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TO AMEND THE COMMODITY EXCHANGE ACT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON DOMESTIC MARKETING

AND CONSUMER RELATIONS

OF THE

COMMITTEE ON AGRICULTURE

HOUSE OF REPRESENTATIVES

EIGHTY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 11788

APRIL 4, 5, AND 6, 1966

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TO AMEND THE COMMODITY EXCHANGE ACT

MONDAY, APRIL 4, 1966

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MARKETING
AND CONSUMER RELATIONS OF THE
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1301, Longworth House Office Building, Washington, D.C., Hon. Spark M. Matsunaga (chairman of the subcommittee) presiding.

Present: Representatives Matsunaga, Hagen of California, Purcell, Redlin, Bandstra, Greigg, Callan, Teague of California, Mrs. May, and Dole.

Also present: Christine S. Gallagher, clerk; Martha Hannah, staff; John J. Heimbarger, general counsel, and Hyde H. Murray, assistant clerk.

Mr. MATSUNAGA. The Subcommittee on Domestic Marketing and Consumer Relations of the House Agriculture Committee will come to order please.

This morning we begin hearings on H.R. 11788, a bill to amend the Commodity Exchange Act, as amended, a bill which has evoked considerable interest among farmers, producers, exchange operators, and users throughout the country.

(H.R. 11788 is as follows:)

[H.R. 11788, 89th Cong., 1st sess.]

A BILL To amend the Commodity Exchange Act, as amended

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 2(a) of the Commodity Exchange Act, 42 Stat. 998, as amended (7 U.S.C. 2), is amended as follows:

(a) By adding the following before the period at the end of the third sentence defining the word "commodity": "and any agricultural or forest commodity or product or byproduct designated as a 'commodity' under section 2a of this Act";

(b) By changing the eleventh sentence defining "floor broker" to read as follows: "The words 'floor broker' shall mean any person who, in or surrounding any 'pit', 'ring', 'post', or any other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market."

(c) By deleting the last sentence of the section: and

(d) By adding the following at the end of the section:

"The word 'manipulate' shall be construed to mean the exacting, causing or maintaining of an abnormal or artificial price by any action or course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to a level different than that which would otherwise prevail. Any such exacting, causing, or maintaining of an abnormal or artificial price shall constitute manipulation irrespective of any acts or omissions by the holders of futures contracts adversely affected thereby."

SEC. 2. The Commodity Exchange Act, as amended, is further amended by adding after section 2 thereof, a new section to read as follows:

"SEC. 2a. The Secretary of Agriculture may designate as a commodity subject to this Act any agricultural or forest commodity not specified in paragraph (a) of section 2 of this Act, or any product or byproduct thereof, or any product or byproduct of any commodity specified in paragraph (a) of section 2, whenever he finds that transactions involving the sale thereof for future delivery are conducted on or subject to the rules of any board of trade and that such designation is necessary to prevent, as to such agricultural or forest commodity or product or byproduct, any acts or practices prohibited by this Act as to commodities specified in said paragraph (a) of section 2. The provisions of this Act shall apply to the designated commodities until such designation is withdrawn by the Secretary of Agriculture upon a finding that it is no longer necessary to effectuate the purposes of this Act."

SEC. 3. Section 4a(1) of the Commodity Exchange Act, as amended (7 U.S.C. 6a(1)), is amended by deleting the second and third sentences thereof and substituting the following: "For the purpose of diminishing, eliminating, or preventing such burden, the Secretary of Agriculture shall, from time to time, after due notice and opportunity for hearing, by order, proclaim and fix such limits on the amount of trading which may be done or positions which may be held by any person under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market as the Secretary of Agriculture finds is necessary to diminish, eliminate, or prevent such burden. Nothing in this section shall be construed to prohibit the Secretary of Agriculture from fixing different trading or position limits for different commodities, markets, futures, or delivery months, or different trading limits for buying and selling operations, or different limits for the purposes of subparagraphs (A) and (B) of this section, or from exempting transactions normally known to the trade as 'spreads' or 'straddles' or from fixing limits applying to such transactions or positions different from limits fixed for other transactions or positions."

SEC. 4. Section 4a(2)(B) of the Commodity Exchange Act, as amended (7 U.S.C. 6a(2)(B)), is amended to read as follows:

"(B) directly or indirectly to hold or control a net long or a net short position in any commodity for future delivery on or subject to the rules of any contract market in excess of any position limit fixed by the Secretary of Agriculture for or with respect to such commodity: *Provided*, That such position limit shall not apply to a position acquired in good faith prior to the effective date of such order."

SEC. 5. Section 4a(2) of the Commodity Exchange Act, as amended (7 U.S.C. 6a(2)), is further amended by deleting the word "commission" wherever it appears therein and substituting the phrase "Secretary of Agriculture."

SEC. 6. Section 4a(3) of the Commodity Exchange Act, as amended (7 U.S.C. 6a(3)), is amended by deleting the first two sentences thereof and substituting the following: "No order issued under paragraph (1) of this section shall apply to transactions or positions which are shown to be bona fide hedging. For the purposes of this paragraph, bona fide hedging transactions or positions shall mean sales of, or short positions in, any commodity for future delivery on or subject to the rules of any board of trade to the extent that such sales or short positions are offset in quantity by the ownership or purchase of the same cash commodity or, conversely, purchases of, or long positions in, any commodity for future delivery on or subject to the rules of any board of trade to the extent that such purchases or long positions are offset by sales of the same cash commodity."

SEC. 7. Section 4a of the Commodity Exchange Act, as amended (7 U.S.C. 6a) is further amended by adding at the end thereof, the following paragraph:

"(5) For the purposes of this section, the transactions and positions of any person shall include the transactions and positions of any persons directly or indirectly controlled by such person, or under direct or indirect common control with such person."

SEC. 8. Section 4b of the Commodity Exchange Act, as amended (7 U.S.C. 6b), is amended as follows:

(a) By deleting from the introductory portion of the section the phrase "for any member of a contract market, or for any correspondent, agent, or employee of any member" and substituting the phrase "for any person"; and

(b) By inserting the word "other" before the word "person" where the latter word appears in clause (2) of said introductory portion of the section, and where

it appears in paragraph (A), and the first time it appears in paragraphs (B) and (C).

SEC. 9. Section 4d of the Commodity Exchange Act, as amended (7 U.S.C. 6d), is further amended by adding at the end thereof, the following new paragraph:

"It shall be unlawful for any person, including but not limited to any clearing agency of a contract market and any depository, that has received any money, securities, or property for deposit in a separate account as provided in paragraph (2) of this section, to hold, dispose of or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the customers of such future commission merchant."

SEC. 10. Section 4f of the Commodity Exchange Act, as amended (7 U.S.C. 6f), is amended as follows:

(a) By deleting from the last sentence of paragraph (1) the words "section 4g of"; and

(b) By deleting paragraph (2) thereof and substituting the following: "(2) Any person desiring to register as futures commission merchant shall meet such minimum financial requirements as the Secretary of Agriculture may by regulation prescribe as necessary to insure his meeting his obligations as a registrant, and if registered shall at all times continue to meet such prescribed minimum financial requirements."

SEC. 11. Section 4g of the Commodity Exchange Act, as amended (7 U.S.C. 6g), is amended to read as follows:

"Sec. 4g. Every person registered hereunder as futures commission merchant or floor broker shall make such reports as are required by the Secretary of Agriculture regarding the transactions of such person, or the transactions of the customers thereof, in commodities for future delivery on any board of trade in the United States or elsewhere; shall keep the books and records pertaining to such transactions in such form and manner and for such period as may be required by the Secretary; and shall keep such books and records open to inspection by any representative of the United States Department of Agriculture or the United States Department of Justice."

SEC. 12. Section 4i of the Commodity Exchange Act, as amended (7 U.S.C. 6i), is amended as follows:

(a) By adding to the last sentence, after the word "hereof," the following: "and of all cash or spot transactions in such commodity entered into and inventories of such commodity held in any month in which he is required to make any report under the provisions of (1) or (2),"; and

(b) By adding at the end of said section the following paragraph:

"For the purposes of this section, the transactions and positions of any person shall include the transactions and positions of any persons directly or indirectly controlled by such person, or under direct or indirect common control with such person."

SEC. 13. The Commodity Exchange Act, as amended, is further amended by adding thereto after section 4i (7 U.S.C. 6i) the following new section:

"Sec. 4j. Whenever the Secretary of Agriculture has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, or excessive speculation in any commodity, or any other activity reasonably expected to restrain trade, in connection with the sale of any commodity for future delivery, or in interstate commerce, under contracts made on or subject to the rules of any contract market, the Secretary of Agriculture may prescribe the minimum margins which such contract market and all futures commission merchants shall require to be initially deposited and subsequently maintained by each person in connection with speculative or hedging positions which may be held by such person under contracts of sale of such commodity for future delivery, or in interstate commerce, made on or subject to the rules of such contract market. Such rules may specify special or different margin requirements for initial margins and maintenance margins and for different types of positions or commodities; and may make appropriate provision with respect to the carrying of undermargined positions for limited periods and under specified conditions, the withdrawal of funds or securities used to margin, guarantee, or secure accounts, the transfer of accounts from one futures commission merchant to another, the bases and methods to be used in calculating margins, and similar administrative adjustments and details. Such rules shall be furnished to the contract market and all futures commission merchants and shall be published in the Federal Register. Because of the nature of future trading and the necessity for expeditious actions in

imposing margin requirements, such rules may be made effective upon actual or constructive notice to persons affected thereby. It shall be unlawful for any futures commission merchant having notice of such a rule to fail to require its customers to meet the margin requirements thereof, or for such contract market having notice of such a rule to fail to enforce it against its members."

SEC. 14. Section 5(b) of the Commodity Exchange Act, as amended (7 U.S.C. 7(b)), is amended as follows:

(a) By deleting, from the first sentence, the phrase "in cash transactions consummated at, on, or in a board of trade, or transactions for future delivery" and substituting the following: "in cash transactions or transactions for future delivery consummated on or subject to the rules of a board of trade"; and

(b) By deleting, from the first sentence, the phrase "consummated at, on, or in a board of trade" the second time it appears in said sentence and substituting the following: "consummated on or subject to the rules of a board of trade".

SEC. 15. Section 5(f) of the Commodity Exchange Act, as amended (7 U.S.C. 7(f)), is amended to read as follows:

"(f) When the governing board provides for making effective the final orders or decisions entered pursuant to the provisions of paragraph (b) of section 6 of this Act and the rules of the Secretary of Agriculture issued pursuant to the provisions of section 4j and 5a of this Act, and for compliance in all other respects with the requirements applicable to such board of trade under this Act."

SEC. 16. Section 5a of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended as follows:

(a) By deleting the word "and" at the end of paragraph (6) and substituting a semicolon for the period at the end of paragraph (7) and adding thereafter the word "and"; and

(b) By adding after paragraph (7) the following paragraph:

"(8) Make such terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market and make and enforce such bylaws, rules, regulations, and resolutions relating to margin requirements and the form and manner of execution of purchases and sales of any commodity, in interstate commerce, or for future delivery on or subject to the rules of such contract market, as the Secretary of Agriculture, to effectuate the provisions of this Act, may direct by rule furnished to such contract market and published in the Federal Register."

SEC. 17. Section 5b of the Commodity Exchange Act, as amended (7 U.S.C. 7b), is amended by deleting the phrase "rules and regulations" and substituting the phrase "rules, regulations, or orders".

SEC. 18. Section 6 of the Commodity Exchange Act, as amended (7 U.S.C. 8, 9), is amended by adding at the end of the first paragraph thereof (7 U.S.C. 8) the following sentence: "In the event of a refusal to designate as a contract market any board of trade that has made application therefor, such board of trade shall be afforded an opportunity for a hearing before the Secretary of Agriculture, with the right to appeal an adverse decision after such hearing to the court of appeals as provided for in other cases in this section."

SEC. 19. Section 6(a) of the Commodity Exchange Act, as amended (7 U.S.C. 8), is amended to read as follows:

"(a) The Secretary of Agriculture is authorized to suspend for a period not to exceed six months or to revoke the designation of any board of trade as a 'contract market' upon a showing that such board of trade is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this Act or that such board of trade, or any director, officer, agent, or employee thereof, otherwise is violating or has violated any of the provisions of this Act or any of the rules, regulations or orders of the Secretary of Agriculture thereunder. Such suspension or revocation shall only be after a notice to the officers of the board of trade affected and upon a hearing: *Provided*, That such suspension or revocation shall be final and conclusive, unless, within fifteen days after such suspension or revocation by the Secretary of Agriculture, such board of trade appeals to the court of appeals for the circuit in which it has its principal place of business, by filing with the clerk of such court a written petition praying that the order of the Secretary of Agriculture be set aside or modified in the manner stated in the petition, together with a bond in such sum as the court may determine, conditioned that such board of trade will pay the costs of the proceedings if the court so directs. The clerk of the court in which such a petition is filed shall immediately cause a copy thereof to be delivered to the Secretary of Agriculture, who shall thereupon file in the court the record in such proceedings, as provided in section 2112 of

title 28, United States Code. The testimony and evidence taken or submitted before the Secretary of Agriculture, duly filed as aforesaid as a part of the record, shall be considered by the court as the evidence in the case. The proceedings in such cases in the court of appeals shall be made a preferred cause and shall be expedited in every way. Such a court may affirm or set aside the order of the Secretary of Agriculture or may direct him to modify his order. No such order of the Secretary of Agriculture shall be modified or set aside by the court of appeals unless it is shown by the board of trade that the order is unsupported by substantial evidence on the record considered as a whole or was issued without due notice and a reasonable opportunity having been afforded to such board of trade for a hearing, or infringes the Constitution of the United States, or is beyond the jurisdiction of the Secretary of Agriculture."

SEC. 20. Section 6(b) of the Commodity Exchange Act, as amended (7 U.S.C. 9, 15), is amended as follows:

(a) By changing the first sentence thereof to read:

"If the Secretary of Agriculture has reason to believe that any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any board of trade, or is engaging or has engaged in any unfair or deceptive act or practice, or is taking or has taken any action with the intent or having the effect of restraining trade, in connection with the sale of any commodity, for future delivery or in interstate commerce, under contracts made on or subject to the rules of any board of trade, or otherwise is violating or has violated any of the provisions of this Act or of the rules, regulations, or orders of the Secretary of Agriculture thereunder, he may serve upon such person a complaint stating his charges in that respect, which complaint shall have attached or shall contain therein a notice of hearing, specifying a day and place not less than three days after the service thereof, requiring such person to show cause why an order should not be made directing that all contract markets, until further notice of the Secretary of Agriculture refuse all trading privileges to such person, and to show cause why the registration of such person, if registered as futures commission merchant or as floor broker hereunder, should not be suspended or revoked."

(b) By deleting the phrase "the weight of evidence" appearing in the last sentence of said section (7 U.S.C. 9) and substituting the phrase "substantial evidence on the record considered as a whole"; and

(c) By deleting the phrase "the commission," from the third sentence of said section (7 U.S.C. 15).

