to $3.30 a bushel at the time you complete your transaction, you would lose 30¢ a bushel in the cash market. But you would make a profit of 30¢ a bushel on your futures contracts so your position would be just where you wanted it to be.

- If prices should drop to $2.70 at delivery time, you would make an extra 30¢ on your cash transaction, but this would be counterbalanced by a loss of 30¢ on your futures contracts.

MERRILL LYNCH GUIDE, supra, at 4-6. Likewise if you were a corn dealer who had forward commitments to buy at $3.00 you would want to protect yourself against a price decline just as you would if you were the corn producer protecting the sale price of his coming harvest.

The above examples are idealized; other factors affect hedging. For example, since futures contract sizes are standard, it may be difficult to trade quantities of futures that are identical to the quantities of the hedger's cash commodities. Rarely is a hedger perfectly hedged. The hedger is usually "underhedged," partially speculating in the cash commodity, or "overhedged," partially speculating in the futures market. See generally id. at 4; see also Working, supra note 14, at 314. And, of course, a producer or a dealer always incurs some risk when deciding on a price to protect. The price will afford one the expected profits only if there will be no unforeseen rise in costs unrelated to the price of the commodity. For example, a hedger might calculate that a price of three dollars per bushel for his corn will yield a profit of x percent based on certain costs of storage, labor, fuel, fire insurance, etc. Profits may dwindle, however, if these costs suddenly and unexpectedly increase. Nevertheless, because hedging protects against major loss, it is indisputably a worthwhile form of insurance for the producer or dealer. Recognizing this, bankers and lenders encourage, and occasionally require, hedging by individuals and companies that wish to use their commodity inventories as collateral for loans, often advancing a higher percentage of the value of the commodity if it has been hedged. See MERRILL LYNCH GUIDE, supra, at 7.
price decline by contracting to sell a quantity of commodity futures identical to the quantity of cash commodity intended for sale. Because futures prices generally parallel cash prices, any decline in the price of the hedger's actual inventory by the time a purchaser is found is gained back by the profit on the futures exchange when the sell contract is offset with a buy contract. Thus, trading in commodity futures can serve as insurance for the dealer in cash commodities interested in protecting the price at which the actual commodity is bought and sold, rather than speculating in price changes for profit. Hedging reduces the effects of adverse price movements, enabling a producer or dealer to operate on a lower profit margin.

The speculator, on the other hand, is a trader willing to assume either a buy position ("long") or a sell position ("short") depending on whether prices are expected to rise or fall. Speculators provide a ready market for the dealer in the cash commodity who wishes only to hedge.

Finally, the prices which result from the interplay between longs and shorts, speculators and hedgers are disseminated worldwide and influence the price of a commodity on the cash market.

**THE PROBLEM: DEFINING MANIPULATION**

For the futures market to perform its "insurance" function effectively, prices must reflect as nearly as possible the forces of sup-

17. See 1 COMM. FUT. L. REP. (CCH) ¶ 305 (1974); T. HIERONYMUS, supra note 6, at 148-72.
18. See note 16 supra.
19. For a discussion of the difference between insurance and hedging, see T. HIERONYMUS, supra note 6, at 149-51.
21. At the end of 1975, Chicago Board of Trade quotations were received in 90 countries, T. HIERONYMUS, supra note 6, at 35.
22. Although cash and futures markets are different, they are subject to the same influences. Commodity exchanges are economic barometers of worldwide weather conditions, political upheavals, labor unrest, consumer trends, and many other factors affecting the supply/demand tug of war for any given cash commodity. The price trends of both cash and futures markets therefore tend to move in the same direction. Absent manipulation, this is especially true as the futures-trading month draws near. As the expiration date approaches, prices are subject to progressively less uncertainty. Ultimately—in the absence of manipulation—as the future becomes the present, cash and futures prices in the expiring contract converge.
ply and demand. Price manipulation impedes the market's performance of its basic economic functions, diminishing the market's utility to those members of the trade and general public who rely on that performance.

Because "[t]he methods and techniques of manipulation are limited only by the ingenuity of man," it is difficult to design reg-


24. When the futures market is manipulated, the futures price is likely to be distorted from its normal relationship with the prevailing cash commodity price. The hedger faces an increased margin of risk if the hedger has to close out the hedge at a time when the futures market is experiencing this distortion. Any monetary loss from the resulting incomplete and inefficient hedging is passed on to the consuming public. See generally H.R. REP. No. 975, 93d Cong., 2d Sess. 48 (1974). Further, fear of a manipulated market has a demoralizing effect on all traders, resulting in widespread avoidance of delivery-month trading. Trading liquidity is consequently lessened during the delivery month. This in turn contributes to the price distortion caused by a squeeze or corner because there will be fewer traders, other than those parties who are manipulating the price, through whom to liquidate. See notes 30-38 infra and accompanying text.

25. Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972). See also David G. Henner Case, 30 Agric. Dec. 1151 (1971) (egg futures purchased at unnecessarily high price at close of trading day to deceive traders relying on price-movement chart formations into thinking that following day would be opportune time to buy). For criticism of chart-formation trading, see Irvin, supra note 14, at 271-77. See also Howard Randolph Case, 21 Agric. Dec. 219 (1962) (egg merchandiser deliberately caused floor broker on New York Mercantile Exchange to pay unnecessarily high purchase price for egg futures to produce higher price for merchandiser's sale of cash eggs, price of which was based on price of egg futures on day of delivery of cash eggs); Landon v. Butler Case, 14 Agric. Dec. 429 (1955) (cotton and grain merchant relied on intentionally transmitted false information about lack of deliverable supply of soybeans). For discussion of the effect that local supply of certificated stock at the end of a delivery month can have on the price of that month's commodity futures, see text accompanying notes 30-38 infra. See also Ralph W. Moore Case, 9 Agric. Dec. 1290 (1950) (circulation of bogus "Memorandum to the Press," purportedly endorsed by Department of Agriculture, containing false and misleading information regarding government purchases of lard); Ruben Earl McGuigan Case, 5 Agric. Dec. 249 (1946) (defendant assumed market position, then advertised and represented himself to be in business of selling market advice to traders and sent out telegrams advising purchases and sales which would favorably affect his position). A relatively common form of manipulation occurs when a floor broker, allowed to trade for his or her own account as well as for other accounts, notices the beginning of a price fluctuation and trades accordingly for his or her own benefit. This dual trading by floor brokers adds momentum to otherwise minor price fluctuations, producing 'mini-manipulations' throughout the trading day. For discussion of floor broker malfeasance, see Commodity Futures Trading Commission Act of 1974: Hearings on S. 2485, S. 2578, S. 2837, H.R. 13113 Before the Senate Comm. on Agriculture and Forestry, 93d Cong., 2d Sess. 207-24 (1974) (statement of Rep. Neal Smith) [hereinafter cited as Senate Hearings]; Note, supra note 3, at 730-39. For discussion of how loopholes in current law give foreign governments the potential to manipulate United States commodity futures prices, see id. at 747-48.
ulations to anticipate and prevent every conceivable case of manipulation. Thus, sections 6b and 9 of the Commodity Exchange Act, as amended, proscribe deceptive and manipulative practices in general terms. Stiff penalties are imposed for violations.

The only way to dictate a manipulated price is through the use of a squeeze or a corner. A squeeze develops when, toward the end of a delivery month, a dominant long apparently wishes to take delivery on contracts rather than offset the price and the local supply of certificated stock is insufficient to meet this delivery.

26. 7 U.S.C. § 9 (1976) (original version at ch. 369, § 6b, 42 Stat. 998 (1922)) (civil penalty for manipulation) which provides in part:

If the [Commodity Futures Trading] Commission has reason to believe that any person is manipulating or attempting to manipulate the market price of any commodity, it may serve upon such person a complaint stating its charges in that respect requiring such person to show cause why an order should not be made prohibiting it from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Commission, and to show cause why the registration of such person, if registered as futures commission merchant or any person associated therewith, commodity trading advisor, commodity pool operator, or as floor broker hereunder, should not be suspended or revoked. Upon evidence received, the Commission may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant, commodity trading advisor, commodity pool operator, or as floor broker hereunder, may suspend, for a period not to exceed six months, or revoke, the registration of such person, and may assess such person a civil penalty of not more than $100,000 for each such violation.