SEC. 21. Section 6 of the Commodity Exchange Act, as amended (7 U.S.C. 8, 9), is further amended by adding at the end thereof the following new paragraph:

"(c) If any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any board of trade, or is engaging or has engaged in any unfair or deceptive act or practice, or is taking or has taken any action with the intent or having the effect of restraining trade, in connection with the sale of any commodity, for future delivery or in interstate commerce, under contracts made on or subject to the rules of any board of trade, or otherwise is violating or has violated any of the provisions of this Act or of the rules, regulations, or orders of the Secretary of Agriculture thereunder, the Secretary may, upon notice and hearing and subject to appeal as in other cases provided for in paragraph (b) of this section, make and enter an order directing that such person shall cease and desist therefrom and, if such person thereafter and after the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall fail or refuse to obey or comply with such order, such person shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not less than \$500 nor more than \$10,000, or imprisoned for not less than six months no more than one year, or both, except that if such failure or refusal to obey or comply with such order involves any offense within paragraph (a) of section 9 of this Act, such person shall be guilty of a felony and, upon conviction thereof, shall be subject to the penalties of said paragraph 9(a). Each day during which such failure or refusal to obey or comply with such order continues shall be deemed a separate offense."

SEC. 22. Section 6a(1) of the Commodity Exchange Act, as amended (7 U.S.C. 10a(1)), is amended as follows:

(a) By deleting the phrases "the commission" and "said commission" and substituting the phrase "the Secretary of Agriculture" and deleting the phrase

"Such commission" and substituting the phrase "The Secretary of Agriculture"; and

(b) By deleting the word "it" from the second sentence in the section and substituting the word "he".

SEC. 23. Section 6b of the Commodity Exchange Act, as amended (7 U.S.C. 13a), is amended to read as follows:

"Sec. 6b. If any board of trade is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this Act, or if any board of trade, or any director, officer, agent, or employee of any board of trade otherwise is violating or has violated any of the provisions of this Act or any of the rules, regulations, or orders of the Secretary of Agriculture thereunder, the Secretary of Agriculture may upon notice and hearing and subject to appeal as in other cases provided for in paragraph (a) of section 6 of this Act, make and enter an order directing that such board of trade, director, officer, agent or employee shall cease and desist from such violation, and if such board of trade, director, officer, agent, or employee thereafter and after the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall fail or refuse to obey or comply with such order, such board of trade, director, officer, agent, or employee shall be guilty of a misdemeanor and upon conviction thereof, shall be fined not less than \$500 nor more than \$10,000 or imprisoned for not less than six months nor more than one year, or both. Each day during which said failure or refusal to obey such order continues shall be deemed a separate offense."

SEC. 24. Section 8 of the Commodity Exchange Act, as amended (7 U.S.C. 12), is amended as follows:

(a) By adding, in the first sentence, after the phrase "make such investigations as he may deem necessary to ascertain the facts regarding the operations of boards of trade", the following phrase: "and other persons subject to any of the provisions of this Act".

(b) By changing the period at the end of the last paragraph of the section to a semicolon and adding at the end of said paragraph the following phrase: "and when requested by any department or agency of the executive branch of the Government of the United States, acting within the scope of its jurisdiction, may, in his discretion, furnish to such department or agency any information in the possession of the Department of Agriculture obtained in connection with the administration of this Act: *Provided, however,* That information so furnished to any such department or agency shall not be disclosed by such department or agency except in any action or proceeding under the laws administered by it to which it or the United States is a party."

SEC. 25. Section 8a(2) of the Commodity Exchange Act, as amended (7 U.S.C. 12a(2)), is amended to read as follows:

"(2) to refuse to register any person—

"(A) if the prior registration of such person has been suspended (and the period of such suspension shall not have expired) or has been revoked:

"(B) if it is found, after opportunity for hearing, that the applicant is unfit to engage in the business for which the application for registration is made, (i) because such applicant, or, if the applicant is a partnership, any general partner, or, if the applicant is a corporation, any officer or holder of more than 10 per centum of the stock, at any time engaged in any practice of the character prohibited by this Act or was convicted of a felony in any State or Federal court, or was suspended by any board of trade, or was debarred by any agency of the United States from contracting with the United States or the applicant willfully made any material false or misleading statement in this application or willfully omitted to state any material fact in connection with the application, or (ii) for other good cause shown; or

"(C) in the case of an applicant for registration as futures commission merchant, if it is found that after opportunity for hearing, that the applicant has not established that he meets the minimum financial requirements under section 4f of this Act: *Provided,* That pending final determination under clause (B) or (C), registration shall not be granted: *And provided further,* That the applicant may appeal from a refusal of registration under clause (B) or (C) in the manner provided in paragraph (b) of section 6 of this Act; and"

SEC. 26. Section 8a(4) of the Commodity Exchange Act, as amended (7 U.S.C. 12a(4)), is amended by deleting the phrase "and for copies of registration certificates" appearing therein.

SEC. 27. The Commodity Exchange Act, as amended, is amended by adding after section 8a thereof (7 U.S.C. 12a) the following new section:

"SEC. 8b. It shall be unlawful—

"(1) for any person, against whom there is outstanding any order of the Secretary of Agriculture denying trading privileges on contract markets, to make or cause to be made in contravention of such order, any contract for future delivery of any commodity, on or subject to the rules of any contract market; or

"(2) for any person willfully to make any false or misleading statement of a material fact in any registration application or any report filed with the Secretary of Agriculture under this Act, or willfully to omit to state in any such application or report any material fact which is required to be stated therein. Any person violating this paragraph (2) is subject to the provisions of section 6(b) of this Act as well as the provisions of title 18, United States Code, section 1001."

SEC. 28. Section 9 of the Commodity Exchange Act, as amended (7 U.S.C. 13), is amended to read as follows:

"SEC. 9. (a) It shall be a felony punishable by a fine of not more than \$10,000 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 board of trade, or to corner or attempt to corner any such commodity, or knowingly or carelessly to deliver or cause to be delivered for transmission through the mails or in interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.

"(b) It shall be a misdemeanor punishable by a fine of not more than \$10,000 or imprisonment for not more than one year, or both, together with the costs of prosecution, for any person to violate the provisions of section 4, section 4a, section 4b, section 4c, section 4d, section 4e, section 4h, section 4i, or section 4j, or paragraph (1) of section 8b, or to fail to evidence any contract mentioned in section 4 of this Act by a record in writing as therein required."

SEC. 29. The Commodity Exchange Act, as amended, is further amended by adding after section 9 (7 U.S.C. 13) a new section to read as follows:

"SEC. 9. (a) Whenever it shall appear to the Secretary of Agriculture that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act, or any rule, regulation, or order thereunder, the Secretary may notify the Attorney General, and the Attorney General may bring an action in the proper district court of the United States or the proper United States court of any territory or other place subject to the jurisdiction of the United States, to enjoin such act or practice and to enforce compliance with this Act, or any rule, regulation, or order thereunder, and said courts shall have jurisdiction to entertain such actions. Upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. Upon application of the Attorney General, the district courts of the United States, and the United States courts of any territory or other place subject to the jurisdiction of the United States shall also have jurisdiction to issue writs of mandamus, or orders affording like relief, commanding any person to comply with the provisions of this Act or any rule, regulation, or order of the Secretary thereunder, including the requirement that such person take such action as is necessary to remove the danger of violation of this Act or any such rule, regulation, or order. Any action under this section may be brought in the district wherein the defendant is found or is an inhabitant or transacts business or in the district where the act or practice in question occurred or is about to occur, and process in such cases may be served in any district in which the defendant is an inhabitant or wherever the defendant may be found."

SEC. 30. The Commodity Exchange Act, as amended, is further amended by adding thereto a new section 13 to read as follows:

"SEC. 13. Any person who aids, abets, counsels, commands, induces, or procures the violation of any of the provisions of this Act, or any of the rules, regulations, or orders issued pursuant to this Act or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations, or orders shall be held responsible under this Act for such violation as a principal."

SEC. 31. If any provision of this Act or the application thereof to any person or circumstances is held invalid, the validity of the remainder of the Act and the application of such provision to other persons or circumstances shall not be affected thereby, and the provisions of the section of the Commodity Exchange Act, as amended, which is amended by such provisions of this Act shall apply to such person or circumstances. Pending proceedings shall not be abated by reason of any provision of this Act but shall be disposed of pursuant to the provisions of the Commodity Exchange Act, as amended, in effect prior to the effective date of this Act.

Mr. MATSUNAGA. Our first witness this morning is the distinguished Congresswoman from Missouri, Mrs. Leonor Sullivan.

We will be glad to hear from you now. We are glad to have you here.

**STATEMENT OF HON. LEONOR K. SULLIVAN, A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF MISSOURI**

Mrs. SULLIVAN. Thank you, Mr. Chairman, and members of the committee.

I know you have a heavy schedule of witnesses for the next several days on this important legislation to amend the Commodity Exchange Act, so I do not intend to take more than a few minutes of your time to share some ideas with you which I hope you will find helpful in this hearing.

As Chairman Cooley knows, and as many of the members of the committee know, I have been introducing since 1954—for a dozen years—bills to bring trading in coffee futures under the Commodity Exchange Act. I introduced the first such bill immediately after the Federal Trade Commission completed and made public a comprehensive investigation, initiated at my instigation 6 months earlier, into the coffee shortage “hoax” of 1953–54 which sent prices of a pound of coffee at retail to as high as \$1.50. The shortage was a fake, deliberately fabricated by certain interests speculating in coffee futures on the unregulated exchange in New York.

Last year, in reintroducing again my 1954 bill on the regulation of trading in coffee futures, I amended it, as you know, to include sugar as well. That derived from the investigation we made in the Subcommittee on Consumer Affairs of the House Committee on Banking and Currency, under my direction, into the gyrating sugar market of 1963. Our studies clearly pointed to excessive speculation in sugar futures, on an unregulated exchange—the same exchange where the 1953–54 excesses occurred in coffee futures trading a decade earlier.

In both instances—in coffee and in sugar—frantic buying and selling of futures by amateurs not connected in any way with the trade—coupled with a tremendous amount of speculation, also, as well as hedging by regular traders—caused chaos in the marketing of these commodities—resulting in wild swings in prices which were reflected in quick order in much higher consumer prices. Both of these episodes could have been prevented, or at least sharply contained, by effective Federal regulation.

It is not my intention this morning to go into the technical aspects of futures trading, because you have experts from the Department of Agriculture and from the exchanges to talk about that. I am here primarily to urge that in amending and, I trust, improving the Commodity Exchange Act to protect the public and to assure orderly

trading, that you now take the necessary steps to include two very important consumer commodities not now covered, coffee and sugar. Other important commodities, such as live cattle, beef carcasses, pork bellies, and additional ones, as trading in them becomes significant, should also be included.

That can be done either by amending the act's definition of "commodities," to include them specifically by name, which I would prefer, or else of including the provision of the administration bill giving the Secretary the discretionary powers to add commodities when necessary to the statutory list. I would, as I say, prefer that we provide specific statutory authority, particularly for coffee and sugar, as regulated commodities, rather than just leave this to the Secretary's discretion. On the other hand, I can imagine instances when it might be more effective in the future to give the Secretary broad authority to add new commodities to the list when the need to do so arises, because Congress seems to be rather slow in acting on this problem. For instance, it is now 12 years since the Federal Trade Commission urged the inclusion of coffee among regulated commodities and since I introduced such a bill for the first time, and yet this is the first time in all those years that there has been a legislative hearing on it. Under present procedures, therefore, the delay in including new commodities is much too long.

Turning to other aspects of commodity regulation, there are many provisions of the administration bill which are controversial, I know. I generally support the intent and direction of the legislation. We must place powers in the Government to prevent cheating and to punish offenders in commodity trading. But we must also give the Government the power to assure orderly trading, to have a voice in the setting of exchange rules—including those relating to the setting of margin and spot price determinations, to name two of the biggest problems which have been uncovered.

The officials of the New York Coffee and Sugar Exchange may claim here that there is no need for any laws applying to them because my subcommittee had investigators looking over all of their sugar operations several years ago and presumably found nothing wrong. It is true that we never accused them of any wrongdoing. Our purpose was to find out how the operations of this exchange were affecting sugar prices, and we found a great deal of important information to show that trading in sugar on this exchange should be brought under regulation. The Federal Trade Commission earlier established the need for regulation of coffee futures.

In our sugar inquiry, we found nothing to warrant putting anyone in jail—and we weren't looking for that kind of evidence. But we found terribly loose practices in the setting of the daily spot quotations on which vast quantities of cash sugar are bought and sold, and on which Government statistics, including the wholesale price index, are based. We found that the exchange applied no really effective margin restrictions until after the need for them had really passed. The 1963 sugar market was wild, and the trade itself could not effectively control it without governmental regulation of trading. The irony was that to the members of the exchange, the more trading which occurred, the more money there was to be made in commissions, even though much of it was from uninformed amateurs gambling on futures. This

is not a situation which can be counted on to contribute to stability in time of market stress. Quite the opposite.

Therefore, I urge:

First, that you amend the present law to include coffee and sugar and other major commodities now outside the law among commodities subject to regulation.

Second, that you amend the law, as proposed by the administration, to tighten Federal authority over rulemaking powers of the exchanges dealing with regulated commodities, and particularly in setting margin requirements where there is reason to believe there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in prices, excessive speculation, et cetera, contributing to market disorder or to unnecessarily higher prices to consumers or to a dislocation of the economy, or excessive costs to businesses using a certain commodity.

Furthermore, I ask that you provide the act with teeth, to make possible the issuance of cease-and-desist orders against continued violations; to deny registration to racketeers or other persons unfit to be turned loose as traders or commission merchant registrants; to require minimum financial requirements for registrants; to set up more severe penalties for violations; to require better recordkeeping on all transactions which affect commodity trading—including spot or cash transactions—and to do many of the other things the administration has proposed in order to prevent dishonest trading activities. Many of these proposals are technical, but the overall concept is to try to guarantee truth and responsibility in all such trading. There is definitely a consumer interest in all of this, which is why I ask for stronger regulation and more protection for consumers and businessmen affected by futures trading.

Mr. MATSUNAGA. Thank you very much, Mrs. Sullivan.

Are there any questions?

If not, we thank you, again, for taking the time to be with us.

Mrs. SULLIVAN. Thank you for allowing me to testify. After all of these years, I am delighted that at least we are now having some hearings on this subject, which is quite important to consumers as well as to businessmen. I appreciate it.

Mr. MATSUNAGA. Our next witness comes from the Department of Agriculture, Mr. George L. Mehren, Assistant Secretary, Marketing and Consumer Service, who is accompanied by Mr. Alex Caldwell, Administrator of the Commodity Exchange, and Mr. Charles Bucy, who is Assistant General Counsel of the Department of Agriculture, in charge of regulatory activities.

Mr. MEHREN.

**STATEMENT OF GEORGE L. MEHREN, ASSISTANT SECRETARY,
MARKETING AND CONSUMER SERVICES; ACCOMPANIED BY
ALEX CALDWELL, ADMINISTRATOR, COMMODITY EXCHANGE
AUTHORITY; AND CHARLES W. BUCY, ASSISTANT GENERAL
COUNSEL IN CHARGE OF REGULATORY ACTIVITIES, U.S. DEPART-
MENT OF AGRICULTURE**

Mr. MEHREN. Mr. Chairman and members of the committee, I am pleased to have this opportunity to appear before you today to present

the Department's position on H.R. 11788, a bill to amend the Commodity Exchange Act.

I am accompanied by Mr. Charles Bucy, who is Assistant General Counsel of the Department of Agriculture in charge of regulatory activities, and Mr. Alex Caldwell, who is the Administrator of the Commodity Exchange Authority.

This act assigns to the USDA the responsibility to supervise trading on commodity futures markets and to protect those who do this trading or who are affected by it.