27. Id. § 13 (1976) (original version at ch. 369, § 9, 42 Stat. 998 (1922)) (criminal penalty for manipulation) which provides in part:

It shall be a felony punishable by a fine of not more than $100,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market.


29. Violators may lose trading privileges and face fines, id. § 9 (1976), and/or jail sentences, id. § 13.

30. A "dominant long" is a long who controls a sufficient number of contracts to enable him or her to dominate the market and exact an arbitrary price for his or her contracts. See Cargill, Inc. v. Hardin, 452 F.2d 1154, 1164 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972). Arguably the last long or short in the market in any expiring future is dominant; however, this argument was rejected in Cargill. Id.

31. Before a commodity can be delivered it must be certificated as being of the proper grade. See id. at 1157; J. BAER & O. SAXON, supra note 6, at 86-95. See generally T. HIEBONYMUS, supra note 6, at 33, 46.
The shorts, finding no other sellers from whom to buy the needed commodity to liquidate their positions, and unable or unwilling to acquire the certificated stock necessary for delivery on the contracts, can then avoid default only by outbidding each other in an effort to persuade the dominant long to sell the contracts back to them. The resulting, albeit temporary, high price for futures does not reflect true supply and demand, but merely a phenomenon peculiar to the particular delivery month. Natural squeezes may develop when the shortage in the delivery month occurs by chance and the long's commitments require that delivery be taken on the futures positions. However, when knowledge of a shortage of deliverable supplies tempts a long into increasing the long position and apparently standing for delivery when the only purpose is to exact an exaggerated price from panicked shorts, the squeeze is considered manipulative and a cause for disciplinary action arises against the long.

A corner in the futures market differs from a squeeze in that the "shortage" of deliverable stock results from a dominant long having secured ownership of that stock. While there may be an abundance of actual deliverable stock, most of it is owned by the party with the dominant long interests in the futures market. This situation is analogous to a squeeze. However, instead of an actual shortage of deliverable stock, there is only a shortage of deliverable stock not controlled by the dominant long. Thus, the long is in a position to dictate both the price of liquidation for the shorts and the purchase price of the deliverable commodity. Natural corners may develop when the owner of most of the stock acquired it for bona fide sales purposes and commitments require that deliv-

32. Cargill, Inc. v. Hardin, 452 F.2d 1154, 1162 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); 7 FTC REPORT, supra note 11, at 243; J. BAER & O. SAXON, supra note 6, at 83.


34. See J. BAER & O. SAXON, supra note 6, at 83; T. HIERONYMUS, supra note 6, at 321-28. See also Cargill, Inc. v. Hardin, 452 F.2d 1154, 1162 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); 7 FTC REPORT, supra note 11, at 242-44.

35. See note 30 supra. See generally Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962); G.H. Miller & Co. v. United States, 260 F.2d 286 (7th Cir. 1958), cert. denied, 359 U.S. 907 (1959); Great W. Food Distrb., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), cert. denied, 345 U.S. 997 (1953); General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948); Peto v. Howell, 101 F.2d 353 (7th Cir. 1939). See also How Jack Simplot, Other Big Traders Waged a Potato War, Wall St. J., June 1, 1976, at 1, col. 1 (describing "Maine potato scandal").
e be taken on the futures contracts. However, if after acquiring a dominant interest in the deliverable cash commodity, the owner increases the long position and stands for delivery to exact an artificial price from panicked shorts, the corner, like the squeeze, is considered manipulative and a cause for disciplinary action arises against the long.

Occasionally the shorts try to squeeze the longs by tendering large numbers of delivery notices early in the delivery month, hoping the longs will panic and liquidate rather than accept deliveries. Theoretically this pushes prices down, enabling the shorts to buy back at a lower price. Conceivably, the mere possibility of this scheme is one cause of manipulative corners: Longs accumulate large holdings of deliverable supplies trying to defend their futures positions against such tactics by the shorts. Nevertheless, when the longs successfully defend themselves and strike back at the shorts by standing for further deliveries, the longs may become subject to disciplinary action.

36. See 7 FTC REPORT, supra note 11, at 243. But see J. BAER & O. SAXON, supra note 6, at 82.

37. The terms "squeeze" and "corner" are sometimes confused. See generally Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962). This is because a pure squeeze, one in which there are no deliverable supplies whatsoever, virtually never occurs. Because there are usually some supplies when there is a squeeze, these supplies must be "cornered." Thus, in practice, a squeeze usually involves some small-scale "corning." See generally 7 FTC REPORT, supra note 11, at 242-44; J. BAER & O. SAXON, supra note 6, at 83.

38. See generally Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962); G.H. Miller & Co. v. United States, 260 F.2d 286 (7th Cir. 1958), cert. denied, 359 U.S. 907 (1959); Great W. Food Distr., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), cert. denied, 345 U.S. 997 (1953); General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948); Peto v. Howell, 101 F.2d 353 (7th Cir. 1938); see also How Jack Simplot, Other Big Traders Waged a Potato War, Wall St. J., June 1, 1976, at 1, col. 1 (describing "Maine potato scandal").

39. See T. HIERONYMUS, supra note 6, at 325; Comment, Manipulation of Commodity Futures Prices—The Great Western Case, 21 U. CHI. L. REV. 94, 102 (1953). See generally Hohenberg Bros. Cotton Co. Case, [1975-1977 Transfer Binder] COMM. FUT. L. REP. (CCH) ¶ 20,146 (1976). The shorts are incapable of employing the equivalent of a long-side squeeze or corner. The effectiveness of a squeeze or corner turns on the long's ability to seize an advantage when there is an insufficient supply of goods available to sellers. For the seller to accomplish an analogous manipulation would require that he or she force a situation wherein there is an insufficient number of buyers for the oversupply of goods. This is impractical if not difficult or impossible to accomplish in any one delivery month, because if the price goes too low in relation to the other months there will generally be buyers ready to take advantage of the bargain. See 7 FTC REPORT, supra note 11, at 254.

40. See generally T. HIERONYMUS, supra note 6, at 325-26.

41. Id. See generally cases cited note 35 supra.
Given these market realities, cornering or squeezing can be properly characterized as manipulative only when (1) traders become aware that their trading behavior is likely to result in a corner or squeeze and they nevertheless persist in that behavior, and (2) the trading behavior is not consistent with any legitimate business purpose. Only then will traders have the requisite knowledge and intent to impute culpability for market manipulation. But such knowledge or intent can rarely be shown unless traders are definitively informed that a corner or squeeze will likely result from their trading behavior. Therefore defining manipulation in terms of cornering or squeezing can be counterproductive. This is illustrated by the inequitable and inconsistent results reached by the various courts that have dealt with corners or squeezes.\[42\]

**Variations in Court and Administrative Decisions**

Although cornering and squeezing\[43\] are prohibited by the Commodity Exchange Act,\[44\] they are never specifically defined.\[45\] Since definition has been left to judicial and administrative construction, it was inevitable that conflicting standards and tests for manipulation would emerge.\[46\] The lack of a coherent definition leaves an aggressive, large-scale trader guessing at what point financial self-interest violates the act.

*General Foods Corp. v. Brannan*\[47\] is the first appellate decision to construe the term “manipulate” in the Commodity Exchange Act. General Foods Corporation allegedly cornered the rye futures market from December 1942 through May 1944. General Foods took delivery of 7,230,000 bushels of rye in satisfaction of futures contracts and allegedly “caused a tight situation in the Chicago rye market, with a resulting inflated and manipulated price.”\[48\] After the Business Conduct Committee of the Chicago Board of Trade warned General Foods that such holdings might

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42. See text accompanying notes 43-108 infra.
43. While squeezing is not expressly prohibited by the Act, it is clearly implicated because, in practice, all squeezing involves some cornering. See note 37 supra.
44. 7 U.S.C. § 9 (1976) (original version at ch. 369, § 66, 42 Stat. 998 (1922)) (civil penalty for manipulation); id. § 13 (1976) (original version at ch. 369, § 9, 42 Stat. 998 (1922)) (criminal penalty for manipulation). For text of statutes, see notes 26 & 27 supra.
46. See generally text accompanying notes 47-108 infra.
47. 170 F.2d 220 (7th Cir. 1948).
48. Id. at 222.
tend to create a corner and that no further purchases were to be made by General Foods without permission of the committee,\textsuperscript{49} associates of General Foods, also named as defendants in the case, bought large numbers of additional rye futures and took delivery on approximately 2,000,000 more bushels.\textsuperscript{50}

At the administrative hearing,\textsuperscript{51} the judicial officer construed "manipulate" to mean causing prices "to go up or down by means directed to either such end or to prevent prices from going up or down by means directed to such end."\textsuperscript{52} However, there was no testimony regarding the normal, unmanipulated price of rye.\textsuperscript{53} Nevertheless, based on inferences drawn from defendants’ trading activities and incriminating statements,\textsuperscript{54} the judicial officer found that General Foods and its associates had manipulated the market in violation of sections 6b and 9 of the Commodity Exchange Act.\textsuperscript{55}

The Seventh Circuit Court of Appeals, however, refused to draw the same inferences and emphasized that the government never contended that the transactions by defendants had any effect upon the price other than to “stabilize” it at a particular level.\textsuperscript{56} The court of appeals concluded that manipulation does not include the mere “stabilization” of a “natural” price but rather “the creation of an artificial price.”\textsuperscript{57} Thus, the order of the judicial officer was set aside,\textsuperscript{58} not because of insufficient evidence, but rather because the court of appeals defined the crime differently.

Both opinions ignored the shorts’ role in the market manipulation. If General Foods and its associates had reached their capacity to accept deliveries while still holding open positions in expiring futures, they would have been forced to liquidate their remaining long futures contracts by selling,\textsuperscript{59} thereby contributing to a price decline. It is plausible that those shorts still in the market during

\textsuperscript{49} Id.
\textsuperscript{50} Id.
\textsuperscript{51} General Foods Corp. Case, 6 Agric. Dec. 288 (1947), vacated, 170 F.2d 220 (7th Cir. 1948). Upon allegations of market manipulation an administrative hearing is held, the outcome of which may be reviewed in the federal court of appeals for the circuit in which the petitioner is doing business. See 7 U.S.C. § 9 (1976) (civil penalty for manipulation).
\textsuperscript{52} 6 Agric. Dec. at 305.
\textsuperscript{53} Id. at 297.
\textsuperscript{54} Id. at 313-15.
\textsuperscript{55} Id.
\textsuperscript{56} 170 F.2d at 230.
\textsuperscript{57} Id. at 231 (emphasis added).
\textsuperscript{58} Id. at 231.
\textsuperscript{59} Otherwise they would have defaulted on their contracts. See note 13 supra.
the final days of the delivery month were holding their positions in anticipation of such an impending profitable price collapse that never occurred. The trading activities of the shorts contributed to the manipulation. Therefore, it is possible that the artificial price was as much a result of the shorts' market activity as the longs' activity.

The failure of the Commodity Exchange Act to specifically define the elements of manipulation proved troublesome for the court in *General Foods.* 60 Official market surveillance by two representatives of the Commodity Exchange Administration who had vast experience with grain exchanges did not detect any irregularities or perceive any need for regulatory preventive measures. 61 Although the Seventh Circuit did not dismiss the charges on vagueness grounds, 62 the court nevertheless evidenced concern:

> Of course, [the failure of Commodity Exchange Administration representatives to invoke regulatory measures] does not impair the right of the government to proceed as it has, but at the same time, we think it casts some reflection upon a determination made long subsequent to the happening of the events relied upon, that respondents attempted to manipulate or corner the market when no such activity was discernible by the agencies' own experienced men, who viewed and understood the situation at close range and while respondents' activities were in progress. 63

Although this concern was voiced obliquely and seemed peripheral to the court's final decision, it was undoubtedly one factor influencing the ultimate outcome. 64

The issue of the shorts' involvement in the manipulation was also ignored in *Great Western Food Distributors, Inc. v. Brannan,* 65 the next major case to involve an alleged manipulative corner. Again, the issue of lack of notice about what conduct constitutes a violation was dismissed. 66 *Great Western* concerned an alleged corner in, and manipulation of, the December 1947 egg futures market. During November and December of 1947, Great Western and associates purchased large quantities of December egg futures. Simultaneously, they purchased large enough quanti-

60. See 170 F.2d at 224.
61. Id.
62. See id.
63. Id.
64. See generally id. at 231.
65. 201 F.2d 476 (7th Cir.), cert. denied, 345 U.S. 997 (1953).
66. See generally id. at 484.
ties of actual or "cash" eggs so that when it came time for Great Western to take delivery in satisfaction of its futures contracts, it allegedly controlled the entire supply of deliverable eggs in Chicago and surrounding areas. At the administrative hearing, "manipulation" was found to include "the effecting of a price which would be different if the price influencing efforts were absent, that is, not only the raising or lowering of price by means directed to either such end but the prevention of prices from going up or down according to free supply and demand conditions." Using this definition of manipulation, Great Western was found to have violated section 9 of the Commodity Exchange Act.

On appeal, however, no specific definition of manipulation was articulated: The Seventh Circuit found intentional cornering coupled with higher than "normal" prices sufficient to uphold the decision below. By comparing the statistical price patterns of January 1948 futures and fresh eggs with the price of the allegedly manipulated December 1947 egg futures, it was "proved" that prices were abnormally high in December. In addition, the court found the price of futures abnormally high in relation to supply and demand. The finding of manipulative intent was based upon statements by one of the defendants to the effect that the trading program was initiated for the purpose of obtaining higher prices for December futures. The court thus narrowly construed the critical issue: whether and how Great Western actually caused the price changes.

As in General Foods, it was only because the defendant longs won the pricing tug of war that they were charged with market ma-

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67. Id. at 478.
69. 7 U.S.C. § 13(b) (1976) (original version at ch. 369, § 9, 42 Stat. 998 (1922)) (criminal penalty for manipulation).
70. See 201 F.2d at 479, 483.
71. Id. at 482. While such criteria is not completely inapposite, any "proof" of price abnormality based on comparisons between past and present price patterns is fundamentally unreliable. If "proper" prices could be predicted with certainty from past market behavior, schools of market statisticians would be able to trade without fear of mistake. See generally Irwin, supra note 14, at 270-77. Because there are so many factors affecting supply and demand at any given time, it is difficult to prove price abnormality based on comparisons between past and present prices, different futures prices, or futures and cash prices without examining minutely all the circumstances surrounding the various prices. See generally T. Hieronymus, supra note 6, at 148-72.
72. 201 F.2d at 482.
73. Id. at 484.
nipulation; the court paid no heed to the likelihood that there had been shorts in the market who held their positions too long in expectation of an eventual price collapse. Moreover, since it was never shown that the defendants ever controlled more than fifty-one percent of Chicago's deliverable supply, many of the shorts who paid the inflated liquidation prices may have done so because they had neither the intention nor the financial capability of obtaining the deliverable eggs even at an acceptable price, and not because they could only get the eggs at Great Western's prohibitive prices. They therefore had to liquidate at any price or default on their contracts.

The court noted that petitioners protested the lack of notice of the specific charges filed against them by citing the Administrative Procedure Act requirement that:

Except in cases of willfulness . . . no . . . suspension . . . of any license shall be lawful unless, prior to the institution of agency proceedings therefor, facts or conduct which may warrant such action shall have been called to the attention of the licensee by the agency in writing and the licensee shall have been accorded opportunity to demonstrate or achieve compliance with all lawful requirements.