This delegation of responsibility reflects a long-held belief that the public interest can be and is broadly affected by trading in commodities. That belief has not changed. If anything, it has grown over the years since the act became law in 1922.

The amendments which are being proposed—and which would be the first major updating of the act since 1936—are framed in this same context. They seek to keep the Commodity Exchange Authority as an effective instrument to protect the public interest for the times we live in today.

The proposals contained in the amendments under consideration are designed to provide more workable tools to carry out the responsibilities of protecting the broad public interest without impairing the necessary and essential function of the various commodity exchanges. None of the amendments proposed are new or experimental tools of public regulation; all of them already have been employed by the Congress to protect the public interest as it relates to stocks and securities, drugs, food and fiber, transportation, gas and power, and antitrust actions.

No one should misunderstand the purpose of the Department in supporting these proposals. The public interest is served not just by regulating the trading of futures in commodities, it is served by the contribution to the Nation's economy from the trading of commodity futures under reasonable and proper guidelines.

There are 14 major proposals under H.R. 11788 to amend the Commodity Exchange Act, together with a number of technical and procedural changes to clarify language or to eliminate some requirements no longer applicable.

If it pleases the committee, I would like to briefly discuss each of the key amendments and then answer any and all questions you may have.

The bill would authorize the Secretary of Agriculture to establish under certain conditions the minimum margins which contract markets and futures commission merchants must require to be initially deposited and maintained by persons trading in the commodity futures markets. Minimum margin requirements for security transactions are established by the Board of Governors of the Federal Reserve System under authority of the Securities Exchange Act of 1934. However, no Federal agency can now set margins on commodity futures transactions. There is a difference between the purpose of margins in the security and commodity markets, and under ordinary circumstances the Government should not establish minimum margin requirements for commodity futures transactions. The exchanges now perform this function, and under normal conditions the exchange margin requirements are satisfactory. Certain situations can develop, and have, in which the Department feels that minimum margins

should be above the normal levels. Excessive speculation in the futures market, for example, can seriously disrupt prices and marketing to the detriment of producers, consumers, and users of the market. Control of a large percentage of the futures market by one individual creates the danger of price manipulation, and can lead to unwarranted or unreasonable sudden upward or downward changes in price, or otherwise restrain trade. Under these conditions, margins should be established to retard the buildup of positions or reduce them to protect the users of the market and the public. The proposed legislation provides for minimum margin requirements when there is reason to believe there is danger of price manipulation, or unreasonable sudden fluctuations or unwarranted changes in price, excessive speculation, or any other activity reasonably expected to restrain trade. We anticipate that this authority would be used infrequently. Minimum margins on security transactions are set at a relatively high percentage of the value of the securities. However, the imposition of comparable margins on commodity transactions could seriously impair the operation of the futures markets and limit the usefulness of these markets for hedging and price-registering purposes.

Under section 3 of the Commodity Exchange Act, the Congress warns that transactions and prices of commodities are susceptible to speculation, manipulation, and control, and holds that these conditions are detrimental to the public interest and the national economy. It finds that these conditions make the regulation of trading imperative.

At present, the means to prevent excessive speculation are limited. The act now authorizes only trading limits to prevent excessive speculation, and these are effective only against the largest traders and only when set by the Commodity Exchange Commission. If a large number of small traders should enter the market, however, their speculative effect could be as great or greater than the largest traders, yet there is no instrument now available to reduce the excessive speculative impact in this kind of situation.

The proposal to establish margins on futures trading would enable us to cope with this condition and thus to carry out the historic directive of the Congress.

The bill would provide that the Secretary of Agriculture, under certain conditions, could designate any agricultural or forest commodity as a commodity under the act. The Secretary could make the designation only after he determines there is futures trading in that commodity and the designation is necessary to prevent, as to such commodity, acts or practices of the kind prohibited by the Commodity Exchange Act. The Secretary would not, and could not, immediately bring under the provisions of the act all unregulated commodities in which there is future trading. He would be bound to follow procedures as established under the Administrative Procedure Act. If, after a commodity is included under the act by action of the Secretary, it appears that regulation is no longer necessary, the Secretary would be authorized to terminate the designation.

The proposed legislation would authorize the Secretary to require contract markets to adopt contract terms and trading rules relating to margin requirements and the form and manner of execution of

purchases and sales of commodities, and to require contract markets to enforce these rules. At present, the Secretary's authority with respect to exchange rules is limited to a very few rules, mostly those on requirements for designation as a contract market. The bill would affect trading rules and not cover rules for the organization or general operations of the exchanges. Members of the commodity exchanges currently have a voice in determining trading rules. However, the operations of commodity exchanges are affected with a national public interest and they serve millions of persons directly and indirectly who are not members. The futures markets are important to producers and consumers and others who may have no voice in the establishment of exchange rules, and their interest—the public interest—should be represented. The most reasonable means to accomplish this would be through supervision, under clear procedures, by the Government.

The rules to be adopted by the Secretary prescribing margin requirements or exchange trading rules or designating new commodities under the act would be issued in accordance with the informal rulemaking procedures of section 4 of the Administrative Procedure Act. In ordinary cases this would involve the publication of a notice of the proposed rule and opportunity for submission of comments by interested persons prior to issuance of the rule.

The Commodity Exchange Act presently provides for a Commodity Exchange Commission, composed of the Secretary of Agriculture, as Chairman, the Secretary of Commerce, and the Attorney General. The act gives the Commission certain specific authority, including the authority to establish speculative trading limits, to issue cease-and-desist orders against a contract market or its representatives, to suspend or revoke the designation of a contract market, and to consider appeals from refusal of the Secretary of Agriculture to designate a board of trade as a contract market. We believe that the duties imposed upon the Commission can be performed by the Secretary of Agriculture and that this would simplify the administration of the act and at the same time lessen the burdens placed upon the other Cabinet officers who must now personally participate in Commission decisions and in some instances sit at Commission hearings. The provision in the bill for review of the decisions of the Secretary of Agriculture by the Federal courts would afford adequate protection to all concerned.

The bill would give the Secretary of Agriculture the authority to issue cease-and-desist orders against a contract market or any person. The Commodity Exchange Commission currently has the authority to issue such orders against a contract market and its representatives and this authority would, under this bill, be transferred to the Secretary. At the present time there is no authority under the act to issue cease-and-desist orders against persons other than a contract market or its representatives. The new legislation would give the Secretary of Agriculture such authority when, after notice and opportunity for hearing, he determines that a person has manipulated or attempted to manipulate prices, engaged in unfair or deceptive acts or practices, taken action with the intent or having the effect of restraining trade, or otherwise is violating or has violated the provisions of the act or the

rules, regulations, or orders thereunder. Experience has shown that there are often situations in which, although there are violations of the act or regulations, such violations are not sufficiently serious to warrant the denial of trading privileges or the suspension of registration, which in many instances would have the effect of putting the person involved completely out of business for a period of time. The authority to issue cease-and-desist orders under such circumstances would provide an effective but less drastic type of action and thus strengthen the overall enforcement of the act.

The act now requires the Secretary to register as a futures commission merchant or floor broker any person who makes application, unless the applicant has previously been registered and his registration is under suspension or has been revoked. There is no provision which would permit the Secretary to deny a person registration because of poor financial condition or unfitness to engage in the business for which application has been made. The proposed legislation would authorize the Secretary to establish minimum financial standards for futures commission merchants and to refuse or suspend or revoke registration as a futures commission merchant if a person fails to meet or maintain such standards. The bill would also authorize the Secretary to refuse a person registration as a futures commission merchant or a floor broker if it is determined that the applicant is unfit to engage in the business because he has been convicted of engaging in practices of the character prohibited by the act, has been convicted of a felony, has been suspended by any board of trade, has been debarred by any agency of the United States from contracting with the Federal Government, or has willfully made a material false statement or omitted to state a material fact in connection with the application, or for other good causes. In all such instances there would be opportunity for hearing and the right to appeal an adverse decision.

In our market surveillance work we sometimes see the development of a situation which almost inevitably must lead to a violation of the Commodity Exchange Act. However, under the act we are unable to take action until we have evidence that a violation is actually occurring or has occurred. The bill would seek to remedy this situation by providing that if it should appear to the Secretary that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of the act or rule, regulation, or order of the Secretary thereunder, the Secretary would be authorized to notify the Attorney General who could bring action in the proper court to enjoin such act or practice and to enforce compliance with the applicable provisions. Upon application by the Attorney General the court also could issue an order, commanding the person to comply with the provisions of the act or the rules, regulations, or orders, including the requirement that the offender take such action as is necessary to remove the danger of the violation. There are numerous statutory provisions conferring comparable authority on other agencies. The Securities and Exchange Commission and the Federal Power Commission have authority to bring actions for injunctions to restrain violations or threatened violations of certain acts which they administer and to seek orders to compel compliance with the statutes. In addition, the Federal Trade Commission has authority

to bring suit to enjoin violations or threatened violations of several statutes administered by that agency. There is available for your reference a list citing examples of these types of statutory provisions.

Although the Department does not believe that the need for injunctive action would arise frequently, the inclusion of this authority in the Commodity Exchange Act would give the Secretary a very effective tool for the prevention of certain types of price manipulation and other violations. It would then be possible for him to take action before damage is done to the market.

The proposed legislation would extend to all persons the fraud, cheating, deceit, bucketing, false records, and false reports provisions of the act. As presently written, these provisions apply only to members of contract markets, their correspondents, agents and employees. The proposed change would extend these provisions to cover the activities of futures commission merchants, professional account managers, and others who are not members of a contract market or correspondents, agents or employees of a member, but who nevertheless handle or direct the execution of trades for other persons. By extending these provisions to any person, the act will afford equal protection to all traders.

The authority provided in the bill would make it possible for the Secretary to take specified action, for example, for suspension of registration, if he has reason to believe that a person is engaging or has engaged in any "unfair or deceptive act or practice, or is taking or has taken any action with the intent or having the effect of restraining trade" in the commodity markets. Similar terminology is contained in various other regularity statutes. The provision regarding unfair acts or practices is similar to provisions contained in the Federal Trade Commission Act, and the Packers and Stockyards Act, 1921, as amended. The provision regarding restraint of trade is similar to a provision contained in the Sherman Anti-Trust Act of July 2, 1890, as amended. If this additional authority is granted the Secretary, we visualize that it would be used, for example, in a situation where, although there is no evidence of price manipulation, there is evidence that a trader has sufficient control over a futures market to effectively restrain the trading in one or more commodities in the market.

The present act prohibits futures commission merchants from commingling customers' funds with the funds of the futures commission merchant or using such customers' funds to margin or guarantee the trades or to secure or extend the credit of any customer other than the one for whom such funds are held. In compliance with this provision, futures commission merchants keep customers' funds in separate bank accounts and in separate accounts with clearing associations and other futures commission merchants. However, there is no requirement in the act that banks, clearing associations, and similar depositories with whom these funds are deposited, treat them as the customers' funds. The new legislation would make it unlawful for the depositories to treat such funds as belonging to the futures commission merchants or any person other than the customer.

The Commodity Exchange Act now requires members of a contract market to keep a record of cash or spot transactions made on that market. The bill would require that members of a contract market

keep a record of cash or spot transactions made subject to the rules of the exchange even though they are not physically made on the exchange. The proposed legislation would also require persons holding futures positions of a reportable size in commodities to keep a record of all cash or spot transactions and inventories in such commodities. The operations of a person in the cash or spot market and his operations in the futures market are often so importantly interrelated that it is almost impossible to determine whether violations have occurred without investigating both types of operations. In such situations the absence of adequate records regarding cash or spot transactions makes it difficult for the Department to make investigations of alleged or suspected violations. The bill seeks to correct this deficiency.

The proposed legislation would give the Secretary authority to take action against a person who trades in commodity futures in violation of an order of the Secretary denying him trading privileges for a previous violation of the act. The act now provides for action by the Secretary in such a case only against the futures commission merchant handling the business, or by the Commodity Exchange Commission against the exchange upon which the business is done. The addition of this proposed provision would greatly strengthen the Commodity Exchange Act by allowing action directly against the person who has traded in violation of the Secretary's order.

In some instances the Department has found that violations of the act could not have been accomplished without the assistance of persons who themselves were not directly involved in the violations. It is our feeling that violations of this type can be sharply reduced if the Secretary is in position to take action not only against the person directly violating the act, but also against those who assist or cooperate with him in such violation. The bill would establish responsibility as a principal under the act for any person who aids, abets, counsels, commands, induces, or procures the violation of any provisions of the act or the rules, regulations or orders thereunder, or who acts in concert with another person in any such violation or who willfully causes an act to be done or omitted which if directly performed or omitted would be a violation.

The present act does not define "manipulate." We believe a definition is important, both to guide those who are subject to the act and to those who must administer it. The proposed legislation would define "manipulate." In order to establish the existence of a manipulation, the Government would have to establish or prove at least three major conditions.

First, that a price deviation does—or in the case of attempts to manipulate, threatens to—exist between prices, spot or futures, of a regulated commodity and the levels of price that would prevail as a result of the normal determinants of such spot or future prices.

Second, the impact of such deviation does or threatens to impair the effectuation of the declared purposes of the act.

Third, there is a direct and demonstrable relationship between the alleged actions of the accused and the emergence of an artificial or abnormal price.

Under the proposed legislation, manipulation and cornering or attempts thereat, and transmitting false, misleading or knowingly in-

accurate crop or market information would be felonies instead of misdemeanors, as is presently the case. These are extremely serious violations with widespread repercussions throughout the agricultural economy. Setting heavier penalties by making these violations felonies should provide a greater deterrent to potential violators and make it possible to take more effective action when these violations do occur.

The Commodity Exchange Act provides that certain administrative action shall be sustained upon judicial review if it is supported by the "weight of the evidence." This is not the standard usually provided in regulatory statutes and it raises a question as to the proper scope of review. The proposed legislation would provide that the administrative action would be sustained if supported by "substantial evidence on the record considered as a whole." Most of the existing provisions for judicial review of administrative actions under the regulatory statutes specify "substantial evidence" as the standard. A list of citations of some of these provisions is available for your reference. This, of course, is not an exhaustive list. Such provisions are applicable to administrative actions of many officials, including the Secretary of the Treasury, the Secretary of Health, Education, and Welfare, the Securities and Exchange Commission, the Federal Trade Commission, the Interstate Commerce Commission, the Federal Communications Commission, the Federal Power Commission, the Atomic Energy Commission, the Federal Reserve Board, the Civil Aeronautics Board, and the Administrator of the Federal Aviation Agency.

The courts have held in many cases that "substantial evidence" means substantial evidence based on a consideration of the entire record. However, the term has been construed differently in other cases and in order to eliminate any possible danger that a court might base its opinion upon only a portion of the record, the proposed legislation provides that the standard be "substantial evidence on the record considered as a whole." Similar language appears in the pesticide chemicals provisions of the Federal Food, Drug, and Cosmetics Act and in the Labor Management Relations Act.

In addition, the bill would make various other changes in the act. It would redefine floor broker to make it clear that any person who makes trades in futures for another person on the floor of a contract market is required to register as a floor broker; eliminate the requirement that registration certificates be issued to futures commission merchants; make it unlawful wilfully to make a false or misleading statement of a material fact or wilfully to omit to state a required material fact in any application or report submitted to the Secretary; clarify the authority to make such investigations as the Secretary may deem necessary with respect to the operations of any person subject to the provisions of the act; and incorporate in the act certain longstanding administrative interpretations regarding the application of speculative limits and the reporting requirements.

Mr. Chairman, this completes my statement of the Department's position on the proposed amendments. Thank you for your courtesy. I will be pleased to answer any questions you may have.

(Two partial lists of statutes relating to injunctions to restrain and the provisions specifying "substantial evidence" as a standard for judicial review follow:)

PARTIAL LIST OF STATUTES PROVIDING FOR INJUNCTIONS TO RESTRAIN
VIOLATIONS OF CERTAIN STATUTORY PROVISIONS

Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499h(d)).
Federal Trade Commission Act (15 U.S.C. 53).
Wool Products Labeling Act of 1939 (15 U.S.C. 68e).
Fur Products Labeling Act (15 U.S.C. 69g).
Textile Fiber Products Identification Act (15 U.S.C. 70f).
Flammable Fabrics Act (15 U.S.C. 1195).
Securities Act of 1933 (15 U.S.C. 77t).
Securities Exchange Act of 1934 (15 U.S.C. 78u).
Public Utility Holding Company Act of 1935 (15 U.S.C. 79r).
Natural Gas Act (15 U.S.C. 717s).
Federal Power Act (16 U.S.C. 825m).

PARTIAL LIST OF STATUTORY PROVISIONS SPECIFYING "SUBSTANTIAL
EVIDENCE" AS STANDARD FOR JUDICIAL REVIEW

Clayton [Antitrust] Act (15 U.S.C. 21).
Securities Exchange Act of 1934 (15 U.S.C. 78y).
Public Utility Holding Company Act of 1935 (15 U.S.C. 79x).
Investment Company Act of 1940 (15 U.S.C. 80a-42).
Investment Advisors Act of 1940 (15 U.S.C. 80b-13).
Natural Gas Act (15 U.S.C. 717r).
Federal Power Act (16 U.S.C. 8251).
New Drug Provisions of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 355).
Federal Alcohol Administration Act (27 U.S.C. 204(h)).
Fair Labor Standards Act of 1938 (29 U.S.C. 210).
Atomic Energy Act of 1954 (42 U.S.C. 2239, 5 U.S.C. 1009).
Federal Aviation Act of 1958 (49 U.S.C. 1486).
Of provisions in the following statutes for judicial review based on substantial evidence "when considered on the record as a whole" or "on the record considered as a whole":
Pesticide chemicals provisions of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 346a).
Labor Management Relations Act (29 U.S.C. 160).

Mr. MEHREN. I have an additional statement. In keeping with our earlier discussion, this very morning the Bureau of the Budget authorized the transmission of three additional amendments that have not been introduced but, if I may, I will read the appropriate paragraphs.

These may be in the record.

Also, I am available for discussion.

Mr. MATSUNAGA. Without objection, you may do so.

Mr. MEHREN. In the transmittal letter to the House, the second paragraph reads:

It is proposed to eliminate from section 4(d)2 of the act, the provision under which a futures commission merchant may invest customers' funds in "investment securities" as defined in section 5-136 of the Revised Statutes as amended, and the provision which permits lending customers' funds on the security of negotiable warehouse receipts.

The last paragraph on page 1 of the transmittal letter:

The proposal to amend section 5a of the act would give the Secretary of Agriculture the authority to specify the type of books, records, minutes, and journals of proceedings which must be maintained by a contract market. The act now gives the Secretary the authority to examine the records of contract markets, and this procedure is currently followed. However, the lack of uniformity in the type and quality of such material prepared by the different exchanges makes such examination difficult at times, and often makes a worthwhile examination impossible.

Finally, in the first paragraph of the second page of the transmittal letter:

The proposal to amend section 9 of the act would make embezzlement or the stealing of customers' funds a violation of the act punishable as a felony. There is currently no specific provision in the act covering embezzlement and any prosecution for such an act would, at best, be punishable as a misdemeanor. The Department believes that the more severe penalty is justified and that it would result in greater protection for the funds of customers trading in the regulated commodities. The Bureau of the Budget advises that there is no objection to the presentation of this proposed legislation from the standpoint of the administration's program.

Thank you, sir. I will be happy to answer any questions.

Mr. MATSUNAGA. Thank you very much, Mr. Secretary. Are your assistants going to make any statements other than what you have made?

Mr. MEHREN. We plan no statements, but we are available for any questions that you and the members may ask.

Mr. MATSUNAGA. We appreciate your very, very comprehensive statement and explanation of the bill. We have received quite a number of communications from those who object to the bill. The principal objection is that the proposed bill would place too much power in the hands of one man, the Secretary of Agriculture.

Would there be any strenuous objection by your Department if the authority were left in the present 3-man commission?

Mr. MEHREN. We have had no formal discussion of that issue, Mr. Chairman. May I say that in my own personal judgment, there is only one provision of this bill to which such statements might properly be applicable. Except for the authorization by the Secretary to impose margins under standards on limitations, and procedures to be defined by regulation, all other activities would be subject to the regular requirements of the Administrative Procedure Act involving the publication of proposals in the Federal Register, public notice to all concerned, opportunity for hearings, opportunity for submission of data, views, and arguments, and appeal to the courts in the event of adverse findings.

I would say, therefore, that again, in my personal judgment, the single provision to which such a reservation might properly be applied would be that associated with margins, and such reservations are not really relevant with respect to the other proposals here.

Mr. MATSUNAGA. Do you feel that the bill sets forth sufficient standards in order that we may not be delegating legislative powers to the Secretary?

Mr. MEHREN. In developing each one of these proposals we asked ourselves two major questions:

Could apparent deficiencies in the administration of this statute be repaired in the absence of such provision?

And second, is such proposed provision the minimal authority necessary in terms of past experience?

That is, effectively to repair deficiencies in the operations of the Commodity Exchange Authority?

Mr. MATSUNAGA. Relative to your statement describing the effect of the act, I notice that in your statement you did mention other agencies

which do have the same provisions, but the first impression I got was that it was similar to a situation where you arrest a man because he is looking at a window full of jewelry, and you feel that he is about to commit a crime, to break the window and to steal the jewelry. Do you feel that you are proposing a provision here which would go a little too far toward enjoining acts which are about to, or which the Secretary feels are about to, take place?

Mr. MEHREN. Let us take, first, Mr. Chairman, the authorization for injunctive or mandamus intervention which presently exists in several of the regulatory statutes of the Department and which for many, many years have been the standard regulatory instrument with other elements of the executive branch, but more important than that, I would say that the provisions proposed here for the exercising of injunctive power are carefully circumscribed. The Department, through the Secretary, would be required, first, to persuade the Attorney General to intervene, because the Attorney General is the single officer of the Federal Government with such powers.

Secondly, the Attorney General would be required to appear before a court and to support this request for injunctive or mandamus relief.

Thirdly, the usual provisions for temporary restraining orders would prevail. And I see no major difference here in terms of the safeguards that are given to the American citizens against capricious or arbitrary uses of the injunctive powers. To me, this seems to be quite carefully circumscribed.

Mr. MATSUNAGA. Are there any further questions?

Mr. TEAGUE of California. I do not want to ask any questions, Mr. Chairman, at this time. That does not mean that I agree with the Secretary. This is a highly technical and difficult subject, and we have to get further along in these hearings before I will be qualified to ask intelligent questions.

Mr. MATSUNAGA. Are there any further questions?

Mr. HAGEN of California. With reference to this matter, the *DeAngelis* case has been cited as a genesis of this proposal.

Mr. MEHREN. The *DeAngelis* case is not the genesis of these proposed amendments. The difficulties associated with the effective handling of the *DeAngelis* case do play a part in some of these amendments, but many of these amendments have been submitted in earlier years. Certainly, it is a judgment of the Commodity Exchange Authority that they were necessary for effective enforcement, and I, certainly, Mr. Hagen, would not attribute any special relevance to the *DeAngelis* case in the generation and presentation of these amendments.

Mr. HAGEN of California. What other examples, without naming them if you don't care to, have occurred? That is, with reference to manipulation, and so forth?

Mr. MEHREN. I would like, if I may, sir, to refer this to Mr. Caldwell, for the simple reason that some cases are presently in various stages of litigation. I would compromise them severely if I were inadvertently to make reference to cases which I should not mention. Will you answer that?

Mr. CALDWELL. There is presently one case pending which, as Mr. Mehren says, we prefer not to mention; however, since the Commodity Exchange Act was passed in 1936 there have been 28 instances of

administrative complaints charging manipulation or an attempt to manipulate, and 3 instances of criminal charges involving manipulation or an attempt to manipulate.

There are many other areas in which we are seeking to get stronger authority. For example, we have found that a person who applied for registration as a futures commission merchant was actually insolvent. We have found other situations in which the manager of a futures commission merchant is under sentence—with a sentence pending for violation of the Securities and Exchange Act. We have to register people of that type. We have found situations in which we have been unable to proceed, because we did not have the authority to seek injunction, and as a result there has been serious damage to the markets which cannot be corrected by any type of action under the act.

These are some of the examples of the things that come to mind.

Mr. HAGEN of California. With respect to the margin requirements—and correct me if I am wrong, but it is my understanding that one motivation for regulating the margin requirement on the stock market is the effect on the whole economy and to somehow prevent a generation of false activities that create speculative booms, et cetera.

So these same considerations apply to the commodity exchange markets?

Mr. CALDWELL. Not precisely. There are situations which are similar in the commodity and securities markets, but the securities margins are, primarily, for the purpose of regulating credit. That would not be the purpose of the margin in the commodity field. The commodity margins would be used only in specific situations as outlined in the bill and not to restrict credit generally.

Mr. HAGEN of California. And what are those specific situations?

If you would refer to them again, in more detail, perhaps?

Mr. CALDWELL. Very well.

Mr. MEHREN. I think, Mr. Hagen, I would like the record to show that the proposal for margin control was not generated by the existence of a full-employment economy. It is not regarded by us as any major instrument of inflation control. What really was at issue here is that there have been instances, I think in the past, in which the declared purposes of that statute, as set out 40 years ago, in section 3, have, in fact, been impaired by the development of excessive speculation, by the development of individual positions—by the development of sudden or unreasonable fluctuations of prices, and these have been declared 40 years ago by this Congress as adverse to the public interest and adverse to the declared purposes of this statute itself.

It is in order to contain, under extreme circumstances and only extreme circumstances, the emergence of such excessive speculation or sudden or unreasonable fluctuations or marked changes in prices of an abnormal or artificial nature that we have asked for this authority. There is no feeling on our part that it would be used with any frequency. It is an instrument to be available for use only in extreme situations where sharp and sudden deviations from normal positions or activities are present and prevent the effectuation of this statute.

Mr. CALDWELL. You ask, Mr. Hagen, whether I would read to you the provisions?

I will be glad to do that, that is, in section 13 of the bill, where it says:

Section 4j. Whenever the Secretary of Agriculture has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, or excessive speculation in any commodity, or any other activity reasonably expected to restrain trade, in connection with the sale of any commodity for future delivery, or in interstate commerce, under contracts made on or subject to the rules of any contract market, the Secretary of Agriculture may prescribe the minimum margins which such contract market and all futures commission merchants shall require to be initially deposited and subsequently maintained by each person in connection with speculative or hedging positions which may be held by such person under contracts of sale of such commodity for future delivery, or in interstate commerce, made on or subject to the rules of such contract market. Such rules may specify special or different margin requirements for initial margins and maintenance margins and for different types of positions or commodities; and may make appropriate provision with respect to the carrying of undermargined positions for limited periods and under specified conditions, the withdrawal of funds or securities used to margin, guarantee, or secure accounts, the transfer of accounts from one futures commission merchant to another, the bases and methods to be used in calculating margins, and similar administrative adjustments and details. Such rules shall be furnished to the contract market and all futures commission merchants and shall be published in the Federal Register. Because of the nature of futures trading and the necessity for expeditious actions in imposing margin requirements, such rules may be made effective upon actual or constructive notice to persons affected thereby. It shall be unlawful for any futures commission merchant having notice of such a rule to fail to require its customers to meet the margin requirements thereof, or for such contract market having notice of such a rule to fail to enforce it against its members.

Mr. HAGEN of California. Thank you. That is all.

Mr. MATSUNAGA. Thank you.

Mr. Purcell?

Mr. PURCELL. I have no questions at this time, Mr. Chairman.

Mr. MATSUNAGA. Mr. Greigg?

Mr. GREIGG. No questions.

Mr. MATSUNAGA. Mr. Dole?

Mr. DOLE. I am not a member of the subcommittee, but would like to ask a question.

Mr. MATSUNAGA. If there is no objection, you may proceed.

Mr. DOLE. Mr. Hagen raised a question I was concerned about. There has been much talk about the *De Angelis* case, and that legislation was therefore needed. Perhaps I do not understand the word "genesis," but would point out that in the committee's print, in reference to H.R. 11788, in paragraph 2, on page 1, there is a statement by Secretary Freeman which does indicate that the reason for this legislation is because of the *Salad Oil* case, in November of 1963. Had this act, as you request it, been effective in 1963, could you have prevented what happened in that case?

Mr. MEHREN. I am not a lawyer. I did not sit on the case. There were certain phases of it that were quite extraneous to futures trading. It was forgery in State warehouse receipts.

Mr. DOLE. That, then, is a question of fraud rather than of the futures market; is it not?

Mr. MEHREN. Certainly, there apparently were extensions of credit on the basis of such forged receipts which would, again, not be subject to the terms of this provision. So again, in that phase of it, I felt that

we should express a belief that possibly one other phase of it would have been that with margin authority we would have been able to move in, in timely fashion, and that we might have been able to mitigate, at least, the development of extremely large long positions, protracted over a long, long period of time, just to put it mildly. It did engender the possibility of manipulation further on down, not at the moment, but in time to come.

I would say that some of the provisions of this statute would have been useful in avoiding, or in trying to avoid, an incident which was not useful to the exchanges. It was not useful to the operation of the futures market as a basis of trading in this country. I believe that a part of it we might have mitigated or even prevented, Mr. Dole. Perhaps, you have something to add to that?

Mr. CALDWELL. No.

Mr. DOLE. There were hearings held on the Senate side, because of that scandal, in March of 1964. At the time, a U.S. Department of Agriculture official testified that nothing could have been done, so far as the Commodity Exchange Authority was concerned, to avoid the salad oil scandal. My point is and I ask the question: Why do you include a definition of "manipulation" in the bill?

Why is that included on page 2 of H.R. 11788?

Mr. MEHREN. I would include it, again speaking personally, for two very good reasons:

As a person who has the responsibility for most of the regulatory activities of the Department, as such a person I think with regard to due process in the American system that my people should know precisely as possible the precise intent of the Congress in proscribing or prohibiting such acts.

Secondly, and much more important than that, I think it is the right of an American business person to know as clearly and precisely as is possible what the Congress really had in mind in proscribing or prohibiting acts or relationships.

The present act does not really have a definition of "manipulation."

Mr. DOLE. Are there any court decisions that define "manipulation"?

Mr. MEHREN. There are, to my knowledge — I would defer to my colleague in the General Counsel's Office, with respect to that matter.

Mr. BUCY. There are, of course, court decisions in connection with antitrust violations and other statutes that used the term, but there is no clear-cut definition—I mean, one that you can read and get a precise meaning—you will get different definitions. The courts applied their own concept to the particular factual situation in a particular case. It is an area and a term that is very broad and general in nature. And each case depends upon facts in the particular case.

Mr. DOLE. There was a case, the so-called *Volkart* decision. Is the purpose of this proposal to overrule the so-called *Volkart* decision?

Mr. BUCY. No.