The court dismissed this defense holding that the petitioners' acts were "willful" because they intentionally set out to raise prices. But this response begs the question. The intent, purpose, and expectation of all speculators is to make a profit. Consequently, they cannot reasonably be expected to curtail their own trading behavior in the absence of clear guidelines if such a curtailment limits or jeopardizes their profits. Thus, assuming arguendo that Great Western and associates traded in a manner that they hoped would raise prices and did in fact do so, it does not necessarily follow that they willfully set out to manipulate the market. Given the ambie-

75. 201 F.2d at 481.
76. Id. at 484 (citing 5 U.S.C. § 1008 (1952) (current version at 5 U.S.C. § 558 (1976))).
77. Id.
78. A long's purpose in accepting delivery instead of liquidating may not be to control the deliverable supply, but to refrain from exerting downward pressure on the futures' price. See generally text accompanying note 59 supra.
79. There is no evidence that Great Western knew, or had reason to know, that its conduct was "manipulative."
guity of the term “manipulation,” only if the longs had been warned that their trading conduct was becoming manipulative and they persisted nevertheless could it be contended that they willfully manipulated the market.

The Fifth Circuit’s decision in Volkart Brothers v. Freeman,\textsuperscript{80} decided nine years after Great Western, reflects an uneasiness about imposing sanctions for violating an undefined prohibition against manipulation and the role of the shorts in producing market distortion.\textsuperscript{81} Volkart involved alleged squeezing of the October 1957 cotton futures market by Volkart Brothers, a large cotton-merchandising corporation. On the last day of trading in October cotton futures, Volkart held 104 long contracts\textsuperscript{82} representing eighty-nine percent of the total open interest\textsuperscript{83} in cotton futures on the New York Cotton Exchange. Volkart allegedly exacted an arbitrary and manipulated liquidation price from the shorts by taking advantage of an insufficient local supply of certificated cotton available for delivery. At both the administrative hearing\textsuperscript{84} and on appeal, “manipulation” was defined as “‘any and every operation or transaction or practice . . . calculated to produce a price distortion of any kind in any market either in itself or in relation to other markets. . . . Any . . . operation, transaction [or] device employed to produce these abnormalities of price relationship in the futures markets is manipulation.’”\textsuperscript{85} On review, however, the Fifth Circuit decided that to constitute manipulation, Volkart would have had to intend to create the shortage of deliverable stock and to exploit the shortage for its own profit.\textsuperscript{86} The court defined “manipulate” to include conduct \textit{calculated} to produce a price distortion and not merely the charging of “unreasonably high” prices.\textsuperscript{87} Otherwise, the statute prohibiting “manipulation” would be arguably unconstitutional as failing “‘to inform persons accused of violation

\textsuperscript{80} 311 F.2d 52 (5th Cir. 1962).
\textsuperscript{81} See generally text accompanying notes 86-90 infra.
\textsuperscript{83} “Open interest” refers to the number of unsettled contracts. T. Hieronymus, supra note 6, at 42.
\textsuperscript{85} 311 F.2d at 58 (quoting \textit{Hearings Before Subcomm. of Senate Comm. on Agriculture and Forestry}, 70th Cong., 1st Sess. 201-02 (1927) (testimony of Arthur R. Marsh, former President, New York Cotton Exchange)).
\textsuperscript{86} Id. at 59.
\textsuperscript{87} Id. at 58.
thereof of the nature and cause of the accusation against them.' 88 Because Volkart did not create the shortage of certificated cotton, but only exploited it, the court set aside the judicial officer's order. 89

Furthermore, the court believed that the shorts' own lack of due diligence in preparing for delivery contributed to their untenable position in the futures market. The court noted that while there had been a shortage of certificated cotton, large supplies of uncertificated cotton had been stored in the port warehouses specified as delivery points for certificated cotton. 90 Because the shorts could have obtained this cotton and certificated it in time for delivery, the court refused to disregard the availability of these supplies in measuring the extent to which Volkart controlled the market.

Nine years later, in Cargill, Inc. v. Hardin, 91 the Eighth Circuit failed to achieve the breadth of analysis displayed in Volkart. Cargill, Inc. is one of the largest grain merchandisers and exporters in the country. By selling huge quantities of wheat abroad, Cargill radically depleted the supply of wheat in the Chicago area available for delivery on May 1963 wheat futures, while taking a long position of 1,990,000 bushels. 92 Cargill then waited until the last fifteen minutes of trading to begin liquidating its long position. 93 The resulting stampede by the shorts created an allegedly artificial price. At the administrative hearing, the judicial officer adopted the definition of manipulation used in the General Foods administrative hearing 94 and found Cargill guilty of market manipulation. On appeal the Eighth Circuit Court of Appeals adopted the definition of manipulation found in the General Foods appeal, 95 modifying it to include artificial price stabilization. 96 The court determined that prices were artificially high by comparing May 1963 wheat price futures with the prices of May wheat futures for the

88. Id. at 58 n.9 (quoting United States v. L. Cohen Grocery Co., 255 U.S. 81, 89 (1921)).
89. Id. at 60. For criticism of this reasoning, see Comment, The Delivery Requirement: An Illusory Bar to Regulation of Manipulation in Commodity Exchanges, 73 Yale L.J. 171 (1963).
90. 311 F.2d at 59.
91. 452 F.2d 1154 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972).
92. Id. at 1160.
93. Id.
94. See text accompanying notes 51 & 52 supra.
95. See text accompanying note 57 supra.
96. 452 F.2d at 1163.
preceding nine years on the Chicago Board of Trade, and by comparing the price of May 1963 wheat futures with the price of cash wheat in May 1963—both patently unreliable methods of determining whether the price had been artificially set. The finding that Cargill caused the “artificially high” price was based on the high liquidation prices Cargill was able to obtain from the shorts. Thus, the court failed to acknowledge the dual origin of any given commodity futures price—the buyer’s bid as well as the seller’s offer—and therefore placed on Cargill undue responsibility for the unnatural rise in prices. Cargill argued that the Administrative Procedure Act requires notice that Cargill’s conduct violated the Commodity Exchange Act. However, the court dismissed this defense as was done in Great Western, stating that no notice is required when the conduct in question is “willful.” The court examined the willfulness of the cornering by noting that Cargill not only exploited the lack of deliverable supplies, but also created the shortage in May wheat by selling huge quantities of wheat abroad, albeit for bona fide sales purposes. Cargill argued that the holding in Volkart is applicable, since Cargill’s creation of the shortage was the inadvertent result of bona fide sales and therefore without manipulative intent. The Eighth Circuit criticized Volkart and refused to consider Cargill’s good faith defense. Rather, the court held that mere exploitation of such a shortage violates the Act, rationalizing that a contrary holding would encourage excessive speculation in deliverable supplies toward the end of delivery months.

The foregoing discussion demonstrates that while sections 6b and 9 of the Commodity Exchange Act prohibit manipulation, traders are without guidance as to what constitutes illegal conduct. Because manipulative trading may closely resemble normal, legiti-

97. See note 71 supra.
98. 452 F.2d at 1169.
99. For criticism of the practice of blaming only the longs for the manipulation, see T. Hieronymus, supra note 6, at 326-37; Hieronymus, supra note 74, at 54.
101. 452 F.2d at 1173.
102. See text accompanying notes 77-79 supra.
103. 452 F.2d at 1173.
104. Id. at 1159-60. See also Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962).
105. 452 F.2d at 1159-60.
106. Id. at 1172.
107. See id.
108. See id. at 1173.
mate trading, transgressions of legal bounds by "manipulators" are often unintentional. Courts may examine the consequences of trading behavior—usually "abnormally" high prices accompanied by complaints from unhappy shorts—and assign blame to the traders who ostensibly "manipulated" the market—usually the longs. Although courts often fail to recognize that commodity futures market manipulation involves a battle of excessive speculation by both longs and shorts, it is the financial harm suffered by the losing speculators that gives rise to complaints against the winners. Consequently, when the cases are adjudicated, courts focus only on the culpable conduct of the winning speculators—only the winners are defendants. This approach ignores market realities and produces inequitable results.