Mr. DOLE. Do you agree with the decision in that case, defining "manipulation"?

Mr. BUCY. I do not agree with all phases of it. I think they had a factual situation in that case where the court determined that there was not adequate proof, a factual basis for holding there was manipulation.

Mr. DOLE. I believe the case at least indicates there must be an intent to influence price, and notice that factor is not included in your definition of "manipulation" on page 2 of the bill.

Mr. BUCY. I think that you infer "intent" very frequently from the action of the man as he knowingly does something, and if it has that result, why, "intent" is inherent when you connect it to his action.

Mr. DOLE. That is not always the case; is it? You are talking about a penalty of \$10,000 maximum and 2 years in jail, and a change from a misdemeanor to a felony. It should require a finding of intent, and I trust that is what you are indicating.

Mr. BUCY. We have any number of other acts on the books where you do not have the affirmative requirement in the statute on intent. You say that if you do this, a thing which will have this result, and you knowingly do it, why, this is against the public interest and should be subject to action.

Mr. DOLE. A lot of us feel the Secretary now is guilty of manipulating the market with reference to the dumping of commodity stocks of wheat and that it is intentional on his part—but we have not tried to proceed under any act.

It does seem that if we are talking about a criminal statute that a person should not be criminally punished when there was no intent to influence the price or in any other way to violate the act. You are not suggesting this, I trust?

Mr. MEHREN. I would like to answer in terms of a layman. I would like to try to answer it in that fashion, as to the intent of the Office of the Secretary. And, again, I do it with a caveat that I am not an attorney.

On page 11 of the statement we indicated that in our judgment there would be three elements of burden impinging upon the Government in any action involving manipulation.

First, it would be the Government's burden to establish that resultant or threatened price was in fact artificial or abnormal. That is a difficult burden to bear, but the Government bears it, and the defendant should not.

Secondly, we would have to show that the actual or threatened manipulation impaired or threatened to impair the effectuation of the purposes of this statute.

And, thirdly, we consider that the Government would be required in such a situation to establish a direct and causal relationship between a series of actions alleged to have been taken by the accused and the actual or threatened outcome of artificiality.

I would assume, again, that the normal legal requirements of intent which relate to a series of actions, presumably taken by a person, with a set of actual relationships would prevail here.

Mr. DOLE. You have no objection then to including in the definition that there must be a willful intent to violate the act.

Mr. MEHREN. I cannot answer as to that. The attorneys probably would take exception to it on the grounds that the third requirement as set out here would encompass the normal requirements impinging upon a prosecuting agency to establish causal sequence between the actions taken by the accused and the outcome, and that in a legal sense,

at least, the notion of intent was there and would be encompassed; is that correct?

Mr. BUCY. Yes. I do not think that we would get, however, into the matter of willful intent. Intentionally, they do it to have an artificial price. And when you tack on "willfully," why, you get into the question of whether they had some fraudulent or other type of intent.

Mr. DOLE. That is getting into the criminal statute again. There must be intent. You cannot lock somebody up if there is no intent.

Mr. BUCY. If you say "intent," I have no objection to that, myself; if you say that they intended to take the action they took.

Mr. DOLE. How do they set the margins now?

Mr. MEHREN. There is no legal authority for anybody to set margins now in the Government. The exchanges may do so.

Mr. DOLE. Does one man set the margins?

Mr. MEHREN. To my knowledge, there is no authority in any component of the National Government to set margins on commodity trading.

Is that correct?

Mr. CALDWELL. That is right.

Mr. DOLE. I am talking about the exchanges themselves. Do they give this authority to one person?

Mr. MEHREN. Mr. Caldwell can answer that. I believe that they do it through standing committees when they do it.

Mr. CALDWELL. The exchanges set the margins through a board of directors or some similar committee.

Mr. DOLE. But you want the Secretary to have that power himself?

Mr. CALDWELL. Not under normal conditions; no, sir. Only under certain conditions would we want the Secretary to have that authority, to set the margins, and even in those cases, we would anticipate that the Secretary would discuss the matter with the exchanges, and we anticipate that the exchanges themselves, in most cases, would set the margins and not require the Secretary to do so.

Mr. DOLE. Have you discussed this proposal with the different exchanges—are they in agreement with this proposal?

Mr. CALDWELL. We discussed it with a great many of the exchanges, and there is general disagreement with the present proposal.

Mr. MATSUNAGA. I did not hear that.

Mr. CALDWELL. We discussed this with many of the exchanges and there is general disagreement with the proposal.

Mr. DOLE. I assume that a lot of those men behind you then are not with you?

Mr. MEHREN. That is a correct assumption, perhaps.

Mr. MATSUNAGA. Are there any further questions?

Mr. HAGEN of California. We learn something about legislating by considering who proposes it and who opposes it. In this instance, as I understand it, some of the people, say, in wheat and cotton and various commodities, traded on the futures market, use the markets as a bona fide hedging operation to protect against swings in prices. As I understand it, some of these ultimate users are opposed to this legislation. That being the case, who, primarily, is this legislation trying to protect, the farmer? Exactly who is it designed to protect?

Mr. MEHREN. Everyone is concerned with the fruitful activities of the exchanges; and we do not wish to impair them. We have only

certain circumstances for intervention where necessary, and where necessary as an extreme matter, to be made available to the only impartial agency, the interest of which fundamentally is not merely the interest of the exchanges and of the trade but the interest of all of the Americans who are affected by it.

I, personally, have no objection to the development of standards, limitations, or even alternatives to the proposal in this legislation. I do personally think that in extreme circumstances that the interests of the public are clearly in jeopardy—the effectiveness of the exchanges may also be in jeopardy; that under appropriate standards the administration through a single agency should effectively and equitably operate it.

Mr. HAGEN of California. With the experience of the Securities and Exchange Commission, why did you not propose that type of operation rather than having the Secretary, as an individual have such authority?

Mr. MEHREN. This, again, Mr. Hagen, is the only provision of the Act in which the unilateral authority of the Secretary exists. To be truthful, I think that we looked away from the Commodity Exchange Commission, primarily, as a matter of effective operation of this most difficult area. The Secretary is a full Cabinet officer with the time and the attention required of him for this.

Mr. HAGEN of California. Could you not create a special board—I mean, the members of the Securities and Exchange Commission are not Cabinet officers.

Mr. MEHREN. The Securities and Exchange Commission does not control its own margins. This is, I believe, a statutory function delegated to the Federal Reserve Board. And, again, as an individual, and I do not think that I can speak without clearance for the whole Department—as an individual, I would take no major exception to finding some resolution of this matter of that sort.

Mr. HAGEN of California. There are some commodities like cotton and wheat which are heavily traded in, and they are grown in large quantities. Mrs. Sullivan testified on coffee and sugar. The trade in that is relatively light, versus wheat and cotton. Is this bill designed to reach abuses in trading of the large volume commodities, such as wheat and cotton, or is it the trading in lesser commodities?

Mr. MEHREN. I think I had better ask Mr. Caldwell to answer this.

Mr. CALDWELL. The big markets at the present time, of course, are the grain exchanges, the potato exchange, and so forth, and not the cotton exchange. That has had little, relatively little, trading in recent years. However, our problems are not directly related to the volume of the trading. We quite often find that there are many problems which must be met on the relatively small exchanges.

Mr. HAGEN of California. Thank you, that is all.

Mr. MATSUNAGA. Mr. Redlin?

Mr. REDLIN. I notice on page 6 of your statement that you talk about minimum financial standards for members of these exchanges. As a layman, I assume, if you expected to get a seat on most of these exchanges, that you would have to be financially responsible. Are there not at present regulations which deal with the fact that you must be financially responsible today?

Mr. MEHREN. To my knowledge, there are no minimum financial requirements for the members of an exchange, or for trading. Again, to my knowledge, this is about the only one in which some minimum financial standards are not required for the people that handle money that belongs to other people. Am I correct?

Mr. CALDWELL. There are certain exchanges that do have financial standards, either for all members or for members of the clearing association.

This proposal would also require that futures commission merchants who are not members of any exchange to be financially responsible. Under the present law they are not required to meet any financial requirement.

Mr. REDLIN. You also say on page 9 of the statement that the bill would help the members; that is, it would require the members to keep records of cash or spot transactions made subject to the rules, even though they are not physically made on the exchange. Would you enlighten us on that and tell me what those transactions would be?

Mr. CALDWELL. The law presently requires that all transactions made on an exchange be recorded. We have always taken the position that this would apply to transactions which are made subject to the rules of the exchange, but that is not clear in the law.

What we are seeking to do here is just to clarify this situation and to make it quite clear that anyone who trades in accordance with the rules of an exchange must maintain records of transactions.

Mr. REDLIN. What would be an example of that type of transaction?

Mr. CALDWELL. A transaction in cash which is made away from the exchange floor but which is made under the rules of the exchange.

Mr. REDLIN. Thank you. That is all.

Mr. MATSUNAGA. Mr. Hagen.

Mr. HAGEN of California. I dislike to get into this further, because this whole subject is so complicated, and I do not want to reveal my ignorance.

Mr. MEHREN. Nor mine, either.

Mr. HAGEN of California. This is in connection with the prohibition on trading in onion futures, and the one pending on trading in potatoes, and I want to ask you in connection with the effort to prohibit such trading: Do the activities with respect to prices and futures affect the prices that the farmers receive and that the consumers pay for these commodities?

Mr. MEHREN. This is a professional judgment. I would say, Mr. Hagen, that, basically, spot prices are determined generally by the supply of the commodity against the expected market demand—supplies of competing or substitute goods, the level of income, et cetera.

I would say that future prices, generally, in an open market are determined by the expectations of what those very same determinants will be at delivery time. So, personally, I would be doubtful that spot prices in any unique sense determine future prices, or vice versa, but that, rather, they are basically determined by the same pricemaking factors with expectations being introduced as an additional element in the determination of futures' prices.

Mr. HAGEN of California. How about the price of the commodities to the consumers, or would that be the same?

Mr. MEHREN. I would say that there are major relationships in those cases between the changes in prices at the farm level, probably measurable relationships between the changes of future prices and the consumer prices, but I know of nothing particularly unusual in those relationships.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Do you have a question, Mr. Teague?

Mr. TEAGUE of California. I just want to say, Mr. Chairman, that many of us feel that the Secretary of Agriculture already has too much power, and while I may support some of the provisions of this proposal, there will have to be a stronger showing to me of the need for it.

Mr. MATSUNAGA. Mr. Secretary, had this bill been in effect in 1963, would it have prevented the fluctuations in the sugar prices?

Mr. MEHREN. We are not ducking your question, Mr. Chairman, but the sugar gyrations occurred prior to my joining the Department of Agriculture. I would suppose that with these provisions, had they then been in effect, the Secretary of Agriculture, under appropriate standards, could have proposed that the sugar market be a designated commodity market; thereafter, the usual publication, opportunity for hearings, submission of data, views and arguments would insure, and, thereafter, I would assume that the Secretary, had his opinion been properly founded, would have designated sugar in that market as being subject to the terms of this act. However, in honesty, I do not know enough about the facts of the sugar situation of some few years ago to give you an effective and valid answer as to whether this statute or the amendments here proposed would have mitigated those gyrations of prices.

Mr. MATSUNAGA. Would the proposed margin requirement have had any part to play so as to control the situation?

Mr. MEHREN. Again, I am not competent without an appropriate factual basis to answer that question. Mr. Caldwell may answer it, if he can.

Mr. MATSUNAGA. Do you have an answer, Mr. Caldwell?

Mr. CALDWELL. The Department did make a study of this sugar situation and did determine that in its opinion excessive speculation was a factor in the price rise. To the extent that margins would have reduced this speculation, I think it would have an effect on the price.

Mr. MATSUNAGA. If you go through the procedure as outlined in the bill, it would take several months before any given situation could be corrected, would it not? Whereas the situation could correct itself in the meantime, as it did in sugar?

Mr. CALDWELL. It could correct itself within a few months with a precipitous drop.

Mr. MEHREN. With respect to that comment, I think that we or any other administration would always have to compromise between immediate action and due process of law. Due process of law in similar emergency situations can be achieved rather rapidly without violation of due process or the rights of the people involved in the situation.

Mr. MATSUNAGA. Thank you very much.

Are there any further questions?

Mr. HAGEN of California. Apropos of the chairman's question, could you pluck out any event that has happened in the past that you

could outline where the provisions of this act would have, say if adopted, affected or corrected the situation?

Mr. CALDWELL. Do you have in mind any particular provision of the act?

Mr. HAGEN of California. Well, any—I would say that the most important ones probably would be the margin requirements. The factors of honesty and solvency of these traders would have some bearing, too. Take any particular situation where the public good would have been achieved in the past had this statute been in effect.

Mr. CALDWELL. We have on several occasions suggested that the exchanges raise the margins because of the speculative activities in the market and on, at least one occasion, that I can think of, it had to do with potatoes, the exchange did raise the margins, and the contracts were settled without any undue price disturbance.

Mr. HAGEN of California. In other words, the Secretary of Agriculture has not been blind all of these years. I assume that without this statute he has been in consultation with the various exchanges with respect to specific situations. If you could give us a record of these it might be helpful in convincing Congressman Teague, for example, that there is a necessity for this legislation. That is the only point I am making.

Mr. CALDWELL. The most dramatic situation occurred back in 1947 or 1948, when there was a wide speculative price movement in grains. At that time President Truman suggested to the exchanges that they raise the margins to 33½ percent, and the exchanges did, at the suggestion of the President, raise them to that level and maintained them at that level for a short period of time. This did have a very marked effect upon the speculative trading in the market.

Mr. HAGEN of California. You say that every time somebody in Government has intervened, the exchanges have responded, so this would appear to be an argument against the legislation. This is entirely without respect to these hearings.

Mr. CALDWELL. I merely pointed out two instances that come to mind where the exchanges did comply. There have been other instances in which they did not comply.

Mr. HAGEN of California. That is what I want to hear, the circumstances where they did not comply.

Mr. CALDWELL. I do not have those documented here.

Mr. HAGEN of California. Could you do that?

Mr. CALDWELL. I think that we can do that; yes, sir.

Mr. HAGEN of California. And bring them in at some later period, when we could call you back, or you could put them in the record.

Mr. CALDWELL. I do want to make one other comment on this 1947 or 1948 situation. At that time, the Secretary of Agriculture did ask the exchanges to raise the margins and they raised them slightly, but not to the level that the Secretary had requested. Then, President Truman made a speech on the radio in which he criticized the speculation in the grain markets and directed the Commodity Exchange Commission to require the exchanges to raise the margins. It was only after President Truman had made this radio appeal that the exchanges did comply.

Mr. HAGEN of California. Now, you are making a case for the legislation.

(The information subsequently furnished is as follows:)

EXAMPLES OF DEPARTMENT OF AGRICULTURE CONCERN OVER MARGIN LEVELS AND ATTEMPTS MADE TO OBTAIN EXCHANGE ACTION

1. In the spring of 1947, a sharp rise in speculation activity in grains indicated the need for substantially higher margins to prevent price distortion. On March 14, 1947, the Commodity Exchange Authority asked the three principal grain exchanges to increase initial margins on grains to at least 25 percent of the market price. At the price of wheat then prevailing, this would have amounted to approximately 70 cents per bushel as compared with the margin of 30 cents (10 percent) then required by the Chicago Board of Trade. The Minneapolis and Kansas City exchanges adopted the 25 percent margins for wheat, but the Chicago Board of Trade met the request only in part. On May 7, 1947, however, the Chicago Board of Trade lowered its margin requirements back to 30 cents for all wheat futures except the expiring May future. The two other exchanges then reduced their requirements. The trading volume in wheat increased following the reduction in margins. A sharp rise early in September in speculative trading in wheat with marked price instability indicated even more clearly the need for more substantial margins. On September 15, the Commodity Exchange Authority asked the grain exchanges to raise initial speculative margins to 33½ percent, or approximately 94 cents per bushel for wheat at prices then prevailing. The exchanges did not accept this proposal. On October 6, as directed by the President in a radio address to the people in which he censured the exchanges, the Commodity Exchange Commission requested the grain exchanges to raise margins to at least 33½ percent. The grain exchanges then raised margins to this level effective October 7.

2. In July and August 1950, the CEA published reports pointing out that low margin requirements for speculative trading in commodity futures contributed to the sharp rise in commodity prices following the outbreak of the conflict in Korea. With minimum margins of the exchanges at levels of 10 to 15 percent, speculators could buy relatively large amounts of commodity futures with relatively small cash margin payments. Beginning late in July 1950, the leading exchanges made some increases in speculative margin rates. Reductions were made, however, in the latter part of the fiscal year and by June 30, 1951, speculative margins were little changed from 1 year earlier when the Korean conflict began.

3. In September and October 1963, activity in the soybean market on the Chicago Board of Trade advanced sharply. Open contracts in all soybean futures reached an alltime high of 358 million bushels on October 31, compared with a high of 276 million bushels on September 30, and an earlier alltime high of 267 million bushels on April 14, 1961. The increase in activity was accompanied by a substantial price rise, with the November future going from \$2.55¾ on August 30, to \$2.84¼ on October 31, 1963. The Commodity Exchange Authority suggested to the leading officials of the Chicago Board of Trade that initial margins on speculative transactions be raised from the current level of 20 cents per bushel to a level of approximately 75 cents per bushel, which would have represented approximately 25 percent of the value of the contract. Following this request, the board of directors of the exchange raised the initial margin from 20 cents to 25 cents instead of the 75-cent figure suggested by the Commodity Exchange Authority. This small increase was not sufficient to have any worthwhile effect upon speculative trading in the market.

The above illustrations show that there is no effective tool available to the Department of Agriculture to curb excessive speculation in a futures market. The times when requests are made for higher margins are infrequent and come only under unusual conditions; but even in these instances the exchanges have acted only under great public pressure, or have taken only perfunctory steps inadequate to the need.

Mr. MATSUNAGA. What will the cost of this bill be if put into effect?

Mr. MEHREN. We have that information.

Mr. CALDWELL. The cost of this legislation which has already been approved by the Bureau of the Budget would be \$277,000 for fiscal year 1967.

Mr. MATSUNAGA. What would the principal cost items be?

Mr. CALDWELL. About 90 percent of that would be for personnel. This would provide 35 additional positions.

Mr. MATSUNAGA. Well, what type of personnel would that be?

Mr. CALDWELL. There would be accountants, market analysts, investigators, clerks, stenographers, and typists.

Mr. MATSUNAGA. Is there any projection for escalation of personnel requirements in the foreseeable future?

Mr. CALDWELL. Only if we take over additional commodities under the act or if the volume of trading should increase in subsequent years.

Mr. MATSUNAGA. The absolute minimum that you have determined is 35 people?

Mr. CALDWELL. Thirty-five, yes.

Mr. MATSUNAGA. For the next fiscal year?

Mr. CALDWELL. Thirty-five is what we anticipate would be required for fiscal 1967. If in fiscal 1968 the Secretary should designate another commodity, then this figure would have to be raised.

Mr. MATSUNAGA. What are the anticipated commodities to be included initially?

Mr. CALDWELL. These 35 positions would cover the commodities which are now under the Commodity Exchange Act.

Mr. MATSUNAGA. And somewhere you might add coffee, which is not at present, I understand, under the act.

Mr. CALDWELL. That is correct.

Mr. MATSUNAGA. Would that mean additional personnel, and, if so, how many if you added coffee?

Mr. CALDWELL. We have not made a study to determine just exactly the number to be required for a particular commodity, but it would not be a marked increase in personnel.

Mr. MEHREN. This is the least expensive regulatory agency in the whole Department, with about \$73 billion worth of trading. You have a budget presently of \$1,200,000?

Mr. CALDWELL. \$1,398,000 is our request for 1967.

Mr. MEHREN. This would be a total of about \$1,500,000 per year without additional commodities were these amendments adopted.

Mr. MATSUNAGA. And you have the trained personnel to fill these 35 positions?

Mr. CALDWELL. No, sir; we would have to recruit personnel. We have some training personnel who would fill the higher level positions, but we would recruit for the lower levels.

Mr. MATSUNAGA. This would not mean that you would raid other departments to secure them, such as from the Securities and Exchange Commission?

Mr. CALDWELL. We would not do that.

Mr. TEAGUE of California. Has the Department had under consideration the proposition of industry fees to pay for the cost of this inspection like they want to do in the meat industry?

Mr. MEHREN. There is a bill which was submitted by the administration proposing user fees on the meat inspection, along with quite a few others. There is a wide variation with respect to financial and regulator activities. Some are supported by fees and others are not. There is a small registration fee here; is there not?

Mr. CALDWELL. Yes.

Mr. MEHREN. There is no proposal to move in that direction, the fee-financed system.

Mr. HAGEN of California. What group of people involved in the various commodities are seeking this legislation?

Mr. CALDWELL. The legislation was generated in the Department of Agriculture. There have been other organizations that have indicated they are supporting it. Whether they will appear at this committee hearing, I just do not know.

Mr. HAGEN of California. In general, what would these organizations be?

Mr. CALDWELL. There has been some support from farm organizations. There has been some support from individual traders in the market.

Mr. HAGEN of California. How about some of the users like those in cotton, and the like?

Mr. CALDWELL. We have not discussed it with them.

Mr. MATSUNAGA. We can develop that later. We will have further witnesses.

Thank you very much, Mr. Secretary.

Mr. MEHREN. Thank you, sir.

Mr. MATSUNAGA. We now know a little bit more about this subject than we did before.

Our next witness is Mr. Philip A. Loomis, Jr., General Counsel, Securities and Exchange Commission, who is accompanied by Walter P. North, Associate General Counsel.

We will be glad to hear you now.

STATEMENT OF PHILIP A. LOOMIS, JR., GENERAL COUNSEL, SECURITIES AND EXCHANGE COMMISSION; ACCOMPANIED BY WALTER P. NORTH, ASSOCIATE GENERAL COUNSEL, SECURITIES AND EXCHANGE COMMISSION

Mr. LOOMIS. Mr. Chairman and members. I am Philip A. Loomis, Jr., General Counsel of the Securities and Exchange Commission. I am accompanied by Mr. Walter P. North, Associate General Counsel of the Commission. We are here to testify on H.R. 11788, a bill to amend the Commodity Exchange Act. We understand that the primary purpose of the bill is to increase and make more effective the regulatory jurisdiction and enforcement powers of the Secretary of Agriculture with respect to commodities markets and commodities brokers and merchants. We are here because the bill would add to the Commodity Exchange Act provisions similar to various sections of the Securities Exchange Act of 1936 giving the Securities and Exchange Commission regulatory authority or enforcement powers with respect to the securities markets and securities brokers and dealers. It was thought that our evaluation of the usefulness of these provisions, based on our experience with them over the past 32 years, might be of some assistance to the committee in its consideration of the bill.

Before discussing particular provisions, I would like to make two general points. In the first place, the Commission has no jurisdiction or responsibility to administer the Commodity Exchange Act, and consequently we have only such indirect understanding and experience of the commodities markets as may result from the fact that certain securities brokers also act as commodities brokers. Indeed, I am not familiar with the Commodity Exchange Act itself, beyond having read

it. Consequently, we are not in a position to determine whether or not provisions which have worked very satisfactorily in the regulation of the securities markets would be equally satisfactory in the commodities markets, or whether, as applied to those markets, they would create any problems. It seems likely that this question would arise more squarely with respect to some provisions than with others. For example, it seems to me that the authority to seek injunctions against violations of the law or the regulations which would be granted by section 29 of the bill would be useful to any agency charged with enforcing the law whether in the commodities markets or in the securities markets. On the other hand, as previous witnesses have pointed out, although the authority granted to the Secretary of Agriculture to prescribe minimum margins in commodity trading appears similar to the authority granted to the Board of Governors of the Federal Reserve System by section 7 of the Securities Exchange Act of 1936 to fix margins for securities trading, I am not sufficiently familiar with the workings of the commodities markets to express a view as to whether margin requirements operate in the same way in those markets as they do in the securities markets.

I believe that this evaluation of the differences between the two markets will have to be made by the committee with the assistance of persons more familiar with the workings of the commodities markets. Essentially, for the foregoing reasons, the Commission has concluded that it does not have a sufficient basis to take a position for or against the bill. On the other hand, if by this legislation the committee is able to resolve certain of the problems which, we understand, have arisen from time to time in the commodities markets, we would be grateful since a substantial number of firms which act as securities brokers or dealers also act as commodities brokers and any difficulties which they may encounter in commodities trading may have an impact on the entire position and operation of the firm.

The bill includes a large number of provisions which have no direct counterparts in the securities laws, and while these may well be valuable, I do not propose to discuss them. With respect to the matter of margins which I alluded to a moment ago, I do not expect to discuss these since I understand that you are also going to receive testimony from representatives of the Board of Governors of the Federal Reserve System who have the authority to fix margins under the securities laws.

The first section of the bill would define the word "manipulate." The Securities Exchange Act does not quite do this, but rather, in section 9, it prohibits various specified types of conduct which, in effect, constitute manipulation. The effect, I think, is very much the same and it is, of course, important in attempting to prevent or punish a manipulation to be able to point to a specific statutory provision which describes the conduct in question. In addition, various provisions of the Exchange Act, notably section 15(e) (2), dealing with the conduct of brokers and dealers authorize the Commission, by rules, to define and prescribe means reasonably designed to prevent manipulative acts and practices. We have found this power to be a useful one.

Section 8 of the bill would amend section 4(b) of the Commodity Exchange Act which prohibits various fraudulent or deceptive practices and false and misleading statements in order to make that sec-

tion applicable not only to members of contract markets and their agents and employees, but also to any person. As I mentioned above, certain provisions of the Securities Exchange Act prohibit such conduct by brokers and dealers, but section 10 of the Exchange Act also makes it unlawful for any person to engage in fraudulent and deceptive practices in contravention of the Commission's rules. The Commission has adopted rules under this section, notably rule 10b-5, which prohibits devices and schemes to defraud or to deceive and false statements or half-truths by any person in connection with the purchase or sale of any security. This has become one of our most important and widely used enforcement provisions and it also has been interpreted by the courts as creating civil remedies for defrauded investors against the person who defrauded them, whether or not such person is a securities broker or dealer. It has been our experience that, at least in the securities field, frauds are perpetrated at least as often by persons who are not in the securities business as they are by persons in that business.

Section 10 of the bill would amend section 4(f) of the Commodity Exchange Act to provide that commission merchants shall meet such minimum financial requirements as the Secretary of Agriculture may by regulation prescribe. The Commission has a corresponding authority with respect to securities brokers and dealers under section 15(c)(3) of the Exchange Act, and has exercised it by requiring that the current assets of a broker-dealer exceed his current liabilities by a specified percentage, and that we have a minimum net worth. We believe that this constitutes a valuable safeguard for persons having dealings with such brokers and dealers, including not only investors but other brokers and dealers with whom they trade, and we have found that generally the securities industry supports the Commission's power to impose capital requirements. The U.S. Court of Appeals for the Fifth Circuit has stated in affirming the Commission's revocation of a broker's registration for violation of the capital rule:

The net capital rule is one of the most important weapons in the Commission's arsenal to protect investors. By limiting the ratio of a broker's indebtedness to his capital, the rule operates to assure confidence and safety to the investing public.¹

Section 11 of the bill would amend section 4(g) of the Commodity Exchange Act to expressly require commission merchants and floor brokers to make such reports as are required by the Secretary of Agriculture, to keep books and records in such form and manner as may be required by the Secretary, and to permit these books and records to be inspected by representatives of the Department of Agriculture or the Justice Department. While existing section 4(g) makes failure in this regard by a commodity broker or dealer a ground for disciplinary action by the Secretary of Agriculture, the amendment would presumably permit enforcement by the use of other remedies. The same is true of the Commission's authority with respect to reports, books, records, and inspections which is contained in section 17(a) of the Securities Exchange Act, and we regard the existence of readily enforceable requirements of this type as essential to any

¹ *Blaise D'Antoni & Associates, Inc. v. Securities and Exchange Commission*, 289 F. 2d 275, 277 (1961).

effective regulatory program. If I may skip a bit, section 25 of the bill would amend section 8(a)(2) of the Commodity Exchange Act to appreciably broaden the grounds upon which the Secretary of Agriculture may refuse to register commission merchants and floor brokers to include not only persons whose registrations have previously been revoked or suspended, but also persons who have violated the act or have been convicted of felonies or who have made false and misleading statements.

In connection with the recordkeeping provisions and this provision, the legislative history of the Investment Advisers Act of 1940 may afford some parallel. As that statute was originally enacted, it gave the Commission no authority to require the keeping of books and records or to inspect such books and records, and the Commission could revoke or deny registration only upon the ground that the registrant or applicant had previously been determined, in a civil or criminal proceeding, to be guilty of violations of the act. In 1960 we came back to Congress suggesting among other things, that the lack of the power with respect to books and records and the narrowness of the grounds for disqualification has made it extremely difficult to enforce the act effectively. Congress agreed, and in Public Law 88-750, approved September 13, 1960, gave us authority over books and records of investment advisers comparable in many respects to that contained in section 11 of the bill, and broadened the ground for disciplinary proceedings in a manner somewhat comparable to that provided in section 25 of H.R. 11788. With respect to books and records, the Senate committee in its report stated that this power as granted in the Securities Exchange Act "has been indispensable in enforcing the requirements of the statute." (S. Rept. 1760, 86th Cong. 2d sess., p. 3.) With respect to the same matter, the House Committee on Interstate and Foreign Commerce stated that without the books and records power, the Commission—

has no adequate means of determining whether investment advisers are engaging in fraudulent or deceptive practices in connection with their businesses (H. Rept. 2179, 86th Cong., 2d sess., p. 3).

Section 16 of the bill would appeal to amend section 5(a) of the Commodity Exchange Act to require contract markets to adopt rules with respect to the execution of transactions on such markets as the Secretary of Agriculture may direct. The Commission has comparable authority under section 19(b) of the Securities Exchange Act. While the Commission has only once found it necessary to conduct a formal administrative proceeding under that section, nevertheless, the existence of this authority provides a legal and jurisdictional basis for making such suggestions to the stock exchanges for modification of their rules as the Commission believes necessary and appropriate, and in that way has been of substantial assistance to the Commission in accomplishing desired modifications in exchange rules. Section 19(b) contemplates that before commencing a formal proceeding, the Commission will first request the exchange to make the desired changes in its rules and thus contemplates formal proceedings only if informal measures are not successful. It is usually possible to work these matters out by agreement with the exchanges, but the existence of express statutory jurisdiction furnishes a legal basis for initiating such discussions.