**Past Attempts to Prevent Manipulation**

Fortunately, the methods of controlling squeezes and corners are not limited to retrospective resolution. Because the factors contributing to a squeeze or a corner fall into a general pattern, these forms of manipulation can be anticipated and controlled by preventive regulation. Thus Commodity Futures Trading Commission notes that speculative position limits are a first line of defense against individual traders dominating the market or engaging in activities that may cause price distortions, manipulations, corners, or squeezes.

109. For example, there are limits on the size of any trader's speculative holdings in the futures market. See 7 U.S.C. § 6(a) (1976); 17 C.F.R. §§ 150.1-12 (1978). The purpose of these limits is to prevent price movements caused by the sheer volume of a trader's holdings. See T. Hieronymus, supra note 6, at 333-39. Such limits are "a first line of defense against individual traders dominating the market or engaging in activities that may cause price distortions, manipulations, corners, or squeezes." Memorandum of Points and Authorities in Support of Plaintiff's Motion for a Temporary Restraining Order and Preliminary Injunction at 3, CFTC v. Hunt, No. 77-C-1489 (N.D. Ill. Sept. 28, 1977), aff'd, 2 Com. Fut. L. Rep. (CCH) ¶ 20,726 (7th Cir. 1979). In Hunt the validity of speculative position limits was challenged by the defendants, who while not exceeding the speculative position limits individually, were far in excess of the position limits collectively. The validity of the speculative position limits was upheld, and the United States Court of Appeals for the Seventh Circuit ultimately upheld Hunt's conviction for violating government speculative position limits on soybean trading. See CFTC v. Hunt, 2 Com. Fut. L. Rep. (CCH) ¶ 20,726 (7th Cir. 1979).

Until recently, daily speculative trading limits specifying the maximum amount that a person could buy or sell during a single day in a single market applied to commodities traded on most domestic exchanges. 44 Fed. Reg. 7124 (1979); CFTC Votes To Remove Daily Speculative Trading Limits, J. Commerce, Dec. 20, 1978, at 7, col. 5. In late 1978 the CFTC voted to remove all daily speculative trading limits. The removal of daily speculative trading limits will now allow speculators to conduct transactions of any volume so long as the existing speculative position limits are not exceeded at any given moment. The CFTC based removal of daily speculative trading limits on the increase in market liquidity that would result and the minimizing effect that increased in-and-out trading would have on the price impact of large or-
mission (CFTC) regulation 1.41(f) provides in part:

(f) Temporary emergency rules. In the event of an emergency, a contract market by a two-thirds vote of its governing board, may place into immediate effect a temporary emergency rule to deal with the emergency without prior Commission approval . . . :

. . .

(3) A temporary emergency rule may provide for, or may authorize the contract market . . . to undertake actions necessary or appropriate to meet the emergency . . . .

Examples of such action include extending the delivery period to provide shorts with additional time to obtain the commodity from a more remote location, and changing delivery points to neutralize any local transportation problems hampering access to deliverable supplies. If, in spite of such measures, the deliverable supply cannot be sufficiently increased, more radical action may be taken. For example, trading might be confined to the mandatory liquidation of contracts and new sales restricted to parties who have the actual commodity to deliver pursuant to such sales.

ders. See 44 Fed. Reg. 7124 (1979); CFTC Votes To Remove Daily Speculative Trading Limits, J. Commerce, Dec. 20, 1978, at 7, col. 5. Another method of alleviating potential manipulative pressures is a track delivery rule, a typical example of which is employed by the Board of Trade of Kansas City, Missouri:

[The track delivery rule] permits deliveries of wheat in railroad cars in the Kansas City market during the last thirty days of a delivery month. This means, for example, that again were a tight situation to develop, persons on the other side of the market could, within the thirty days, fairly easily arrange to have wheat brought in on track in an effort to modify any developing problems.

Letter from W.N. Vernon, III, Executive Vice President and Secretary of the Board of Trade of Kansas City, Missouri, to the Author (Jan. 19, 1977) (on file in office of the Hofstra Law Review).

110. 17 C.F.R. § 1.41(f) (1978) (emphasis added).
111. Id. See COMM. FUT. L. REP. (CCH) ¶ 2177 (1976).
112. COMM. FUT. L. REP. (CCH) ¶ 2177 (1976). A typical mandatory liquidation was effected as follows:

Any person who, at the close of business on November 23, 1977, directly or indirectly owns or controls any December 1977 Coffee “C” contracts (long or short) through any clearing member shall reduce the number of such contracts (either by effecting liquidation trades or by making or accepting delivery of coffee) as follows: to 75% of the number so owned or controlled on November 23, 1977 by the close of trading on December 2, 1977; to 50% of the number so owned or controlled on November 23, 1977 by the close of trading on December 9, 1977; to 25% of the number so owned or controlled on November 23, 1977 by the close of trading on December 16, 1977; and to 10% of the number so owned or controlled on November 23, 1977 by the close of trading on December 20, 1977. In any case
Commodity exchanges have long been aware of the utility of emergency action\textsuperscript{113} and most exchange bylaws authorize such actions.\textsuperscript{114} That this discretionary action has not always been taken is due less to the subtle effects of manipulations\textsuperscript{115} than to two other factors. First, exchange members lack self-discipline.\textsuperscript{116} They are

where the application of any of the aforesaid percentages to the number of contracts so owned or controlled on November 23, 1977 results in a number other than a whole number, the reduction required under the preceding sentence shall be the next smaller whole number of contracts.


113. \textit{See} 7 FTC REPORT, \textit{supra} note 11, at 252-53. “In the opinion of one prominent grain trade man, who is a member of the Chicago Board of Trade, the anti-corner rule now (since its amendment in 1921) ‘absolutely prohibits any possibility of a squeeze,’ absolutely stops ‘what is commonly known as a corner,’ and ‘will absolutely work.’” \textit{Id.} at 253. A forerunner of this general procedure was adopted by the Chicago Board of Trade as early as 1869. 5 FTC REPORT, \textit{supra} note 11, at 178-79.

114. \textit{See}, e.g., COFFEE, SUGAR \& COCOA EXCHANGE, INC., Bylaw § 602 (1979); COMMODITY EXCHANGE, INC., Bylaw § 408 (1975); N.Y. COTTON EXCHANGE, Bylaw § 1.38 (1977).

115. For an early legal opinion discussing the notoriety of some corners, see 5 FTC REPORT, \textit{supra} note 11, at 325 (quoting statement from \textit{Ex parte} Young, 6 Biss. (Bissel’s U.S.C.C. Rep.) 58 (1874) (discussing general participation in corner by members of exchange)). Although some corners may be effectuated in clandestine manner through the use of several different brokers to obtain a dominant market position, see Peto v. Howell, 101 F.2d 353 (7th Cir. 1938), it would be impossible for clearinghouses not to notice a greater-than-normal open interest as the delivery month expires and, therefore, have reason for alarm. \textit{See generally} J. BAER \& O. SAXON, \textit{supra} note 6, at 164-87; T. HIERONYMUS, \textit{supra} note 6, at 43-47. In any case, the difficulties in determining market domination are not substantially different from the difficulties in determining violations of position limits. For other indications of the general notoriety of squeezes and corners, see G.H. Miller Case, 15 Agric. Dec. 1015, 1027-31 (1956) (reference to market letters from various brokerage houses speaking of “concentrated buying,” “the development of a squeeze,” and “congestion of the delivery month contributing to the price rise”). In General Foods Corp. Case, 6 Agric. Dec. 288 (1947), the Business Conduct Committee of the Chicago Board of Trade called one of the respondents before the committee and “informed” him that the “combined position” of General Foods and others “might tend to create a corner and be in a position to dominate price movements.” \textit{Id.} at 299. And the court in Fox Delux Case, 18 Agric. Dec. 582 (1959), mentions a market letter from a brokerage house speaking of “a large merchandising interest which has been conspicuous on the long side of December eggs.” \textit{Id.} at 597 (emphasis added). In Volkart Bros. Case, 20 Agric. Dec. 306 (1961), \textit{vacated}, 311 F.2d 52 (5th Cir. 1962), the court indicates “that professional traders recognized the obvious fact that a concentrated long would make or determine prices . . . on that day.” \textit{Id.} at 332 (emphasis added). The exchanges constantly receive information with regard to the availability of deliverable supplies and the identity of parties asking for or making delivery, and they are in a position to know of the development of a squeeze or corner. \textit{See} 17 C.F.R. § 1.51 (1978).