Section 29 of the bill would add a new section authorizing the Secretary of Agriculture, whenever it appears to him that a person has engaged, is engaging, or is about to engage in any conduct which violates the act or the rules thereunder, to notify the Attorney General who may bring an action for an injunction or other appropriate relief. This provision closely resembles section 21(e) of the Exchange Act and comparable provisions in the remainder of the Federal securities laws, except that since the Commission is an independent agency, it brings civil actions itself instead of referring them to the Attorney General.

We have found this provision to be an important, indeed an essential, means of enforcement. There are two primary reasons: First, it enables us to move rapidly when speed is essential to the protection of the public. An administrative proceeding or a criminal prosecution takes considerable time before a final order can be issued or conviction obtained. Often the damage has been done. This is particularly true if a manipulation or fraud is in progress or if a broker-dealer is in violation of the capital rules or is insolvent. A Federal court, on the other hand, has power, if a satisfactory showing is made to it, to enter a temporary restraining order or preliminary injunction which puts an immediate stop to the violation. The second primary advantage of the injunctive remedy is that it is available in situations where a broker-dealer or exchange, subject to administrative proceedings, is not involved and where the necessary evidence of criminal intent is not available, or for any other reason criminal prosecution does not appear appropriate. Absent the power to seek an injunction, the enforcing agency may have no other remedy. Between the enactment of the Securities Exchange Act in 1934 and June 30, 1965, the Commission has brought 1,420 actions to enjoin violations and has obtained injunctions in 1,269 cases. This averages appreciably more than 40 per year.

Finally, we note that section 30 of the bill would make any person who aids, abets, counsels, commands, or induces a violation responsible as a principal. This would, I believe, in any event be the law for purposes of criminal prosecution in view of the provisions of the criminal code. It is equally desirable that this doctrine can be applied in civil or administrative proceedings. For that reason Congress, as part of the Securities Acts Amendments of 1964, amended section 15(a) of the Exchange Act to include a provision comparable to section 30 of the bill to be applied in administrative proceedings against brokers and dealers.

I believe these are the principal respects in which the provisions of H.R. 11788 as applied to the commodities markets parallel the provisions of the Securities Exchange Act of 1934 as applied to the securities markets.

We will be happy to try to answer any questions which the members of the subcommittee may have.

Mr. MATSUNAGA. Thank you very much, Mr. Loomis. We certainly appreciate your contribution. Your experience can certainly be taken advantage of in consideration of H.R. 11788.

Mr. DOLE. I have just one question.

Mr. MATSUNAGA. Please proceed.

Mr. DOLE. I certainly appreciate your very fine statement, Mr. Loomis.

Mr. LOOMIS. Thank you.

Mr. DOLE. I notice that you cited some of the parallels between the Securities and Exchange Commission and the Commodity Exchange Authority in the two bills—this bill and your own operation. Are there any serious questions that you have in your own mind with reference to H.R. 11788 that it might vest too much power in one person, in the Secretary, for example?

Mr. LOOMIS. I have not studied all of it. I am not any expert on the commodities markets, anyhow. I do think there is a tendency where regulatory jurisdiction is vested in one of the executive departments, rather than in an independent agency, to give the authority, at least, in terms to the head of the department, the Cabinet officer. And, presumably, there are people advising and consulting with him as to the exercise of it.

Mr. DOLE. Thank you. That is all.

Mr. MATSUNAGA. Thank you again.

Mr. Hagen?

Mr. HAGEN of California. You mention the injunctive procedure on page 2 and then back over on another page; that is, page 7, is that the same?

Mr. LOOMIS. On page 2 I happen to point out that it seems to me that in injunctions they would be useful in most any regulatory atmosphere; and, therefore, the differences between the two markets might not be as significant in connection with the authority to seek injunctions as it might be, for example, in connection with the authority as to margins. On page 7 I was describing our injunctive authority. Incidentally, in skipping through, I omitted a statement in here that since the act was passed we have brought 1,420 actions to enjoin in violations and have obtained injunctions in 1,269 cases, which averages about 40 a year.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Thank you again.

Mr. LOOMIS. Thank you.

Mr. MATSUNAGA. Our final witness for this morning is Mr. Everette B. Harris, of the Chicago Mercantile Exchange.

**STATEMENT OF EVERETTE B. HARRIS, PRESIDENT, CHICAGO
MERCANTILE EXCHANGE; ACCOMPANIED BY N. A. WERT-
HEIMER, CHAIRMAN OF THE BOARD, CHICAGO MERCANTILE
EXCHANGE**

Mr. HARRIS. First I would like to introduce my colleague, Mr. Wertheimer, who is chairman of our board of governors, whom I am sure will be very helpful in answering any questions if there are any at the conclusion of my statement.

I want to thank you for the opportunity to be here.

My name is Everette B. Harris. I live at 524 Parkwood in Park Ridge, Ill., a suburb of Chicago. Since June 1, 1953, I have been president of the Chicago Mercantile Exchange, an organized commodity exchange, second only to the Chicago Board of Trade in futures

trading volume, and the Nation's largest exchange trading in perishable commodities.

For almost 5 years prior to my present position, I was secretary of the Chicago Board of Trade.

I was born a fourth-generation farmer in southern Illinois. Throughout the years I have maintained an intense interest in farm problems. Because agricultural price determination is so much a part of our economic function on the exchange, I have tried to be a competent student of farm products, farm prices, and all aspects of the intricate marketing mechanisms which have distributed food so efficiently to consumers for the past several decades.

I am a graduate of the University of Illinois with a master's degree from the University of Chicago. I also did graduate work at American University and taught economics in evening schools of the University of Chicago and De Paul University for 5 years. I spent 11 years in the Federal Government; 3 in the Department of Agriculture and 8 in the Labor Department.

That briefly is my background.

I would like to begin my testimony today by saying that I appreciate the opportunity to be here and discuss the pending bill, H.R. 11788. We of the Chicago Mercantile Exchange have always enjoyed excellent relations with the Commodity Exchange Authority and we expect to continue to work closely with the CEA in the future.

Our work with the CEA in the supervision of futures trading on our market embraces (a) examination and analysis of reports and other market data, making market position surveys, and publication of reports on market situations; (b) establishment, review, and enforcement of speculative limits; and (c) cooperative activities with control committees of contract markets.

We have cooperated fully in all CEA investigations. We have submitted minutes of our board meetings and exchange rules and regulations to the CEA for review to insure that legal requirements are met.

We believe that these arrangements have worked well in the past under the capable administration of Mr. Alex Caldwell and predecessors. We believe that they will work well in the years ahead.

Let me detail some of the recent history of the Chicago Mercantile Exchange for you. We have come a long way since Will Rogers dedicated our building just after it was built in 1929. Originally, we were a butter-and-egg marketplace but the times have changed. Because of changing technology in the butter-and-egg industry and Government price-support policies, trading ebbed in these commodities.

To stay alive—just like other free enterprise businesses—we had to look for other products for our exchange. And we found them. Since World War II we have opened several new contracts for various commodities.

Currently we are trading successfully in shell eggs (refrigerator eggs with fresh eggs deliverable at a premium), strictly fresh eggs (a new contract), frozen eggs, butter, frozen pork bellies, live hogs, live beef cattle (deliverable in Chicago or Omaha), and western live cattle (deliverable in Los Angeles). We are especially proud of our markets in live beef cattle, frozen pork bellies (uncured bacon), and live hogs. Before starting these markets we engaged in research in depth using qualified consultants, promotion and educational work

and careful consultation with all types of producer and processing organizations. Prior to the opening of contracts I listed four advantages which I believed would accrue to producers and processors due to their initiation:

1. Price stabilization (elimination of extreme peaks and valleys);
2. Indication of trend of prices which will help producers in their planning;
3. Provide needed price insurance (hedging opportunities);
- and
4. Be a great incentive toward standardization and quality control.

I expressed optimism relative to these futures contracts and confidence that they would be used widely by all elements of the industry to shift price risks to speculators who wish to assume them. Results have exceeded my highest expectations.

In discussing H.R. 11788 I wish to emphasize that I speak only for the Chicago Mercantile Exchange. While there is a great mutuality of interest and cooperation between the several exchanges, each is operated as an individual association of members, and policy for each is determined by their board of governors. Since we have worked successfully with the CEA on controlling commodities on our exchange which are covered by the act, we would see no great opposition to our new and exciting meat markets being placed under supervision. This could, however, be accomplished by an act of Congress, as has occurred with other commodities in the past and would not require passage of the proposed bill.

Our most serious objection to any of the various features of H.R. 11788 is the provision which gives the Secretary of Agriculture authority to set margin requirements on contract markets whenever he—has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, or excessive speculation in any commodity, or any other activity reasonably expected to restrain trade, in connection with the sale of any commodity for future delivery, or in interstate commerce, under contracts made on or subject to the rules of any contract market * * * (sec. 12).

If passed, this provision will give the Secretary unprecedented power. If used mistakenly by the present or any future Secretary, it could disrupt completely and ultimately destroy our entire system of futures trading in agricultural commodities. Margins are presently set by a majority vote of a board of governors. In our case, this is 12 gentlemen of long experience and training in the business who have been selected by a majority vote of our 500 members. It is too important a decision to be entrusted to any one man, in my opinion. Our system has worked well in the past. Futures trading is an efficient, useful, and long-proven marketing mechanism where the forces of supply and demand are brought into open conflict in the marketplace to provide a price which will most efficiently distribute our tremendous agricultural production. It is a most effective price mechanism for rationing food-stuffs so that we need never deplete our stocks completely during a crop year. It is like a valuable watch which has been keeping proper time for a long period. If the watch is taken apart, it may never run again or, if so, may not keep the right time. Unfortunately, there is a tendency to confuse the function of margins on commodity markets

with those set by the Federal Reserve Board for the security markets. There is no valid analogy between the two. In the case of commodities, the margin is "earnest money" which guarantees the sanctity of the contract. In the case of securities it is, of course, the owner's equity or downpayment required to hold title. Title to commodities does not pass to the buyer until actual deliveries are made, in which case the margin actually and automatically becomes 100 percent when the buyer takes title.

It has been indicated in the press and elsewhere that the bill under discussion was proposed due to the famous "salad oil scandal." Speaking before the annual meeting of the American Meat Institute in New York last September, Mr. Ellmore C. Patterson, vice president of the board of Morgan Guaranty Trust Co., stated relative to our market in live beef cattle:

The existence of an effective futures market has proven indispensable in a number of processing industries. Sugar refining is a classic example. In the banking business, the ability to buy and sell currency futures is essential to trading in foreign exchange.

The history of futures markets shows that they take time to develop. Where the industry that utilizes or processes the commodity makes active use of the market, future trading tends to contribute to price stability rather than detract from it. A market evolves in response to the needs it is supposed to fill and the uses that are made of it. The evolution in turn can enlarge the area of usefulness. For instance, the availability of a greater frequency of contracts—possibly one for each month—would increase the usefulness of the market in live cattle futures. And perhaps experience will encourage the opening of trading in additional meat or livestock lines.

It may seem odd for a banker to be speaking favorably of futures transactions in any commodity, after the vegetable oil bath of nearly 2 years ago. But the trouble there was not the futures, but fraud. From a banker's standpoint, I would say in general that a processing industry which is able to hedge its price risks gains added attractiveness both as a borrower and as an investment.

On March 19, 1964, Senator Ellender asked Alex C. Caldwell the following question:

Was there any way by which your Department could have prevented a thing like this? (The "this" refers to the DeAngelis scandal.)

CALDWELL. No, sir. There was no way the Department could have prevented the cash oil operations which allegedly involved some fraudulent warehouse receipts.

At another place, Mr. Caldwell said:

This operation [DeAngelis], Mr. Chairman, was, as I had mentioned earlier, completely outside the futures markets, so I do not believe any strengthening of the regulations of the futures markets would have prevented this situation from occurring. This had to do with alleged fraud which should be covered under various fraud statutes and not under the Commodity Exchange Act.

Not being an attorney, I am reluctant to try to testify as an expert on the many complicated legal aspects of this bill. However, as a layman, it seems to me that the bill in many sections would give the Secretary—one man—absolute authority extending beyond the present authority of other administrative agencies or courts. It provides for the issuance of cease and desist orders for which a person who fails to comply—

shall be fined not less than \$500 nor more than \$10,000, or imprisonment for not less than six months nor more than one year, or both * * *.

It seems to me, based on long experience, that the Commodity Exchange Commission, consisting of the Secretary of Agriculture, the

Secretary of Commerce, and the Attorney General, serves a very useful purpose and should be retained. Many individuals and firms with an interest in futures markets, including businessmen and consumers, deserve a right to be heard by the Secretary of Commerce and the Attorney General as well as the Secretary of Agriculture.

Please do not believe that we oppose any and all changes in the Commodity Exchange Authority regulations. For example, I would like the CEA to have authority to review and approve all of our rules before they go into effect, but not to write the rules for us.

In conclusion, may I respectfully suggest that because of the far-reaching features of certain portions of this bill, it might be referred back to the Department for further study and revision after additional consultation with economists and experienced experts outside of the Department.

Thank you very much.

Mr. MATSUNAGA. Thank you very much for your statement.

Mr. HARRIS. Thank you.

Mr. HAGEN of California. Let me ask you a question. Does the Commodity Exchange Authority now have some regulatory power?

Mr. HARRIS. I think that they have a great deal.

Mr. HAGEN of California. Do they regulate all futures, trading on all commodities?

Mr. HARRIS. No, sir.

Mr. HAGEN of California. Why do they not? I was intrigued by your reference on page 3 to include the meat market. Is this trading in meat included?

Mr. HARRIS. No, sir.

Mr. HAGEN of California. Under their regulations?

Mr. HARRIS. No.

Mr. HAGEN of California. Why not?

Mr. HARRIS. You may recall the onion situation at one time when we traded in onions. You were on the committee, I remember. They were not under the Commodity Exchange Authority. Then Congress did pass a bill putting it under the Commodity Exchange Authority. Then they mistakenly passed a bill taking them out. And now the Government is buying onions to support the price.

Mr. HAGEN of California. Only those commodities which are specified in the statute are under the regulations of the Commodity Exchange Authority?

Mr. HARRIS. Unless Congress puts another commodity under it after these hearings. And it is a rather laborious task to do. It has been done many times.

Mr. HAGEN of California. There are many commodities that are being traded in without any supervision at all in the futures market?

Mr. HARRIS. I will confine my comments to our own. Eggs are under it. Butter is under it. I will confine these remarks to my own exchange. Beef cattle and hogs are not under it, for example. We are fish and fowl in that sense.

Mr. HAGEN of California. On page 3 of your statement in referring to live beef cattle, frozen pork bellies and live hogs, and further, you state—

prior to the opening of contracts I listed four advantages which I believe would accrue to producers and processors due to their initiation, and No. 1, price stabilization (elimination of extreme peaks and valleys)—

that assumes that futures trading prices do affect the ultimate price, is that correct?

Mr. HARRIS. In the long run prices are made by supply and demand, and the other factors that Mr. Mehren mentioned this morning, income levels, substitutions, et cetera. However, in the interim I think that it is considered socially desirable to have prices as stable as practical, as pointed out earlier when someone was upset some years ago when sugar ran up and down hurriedly. That has occurred in some of our commodities at times. Due to the outbreak of war or something of that sort. Normally, year in and year out, there is a more stable price structure when you do have futures, trading than where you do not, because when the price goes low, the people buy price—the general public likes to buy when the price seems to be a bargain, and when the price seems unduly high there is a tendency for the speculating public to take the other side of the hedger's contract. There is strong evidence and indisputable evidence, in my opinion, that futures trading does, over the long run, stabilize prices and I think it is desirable.