116. In all the cases involving corners listed in note 35 \textit{supra}, exchange mem-
more likely to be either conducting the manipulation\textsuperscript{117} or seeking to profit from the developing crisis than to be taking the necessary steps to rectify the market situation before it becomes critical. Thus when squeezes and corners occur, exchange members may be found on both sides of the market late into the delivery period, exacerbating the crisis rather than alleviating it.\textsuperscript{118} Second, there is a need for objective standards for identifying potentially disruptive situations.\textsuperscript{119} Some traders are likely to challenge the objectivity of

\textsuperscript{117} See generally Fox Deluxe Case, 18 Agric. Dec. 582, 612-13 (1956) ("Until the last few trading days, a substantial portion of these clearing members had positions on both sides of the market, although the concentration of long trading through respondent Fox Deluxe was by this time quite apparent."). Such tactics by brokers were suspected in CFTC v. Hunt, 2 COMM. Fut. L. REP. (CCH) ¶ 20,726 (7th Cir. 1979). See Maidenberg, Questions in the Hunt Soybean Saga, N.Y. Times, May 2, 1977, at 54, col. 1. See generally cases cited note 35 supra. See also U.S. to Review Role of Chicago Board Official, N.Y. Times, Mar. 23, 1979, at D1, col. 3.

\textsuperscript{118} \textsuperscript{119} See 43 Fed. Reg. 15,438 (1978), reprinted in 2 COMM. Fut. L. REP

\textsuperscript{117} See note 142 infra. See also 2 COMM. Fut. L. REP. (CCH) Report Letter 80, at 4 (Aug. 25, 1978), which states in part:

After an investigation of the New York Mercantile Exchange's rule enforcement program, the CFTC Division of Trading and Markets has concluded that the exchange has the rudiments of a strong program in both market surveillance and trade practice surveillance, but that exchange members must become more involved into [sic] the analytical phases of compliance work.

... The Division commented that the extent and quality of member participation in compliance matters was limited and that members did not appear totally committed to discharging their disciplinary functions....

... Investigations of trading practice... were cited as being deficient in effective questioning of the brokers involved. ...

... Criticized by the Division was the disciplinary procedure of the exchange. Calling the procedure "neither prompt nor effective" the Division required that a report be submitted... explaining the steps that will be taken to accelerate the final resolution of complaints....

Id. See also id. Report Letter 86, at 3 (Nov. 20, 1978), which provides in part:

The CFTC Division of Trading and Markets has criticized the rule enforcement program of the New York Cotton Exchange following a review of that program. ... The Division called the Exchange's program disorganized, cursory, reactive, and reflecting little, if any, improvement from a similar review conducted in 1976.

Warning that enforcement action may be recommended, the Division asked that improvement be forthcoming in the next several months in the areas of market surveillance, trade practice surveillance, the handling of customer complaints, and compliance program record keeping. Along with these problems, the Division noted particular interest in the Exchange developing an affirmative approach toward self-regulation.

Id.
an exchange's ad hoc determination that trading prices have become, or are about to become, "artificial."  

PROPOSED SOLUTION

Because of the failings of discretionary ad hoc emergency action, the CFTC would do well to employ a consistent, predictable, and objective method for identifying and alleviating emergency situations.

As a contract expires, so long as the deliverable supply of a given commodity is neither depleted nor cornered, any inordinate rise in futures prices will always induce price-correcting short

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(CCH) ¶ 20,578 (1978) (describing proposed rule 1.52, better known as "The Twenty-five Percent Rule"). Essentially, proposed rule 1.52 would limit the size of trading positions during the last 15 days of the delivery month to less than 25% of the open interest, unless the exchange makes a determination that the holding is "not likely to result" in disorderly trading. The purpose of the rule was to prevent trading congestions during the delivery month "by placing an affirmative obligation on the contract market to analyze major positions and to take action if such positions could adversely affect trading." Division of Economics & Education, Commodities Future Trading Commission, Summary and Recommendations on Proposed Rule 1.52 (The "Twenty-five Percent Rule") 1 (1978) [hereinafter cited as Summary and Recommendations]. On April 13, 1978, the Commission solicited comment on the rule, to be received by July 12, 1978. 43 Fed. Reg. 15,438 (1978). The Commission received thirty-six comments on the proposed rule, including comments from exchanges, commercial users of futures markets, and private parties. Thirty-five of the responses to the proposed rule were unfavorable. The Commission decided to abandon the rule, largely because the "not likely to result in price manipulation or market congestion" standard could result in unneeded market intervention by an exchange that feared that failure to intervene might lead to ex post facto CFTC enforcement action against the exchange. Among other reasons for Commission abandonment of the proposed rule was recognition that a more important factor than position concentration affects the potential for market disruption, namely the magnitude of deliverable supplies. Consequently, a trading position of less than 25% of the open interest could be disruptive if the deliverable supply is insufficient, and a trading position of more than 25% of the open interest might not be disruptive if there is sufficient deliverable supply. See Summary and Recommendations, supra, at 5-9.

120. See generally Summary and Recommendations, supra note 119, at 12. Such challenges are not likely to be successful: Courts apply a standard of liability for exchange market intervention highly favorable to the exchange. In Compania Salvadorena de Cafe, S.A. v. CFTC, 446 F. Supp. 687 (S.D.N.Y. 1978), the court described the exchange's power to take emergency actions to prevent market disorders as "without limit except that the Board must act in good faith." Id. at 691 (citations omitted). Likewise, in Lagorio v. Board of Trade, 529 F.2d 1290 (7th Cir. 1976), the court stated: "[W]e cannot believe that Congress intended . . . to impose liability for the good faith performance of regulatory duties . . . ." Id. at 1292. Nevertheless, an exchange's successful defense against such a suit can be expensive. See Letter from Bennett J. Corn, President, New York Coffee and Sugar Exchange, Inc., to Jane K. Stuckey, Executive Secretariat, CFTC, at 4 n.3 (July 12, 1978) (comments on proposed regulation 1.52) (on file in office of the Hofstra Law Review).
sales from traders capable of profiting by delivering the actual commodity instead of paying the inflated liquidation price on the futures market.\footnote{121} However, once the deliverable supply of a commodity is depleted or cornered, traders are incapable of delivering the actual commodity and further short sales only aggravate the ensuing liquidation by already panicked shorts.\footnote{122} Thus, it is the presence of a sufficient uncornered deliverable supply of a commodity that provides the market’s inherent price-correcting mechanism. Without this mechanism, futures prices are subject to the control of the dominant long and the market is void of integrity. Therefore, while an exchange should be allowed to choose any reasonable method of averting an emergency situation before it develops,\footnote{123} once an exchange ascertains that the deliverable supply\footnote{124} of a given commodity is so dangerously low in proportion to the amount of open interest that there is no realistic delivery alternative to liquidation,\footnote{125} mandatory emergency measures should be

\footnote{121}{See Volkart Bros. Case, 20 Agric. Dec. 306, 338 (1961), \textit{vacated}, 311 F.2d 52 (5th Cir. 1962); Comment, \textit{supra} note 89, at 174.}

\footnote{122}{See text accompanying notes 30-38 supra.}

\footnote{123}{See generally 17 C.F.R. § 1.41(f)(3) (1978).}

\footnote{124}{For these purposes “deliverable supply” includes all supplies reasonably capable of delivery within the prescribed grace period, see 1 COMM. FUT. L. REP. (CCH) § 6315 (1976), and would exclude supplies controlled by long interests, since those supplies are unlikely to be used to hammer down any upward price movement. Obviously computation of “deliverable supply” will be little more than an informed estimate in some cases, depending upon the relative ubiquity of the commodity involved. For example, it would be much easier to trace the availability of deliverable supplies of “Maine potatoes” or “Kansas City wheat” (both of which have concentrated growing areas and delivery points) than deliverable supplies of “world sugar” with delivery points in the country of origin and growing areas in Argentina, Australia, Brazil, British Honduras, Colombia, Costa Rica, Dominican Republic, El Salvador, Ecuador, Fiji Islands, French Antilles, Guatemala, Haiti, Honduras, India, Jamaica, Mauritius, Mexico, Nicaragua, Peru, Republic of Congo (Brazzaville), Republic of the Philippines, Reunion, South Africa, Swaziland, Taiwan, Thailand, Trinidad, Venezuela, and the United States. See \textit{NEW YORK COFFEE AND SUGAR EXCHANGE, INC.}, \textit{TRADING IN SUGAR FUTURES 11} (1977). Fortunately, however, the more ubiquitous the commodity and the more delivery locations, the less susceptible the commodity is to manipulation. See generally Hieronymus, \textit{supra} note 74, at 47-50.}

\footnote{125}{The following is a typical example of how such a determination is made and acted upon: }

\textit{In mid-November, concerns over the diminishing supply of tenderable coffee available for delivery appeared valid as prices for the expiring December 1977 “C” coffee contract began to widen from those of the March [1978] contract. Much of the coffee delivered on the July and September contracts was still held either by those interests which [accepted] the deliveries, or sold to interests with declared domestic and export commitments. It}
triggered automatically. Normal trading should cease, and liquidations should be compulsory. New sales should be restricted only to

appeared probable that this coffee, although certificated, was an unlikely source for fulfilling the large open interest persisting midway through November. The estimated available [sic] deliverable stocks were only a small fraction of that required to satisfy the large open interest.

The Commodity Futures Trading Commission and officials of the New York Coffee and Sugar Exchange agreed that an extremely tight situation existed.

Day-by-day surveillance of the market indicated a developing problem. . . . On November 21, the Commission met with Exchange representatives to discuss a course of action. An executive session of the Commission and staff was held on November 22 for further discussion of the December contract.

. . . Most coffee interests had predicted the problem would not be alleviated by new crop arrivals in New York until late December or early January. . . . Moreover, rumors persisted that a number of coffee shipments moving into New York either did not meet grade requirements or were only marginally within minimum deliverable quality standards for delivery on the “C” contract.

Commission and Exchange officials concluded that an emergency did, in fact, exist. On November 23, the Exchange declared the emergency and ordered trading for liquidation only. The Commission supported the Exchange action and also issued a formal declaration of an emergency and ordered a scheduled liquidation of the open interest.

The Commission said that on the basis of market surveillance data and information reported to and collected by the CFTC and acquired from the Exchange and other sources there was an emergency. There was a high level of open interest relative to known or anticipated supplies of coffee deliverable under the December contract. There was a concentration among a small group of traders both of positions to take delivery and of ownership of the known deliverable supply. Seventy-five percent of the open interest was held by three foreign traders. The deliverable supply on November 23 was estimated to be sufficient to cover only 200 contracts, while there existed 1132 open interest contracts.

. . . Effective as of the close of trading on Wednesday, November 23, the Exchange was ordered to limit trading in the December 1977 “C” coffee contract to liquidation only, and to direct and enforce the reduction of open interest on the following schedule:

- Open interest as of the close of trading on December 2 was not to exceed 75 percent of the open interest as of the closing of trading on November 23.
- Open interest as of the close of trading on December 9 was not to exceed 50 percent [sic] of the November 23 open interest.
- Open interest as of the close of trading [sic] on December 16 was not to exceed 25 percent of the November 23 open interest.
- Open interest at the close of trading December 20 was not to exceed 10 percent of the November 23 open interest.

parties who have the commodity available to deliver.\textsuperscript{126} Enough outstanding contracts should be mandatorily liquidated to restore a "safe" ratio of deliverable supply to open interest. Trading could then resume as usual until the "safe ratio" requires restoration. Such mandatory liquidations and resumptions of trading could occur repeatedly until the delivery month expires.

Because mandatory liquidation of contracts precludes delivery on those contracts, the shorts should bear some liability for any expenses incurred by the long as a result of the short's failure to deliver. However, if the long had no prior commitments for the certificated stock or if supplies were already owned beyond the long's prospective needs, no harm would result from liquidation of the contracts as opposed to delivery, and there would be no compensation. Furthermore, since a short hedger may enter the market not for any predetermined period of time but for as long as the hedger's cash position needs protection,\textsuperscript{127} such a course may result in the hedger holding that position into the delivery month. Because one of the main functions of an exchange is to provide a protective mechanism for the hedger,\textsuperscript{128} a hedger still holding in the delivery month to protect a cash position, rather than to reap speculative profits, should not be penalized.\textsuperscript{129} In any case, the ceiling on the compensation that would be paid to the longs by shorts would be the added cost of importing deliverable supplies from a more remote location.\textsuperscript{130}

Determining the need for mandatory liquidations should not be discretionary, as it is currently under regulation 1.41(f)(3)(i), lest the determination give rise to lawsuits by disgruntled traders forced to liquidate;\textsuperscript{131} more important, a discretionary determination might never be made at all.\textsuperscript{132}

To the extent that the necessary records are available, the

\textsuperscript{126} See 17 C.F.R. § 1.41(f)(3)(i) (1978). For text of this provision, see note 1 supra.

\textsuperscript{127} See generally note 16 supra.

\textsuperscript{128} See generally id.

\textsuperscript{129} See 7 FTC REPORT, supra note 11, at 253.


\textsuperscript{131} See note 120 supra.

\textsuperscript{132} See notes 116-117 supra and accompanying text.
CFTC and the exchanges should compile statistics that disclose the ratios of deliverable supplies to open interests on those occasions when the rule has been implemented\textsuperscript{133} and when known or suspected manipulations have occurred\textsuperscript{134} in the past. These statistics should be supplemented with corresponding statistical data from emergency situations that develop over an appropriate number of months.\textsuperscript{135} An analysis of these statistics would provide objective and consistent criteria for establishing reliable estimates of the points at which deliverable supplies are so diminished in comparison to volumes of open interest that the possibilities of delivery are "too remote." Likewise, daily application of such established estimates during the delivery month would provide objective and consistent criteria for identifying statistically safe ratios of deliverable supply to open interest for every commodity traded on every exchange.\textsuperscript{136}

Traders should be afforded notice of the safe ratio as well as continuous notice of the prevailing ratio of deliverable supply to open interest for any given commodity during the expiring delivery month. This information would be the focal point from which necessary guidelines for prudent trading behavior could be inferred.

Compared to the imposition of penal sanctions, the preventive approach to corners and squeezes has several advantages. First, the preventive approach, by making criminal prosecutions of manipulative squeezes and corners obsolete, renders moot the question

\textsuperscript{133} Exchanges commonly maintain such records. See, e.g., Lagorio v. Board of Trade, 529 F.2d 1990, 1292 (7th Cir. 1976) ("In the case at hand, an affidavit by the president of the Board lists nine instances between 1936 and 1955 in which the Board took the same action it took here, and additional instances in which it allowed liquidation sales only.").

\textsuperscript{134} A manipulation might be suspected where the cash price of a commodity at the delivery point temporarily rose relative to the commodity's cash price elsewhere (due to its control by the dominant longs, as in a corner, or its temporary unavailability, as in a squeeze), and then dropped back into line with the prevailing cash price at the end of the delivery period. See Hieronymus, supra note 74, at 53-55.

\textsuperscript{135} The period of time for which such statistics should be collected would vary depending upon the commodity and the speed with which a sufficiently representative compilation of statistics can be acquired. The judgment of what constitutes a "sufficiently representative compilation" would be left to the exchange, the Commission, and their experienced statisticians.

\textsuperscript{136} Those commodity futures most susceptible to delivery-month congestion or manipulation would be the first to yield the statistics necessary for determining safe ratios. Conversely, those commodity futures least susceptible to delivery-month congestion or manipulation would be the last to yield such statistics.
whether traders have sufficient notice of those elements of a corner or squeeze proscribed by the Commodity Exchange Act.

Second, the current practice of disciplining longs necessarily comes after the fact; the distorted price has already adversely affected market operation. Subsequent sanctions merely punish manipulators; they cannot prevent manipulation. In contrast, mandatory liquidation of open contracts until the safe ratio is restored prevents manipulation from occurring.

Third, if the squeeze or corner is expertly effectuated, it may not engender the gross distortions in price that incite complaints, yet nevertheless may impede performance of the market's basic functions. However, the safe-ratio method of controlling squeezes and corners would prevent even those manipulations otherwise too subtle to incite litigation.

Fourth, the safe-ratio method makes no attempt to allocate blame for the manipulation. Punishing longs for an evil that frequently occurs with the voluntary involvement of the shorts is inequitable. Price distortion is often as much a result of shorts overstaying the market—expecting longs to sell their holdings to avoid taking delivery—as it is a result of longs standing for delivery to panic unprepared shorts into paying a higher price to offset their contracts. Furthermore, punishing only longs after a manipulative squeeze or corner actually encourages shorts to hold their positions too long by giving them reason to believe longs will capitulate and liquidate early rather than face possible penalties for market manipulation. When it is erroneous, this prognostication by shorts works in a circular fashion, reinforcing the framework for manipulation. Because the system proposed here does not allocate blame, this kind of excessive speculation in the delivery month would be curbed.

Finally, this proposal would deny the longs any hope of

137. See text accompanying note 21 supra.
138. Sometimes a "rise" in price can be hidden by not asking a price at the end of the month as high as obtained earlier in the month, and, in turn, selling short in a future month and using the accepted deliveries from the squeezed month to deliver on the short sales. Thus, the profit will not be determined by the degree of price rise in the squeezed month but from the relative difference in prices effected by the spread between the near and future months. See Comment, supra note 39, at 100-02. See generally Great W. Food Distribs., Inc. Case, 10 Agric. Dec. 783 (1951), appeal denied, 201 F.2d 476 (7th Cir.), cert. denied, 345 U.S. 997 (1953).
139. See note 24 supra.
140. See text accompanying note 74 supra.
dictating the shorts' liquidation price, thereby removing the incentive for cornering the market. On the other hand, the prospect of the shorts having to defend their trading behavior to minimize their liability to the long would deter the shorts from overstaying the market.

Professor Hieronymus suggests that any processes that "reduce the extent to which the full forces of competition are allowed to work themselves out in price formation" will weaken the market's integrity. Such notions falter, however, when, as with a successfully cornered or squeezed market, shorts are at the mercy of overwhelmingly strong longs. Unrestrained competition in the commodity futures market is desirable only to the extent that it preserves the integrity of price formation. When free competition leads to the total disintegration of competitive trading ability, appropriate measures should be taken to neutralize any excessive advantage accruing to either side of the market.

CONCLUSION

The inefficacy of self-regulation by exchanges was a compelling factor in the enactment of the Commodity Futures Trading Act of 1974 and continues to be a source of CFTC concern; therefore, any regulation which authorizes an exchange to decide

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141. Hieronymus, supra note 74, at 52.
142. Then-Chairman of the House Committee on Agriculture W.R. Poage stated in 1974:

On the floors of the exchanges where commodity futures are bought and sold there is little or no real security for the customer despite the inherent honesty of most brokers. Brokers, like many futures commission merchants, number among themselves the most honorable of men. Yet, there are also those who have been attracted to futures markets for their volatile environment and the hoped for ability to reap great profits in a hectic atmosphere...often times taking advantage of that atmosphere at the customer's expense. Again, because not all commodities are covered under the present Act, many attempts at self-regulation in those exchanges have been and continue to fail [sic]. Attempted investigations in regulated exchanges are often characterized by the unwillingness of the investigating committees composed of exchange members to inquire too closely into the possible excesses of their own brethren. In one or more unregulated exchanges it is continually charged that the owners of the exchange manipulate and evade the traditional rules for their own personal gain. Brokers, customers, and eventually the American economy suffers in this atmosphere of so-called "self-regulation" where tradition and self interest has been allowed to displace the public interest.

143. See generally note 116 supra; see also note 119 supra.
whether and how to deal with a squeeze or a corner is an anachronism. Commodity exchanges need objective standards for identifying and preventing price manipulations through squeezes and corners during the delivery month. In developing and implementing such standards, however, the CFTC must be careful not to compound the problem. The CFTC should first conduct an empirical study to determine the effects of delivery-month trading disruptions on all market participants and the consumer public. Second, the CFTC should make use of all obtainable statistics to establish the frequency of these disruptions. Third, the CFTC should make a cost-benefit analysis of the safe-ratio method of preventing squeezes and corners and, in accordance with standard rulemaking procedure, solicit public comment on its potential consequences.

There is a widely held opinion that the most convenient method of dealing with delivery-month trading disruptions is for a trader who is not prepared to deliver or accept delivery to stay out of the delivery month. However, there have been complaints that mechanical avoidance of the delivery month by traders who have no intention of making or taking delivery can reduce the efficiency of hedging, increase the hedger's risks, and result in higher commodity prices to the consumer. Furthermore, since

144. For early criticism of the idea of allowing an exchange discretion over the enforcement of its own anticorner provisions, see 7 FTC REPORT, supra note 11, at 285:

The chief evil of corners and squeezes is artificial price changes and price levels brought about by them. The need is prevention. . . . The question about which there is room for difference of opinion with regard to the anti-corner rule is not the moral and commercial soundness of the rule, but whether its administration solely by a committee on the exchange is the best practicable arrangement.

See generally note 113 supra. Although Professor Thomas Hieronymus criticizes suggestions for suspension of trading and fixed settlement prices, T. HIERONYMUS, supra note 6, at 327-28, he does concede that current rules may be in need of change. He states:

Conceptually, the courts are not a good place to adjudicate manipulation. However, the mechanism of the CFTC is much worse. Prevention is the desirable solution, but it should be accomplished only in the rules. . . . Once the rules are made, the market should be allowed to trade out. If there are repeated congested expirations the rules should be changed.


commodity exchanges were developed to accommodate traders, and not the reverse, notions of "solving" the market's functional problems through problem avoidance seem unpersuasive at best and could lead to dereliction of duty by traders, exchange personnel, and the CFTC—all obliged to free commodity futures markets of operational defects.\textsuperscript{148}

Amendment of regulation 1.41(f) to provide mandatory liquidation of contracts, except for the delivery of the actual commodity, once the deliverable supply of a commodity falls below its safe ratio to open interest, should be given full consideration by the Commodity Futures Trading Commission. It may be the most predictable, impartial, and efficient means of freeing the commodity futures market from the deleterious effects of manipulative squeezes and corners.\textsuperscript{149}

\textit{Ralph T. Byrd}\textsuperscript{*}

\textsuperscript{24} supra. Premature removal of a hedge due to fear of delivery-month disruptions results in incomplete protection for the hedger's cash position. \textit{See generally} note 16 supra.

\textsuperscript{148} See, e.g., 7 U.S.C. § 5(d) & (g) (1976).

\textsuperscript{149} Control of manipulation was a primary purpose for the development of federal regulation of commodity futures trading. \textit{See} H.R. REP. No. 421, 74th Cong., 1st Sess. 1-3 (1935); 80 CONG. REC. 6161, 6164 (1936); 62 CONG. REC. 9404, 9406, 9414 (1922). For a thorough discussion of early federal regulation of commodity futures trading, see Campbell, \textit{supra} note 11; Rainbolt, \textit{Regulating the Grain Gambler and His Successors}, 6 HOFSTRA L. REV. 1 (1977).

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