Mr. HAGEN of California. Does it affect the actual cash market?

Mr. HARRIS. Not on the average, but in the short run it does, I believe, over a period—over a period of 100 years I do not think that it would.

Mr. HAGEN of California. That was the argument for abolishing trading in onions and abolishing trading in potatoes, that it obviously affected farmers' prices.

Mr. HARRIS. Professor Gray—I have not seen him at these meetings today—I have not seen him for several months—he is from California—made studies that have indicated that since futures trading was stopped in onions they have had more ups and downs and more difficulties. And I have in mind that the U.S. Department of Agriculture's release dated March 14, 1966, says:

USDA announces plans to buy onions. Plans to help growers market abundant supplies of onions through a section 32 (Public Law 320) purchase program were announced today by the U.S. Department of Agriculture.

I will put that in the record, if I may.

Mr. MATSUNAGA. How long is that statement?

Mr. HARRIS. It is very brief.

Mr. MATSUNAGA. Without objection, it will be made a part of the record at this time.

(The document referred to follows:)

U.S. DEPARTMENT OF AGRICULTURE,
Washington, March 14, 1966.

USDA ANNOUNCES PLANS TO BUY ONIONS

Plans to help growers market abundant supplies of onions through a section 32 (Public Law 320) purchase program were announced today by the U.S. Department of Agriculture.

USDA's Consumer and Marketing Service said purchases are expected to be made in onion-producing areas in New York State, where growers are experiencing marketing difficulties.

Buying will begin as quickly as arrangement can be completed. The onions will be distributed to eligible schools and institutions.

Purchases will be made on the basis of onions packed in new 50-pound open mesh sacks, loaded on board cars or trucks (USDA option). Quantities acquired will depend on marketing conditions at time of purchase, and availability of outlets for using the onions without waste.

Announcements containing details and specifications of the offer will be issued shortly by the New York State Agricultural Stabilization and Conservation (ASC) Committee.

Mr. MATSUNAGA. Are there any other questions?

Mr. DOLE. It is noteworthy that you are not opposed to everything in this bill. There are some features of the bill that you can live with?

Mr. HARRIS. That is my opinion. I do not speak for the other exchanges. That is the way we feel about it on our exchange.

Mr. DOLE. What do you feel is the real purpose of this legislation—what is it here for?

Mr. HARRIS. I did not think that there would ever be hearings on the bill, sir. I do not know who is for the bill.

Mr. DOLE. How do you now correct all of the things the Secretary testified about this morning?

Mr. HARRIS. I believe that we could do just as good a job without them, but I think that the public, generally, has a little more confidence. We are partly under it already. And some of these meat associations, for example, the feeders association has been very cooperative with us and very helpful. I think that they have a resolution saying that they thought that they would feel more secure if it were under regulation. I think it might give us a little better public image, but I think that we can do the job ourselves, and we are doing it.

Mr. DOLE. In other words, are you alarmed about all of the things mentioned this morning?

Mr. HARRIS. I am not alarmed about them. I want to say one other thing. So far as our market in meat is concerned we have voluntarily cooperated with the packers and stockyards people. They have called on us for information. They have made a survey of all of our customers' positions. They used the Commodity Exchange Authority to do that. That was completely voluntary on our part at their request. Mr. Don Campbell is the administrator. So I think that we have plenty of Government surveillance at the moment.

Mr. DOLE. Thank you.

Mr. MATSUNAGA. We thank you again for your statement. We appreciate your being here.

Mr. HARRIS. We thank you, sir.

Mr. MATSUNAGA. Without objection, a letter received by the chairman of the committee, Mr. Harold D. Cooley, dated March 28, 1966, will be made a part of the record at this point.

(The document referred to follows:)

WILSON & CO., INC.,
Chicago, Ill., March 28, 1966.

HON. HAROLD D. COOLEY,
*Chairman, House Committee on Agriculture,
House of Representatives, Washington, D.C.*

DEAR CONGRESSMAN COOLEY: I have studied H.R. 11788, which is a bill to amend the Commodity Exchange Act, and am deeply concerned about certain of the provisions therein. Inasmuch as I understand the bill is scheduled for hearing before your committee on April 4, 1966, I take this opportunity to express my views in the hope that they may be useful in the deliberations of your committee.

My interest in H.R. 11788 is based upon memberships held by officers of Wilson & Co., Inc., in the Chicago Board of Trade and the Chicago Mercantile Exchange. These memberships are used in the conduct of certain of the company's operations involving futures transactions in commodities such as lard, pork bellies, dressed beef, and livestock.

The provision of H.R. 11788 of most concern to us is found in section 13 which would enact a new section 4(j) to the act. This new section would authorize the Secretary of Agriculture to prescribe minimum margin requirements in connection with speculative or hedging positions which may be held by persons under contracts of sale for future delivery whenever the Secretary of Agriculture "has reason to believe" such margins are necessary because of danger of manipulation, sudden or unreasonable price fluctuations or unwarranted changes in the price of any commodity, excessive speculation, or any other activity reasonably expected to restrain trade, in connection with the sale of any commodity for future delivery.

In our view, the above provision is totally unnecessary and appears to involve a misconception of the function of margin requirement in relation to commodity futures trading on exchanges such as the Chicago Board of Trade and the Chicago Mercantile Exchange. The purpose of margins with respect to such trading is not the control of credit as in the case of securities, but rather is and has been to provide protection to members of the Commodity Exchange insuring that the financial commitments of futures traders will be fulfilled. The self-imposed margin requirements of the commodity exchanges have heretofore been entirely adequate to accomplish this objective. We are without knowledge of any instance in the past where any of the undesirable circumstances sought to be prevented have in any manner, directly or indirectly, been attributable to the level of existing margin requirements.

There is simply no need to invest the Secretary of Agriculture with authority to prescribe margins when such authority would be unrelated to the objectives sought to be accomplished thereby; namely, control of credit as a means of dealing with excess speculation, manipulation, etc. Moreover, existing authority to fix and limit the amount of trading in commodity futures appears to be entirely adequate to accomplish the objectives sought to be achieved by the new section 4(j). In our view, the new authority to prescribe minimum margin requirements would probably deteriorate to a means of distorting natural and normal price movements contrary to the basic economic function of a commodity market.

Section 2(a) of H.R. 11788 would enact a definition of the word "manipulate," which departs from longstanding judicial definition and which, we believe, is objectionable. The new statutory definition would render unimportant the intent of the trader whose activities are claimed to result in prohibited manipulation. This is contrary to the decided cases dealing with manipulation under the Commodity Exchange Act. For illustration, in the case of *General Food Corporation v. Brannan* (CCA 7) 170 F. 2d 20, the court of appeals adopted a definition of price manipulation under the Commodity Exchange Act as follows (p. 231):

"We are favored with numerous definitions of the word 'manipulation.' Perhaps as good as any is one of the definitions which appears in the Government's brief, wherein it is defined as 'the creation of an artificial price by planned action, whether by one man or a group of men.'" [Emphasis supplied.]

Similarly, in the recent decision of the Court of Appeals for the Fifth Circuit in the case of *Volkart Brothers, Inc. v. Freeman* (December 1962), 311 F. 2d 52, the court approved testimony defining the word "manipulate" (p. 58):

"As Mr. Marsh's testimony indicates, there must be a purpose to create prices not responsive to the forces of supply and demand; the conduct must be 'calculated to produce a price distortion.'"

We believe price manipulation such as prohibited by law should be the intended objective of the person or persons accused thereof. The proposed statutory definition would eliminate the important element of intent and is, therefore, objectionable. Without consideration of the element of intent, many normal price movements might improperly be characterized as "manipulation."

Section 5(b) of H.R. 11788 would vest solely in the Secretary of Agriculture the authority heretofore exercised by the Commodity Exchange Commission composed of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General. We believe the continued existence of a Commodity Exchange Commission so composed is desirable and in the public interest. The responsibilities exercised under the act are complex and most important. The experience, knowledge, and judgment of the Secretary of Commerce and the Attorney General should be availed of in the discharge of such responsibilities.

We urge your thoughtful consideration of the foregoing.

Sincerely,

ROY V. EDWARDS.

Mr. MATSUNAGA. The subcommittee will stand in recess until 10 o'clock tomorrow morning.

Thank you.

(Whereupon, at 12:15 p.m., the subcommittee was in recess, to reconvene on Tuesday, April 5, 1966, at 10 a.m.)

TO AMEND THE COMMODITY EXCHANGE ACT

TUESDAY, APRIL 5, 1966

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MARKETING
AND CONSUMER RELATIONS OF THE
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1301, Longworth House Office Building, Washington, D.C., Hon. Spark M. Matsunaga (chairman of the subcommittee) presiding.

Present: Representatives Matsunaga, Cooley, Hagen of California, Redlin, Greigg, Teague of California, and Dole.

Also present: Representative Grider, of Tennessee.

Christine S. Gallagher, clerk; Hyde H. Murray, assistant clerk; and Fowler C. West, staff.

Mr. MATSUNAGA. The Subcommittee on Domestic Marketing and Consumer Relations of the House Agriculture Committee will come to order, please.

We will now continue our public hearing on H.R. 11788.

The first witness for this morning is Mr. Robert L. Martin, chairman of the Chicago Board of Trade. We will be glad to hear from you now.

STATEMENT OF ROBERT L. MARTIN, CHAIRMAN, CHICAGO BOARD OF TRADE; ACCOMPANIED BY WARREN M. LEBECK, EXECUTIVE VICE PRESIDENT AND SECRETARY OF THE CHICAGO BOARD OF TRADE; AND JOHN E. NOLAN OF STEPTOE & JOHNSON, WASHINGTON LEGAL COUNSEL

Mr. MARTIN. Mr. Chairman and members of the committee, my name is Robert L. Martin. I am an officer of Archer-Daniels-Midland Co. and am currently the chairman of the board of directors of the Chicago Board of Trade.

I am accompanied on my left by Warren M. Lebeck, executive vice president and secretary of the Chicago Board of Trade, and on my right by John E. Nolan of Steptoe & Johnson, Washington legal counsel.

I appear today on behalf of the Chicago Board of Trade. For the board, I would like to thank you for this opportunity to appear before your committee.

As you know, commodities trading is the Chicago Board of Trade's function and has been its day-to-day business for the past 118 years. During this period, the board has developed an essential role in

minimizing the cost of marketing commodities including wheat, corn, oats, rye, soybeans, and soybean products. These commodities now move in ever-increasing volume from American farms to American consumers and businesses, and to foreign lands.

No phase of the board's existence is of greater concern to it than its responsibility to the public at large. In distribution of basic agricultural commodities, the board is an essential link between the American farmer and the American consumer. We are conscious of our responsibility to both.

Thus, the regulation of commodity futures trading is of the most vital interest to us. We have carefully reviewed H.R. 11788, and I will be glad to give you our impressions of those parts of the bill that we consider most significant.

It might be helpful at the outset to deal with one misunderstanding that has gained some currency. This is not a bill to prevent another "DeAngelis affair." Officials of the CEA and the Department of Agriculture have readily conceded this, most recently in this hearing yesterday.

For this reason we may consider the main provisions of H.R. 11788 on their merits apart from the emotional response arising from reference to Mr. DeAngelis.

I would like to speak first about that provision of the present bill which would give the Secretary of Agriculture the authority to prescribe margins, under certain conditions, for commodities futures. To us this does not seem to be a wise or a desirable provision. I would like to tell you why.

First, candor and direct statement are commendable in everything; no less so with legislation. In our view, this provision suffers from lack of candor. It was originally described by the letter of transmittal as a measure to prevent a recurrence of the DeAngelis affair. Later, before representatives of the grain trade in Chicago, the Department emphasized its price control purpose. Yesterday you were told that it is really aimed at "danger of manipulation," "sudden or unreasonable fluctuations," "unwarranted changes in * * * price," "excessive speculation"—which is an interesting phrase—and restraint of trade. These, of course, are undesirable conditions. They are conditions which we at the Chicago Board of Trade would oppose with all of the force at our command.

But I doubt that these conditions can be the real purpose of the legislation before your committee now.

There has not been, in regulated commodities, the kind of manipulation, unreasonable fluctuation, or excessive speculation on which this section would appear to be based. Interestingly enough, the Department in proposing the bill does not even suggest that such conditions have existed at any time since the release of price controls after World War II.

Beyond that it has not been suggested that the self-regulation of the exchanges themselves has not proved an entirely adequate means of setting commodity futures margins. At the Chicago Board of Trade establishment of margins is vested in the board of directors. This complex and delicate function is regarded as a trust. It is discharged by men representing the broadest range of interests in the market. The factors on which they rely are under constant, even hourly, surveillance. They operate against a background of years

of experience in commodity futures. They have always cooperated closely with the CEA.

And we tend to feel that they have compiled an impressive record. It is a record of which we are proud because the conditions listed in the bill have not occurred. We have maintained a free and fluid market; we have maintained stable prices which have served well the interests of farmer and consumer.

There is no need for such a provision to maintain stability in the commodity futures markets. To the extent that its purpose is to provide the Secretary of Agriculture with a means of controlling the prices of commodity futures, we feel that it is unwise and inappropriate.

It is true that we live in troubled and uncertain times. Twice in the past quarter century wartime conditions have made it necessary to impose mandatory price controls on the American economy. If similar conditions should arise in the future, we would not urge that an exception be made for commodity markets. In the absence of a general price control, however, we do urge that it is neither effective nor desirable to single out commodity futures for selective price control treatment.

I know that the members of this committee have a good general background in commodity futures trading, and I would not attempt a review of that broad subject here. There are, however, some general areas of misunderstanding arising from the comparison of the commodity futures market to the stock market. It might be helpful to mention these areas specifically and to keep them in mind as we talk about the attempt to control prices by controlling margins.

1. Unlike the stock market, in the commodity futures market margins are not downpayments on credit transactions. They are merely payments designed to guarantee performance on futures contracts—either to buy or to sell. A futures contract is an agreement to make or take a delivery at a future time. When the delivery is made or taken, it is a cash transaction—immediate payment by certified check with no credit involved. Since commodity futures contracts are not credit transactions, raising commodity futures margins does not limit credit and thus hold back price. For this reason, the Federal Reserve Board's power—as a credit-regulating agency—to prescribe margins for stock purchases is entirely inapplicable to futures trading.

2. Also, unlike the stock market, new capital flows into the commodity futures market on the selling as well as the buying side. Thus, the pressure of new capital is deflationary as well as inflationary. In the stock market, however, the flow of new capital is always inflationary. Furthermore, as market economists generally agree, increased participation in the commodity markets makes for a broader, more stable market. This fact was recognized earlier by Chairman Cooley, of your committee, when he observed that:

Where there has been a relatively small volume of trading the increase in price tends to be even larger than where there are many traders and much activity in the market (96 Congressional Record 11754).

3. Finally, unlike the stock market, commodity futures prices are already limited by firm controls other than margins. Every board of trade commodity futures price is subject to a daily trading limit, a

maximum possible price variation in any one day—10 cents for wheat, 8 cents for corn, 6 cents for oats, et cetera. These, I might add, are adopted and enforced by the exchange itself. In addition, futures prices normally come to the actual price of the commodity itself from 4 to 12 times each year during delivery months. There is in the stock market no comparable automatic adjustment.

These considerations demonstrate that commodity futures margins have a different function and serve a purpose different from stock margins. Much of the confusion in discussing commodity futures margins, however, arises from talking about them as if they were stock margins. They are not, as both the Department of Agriculture and the SEC testified here yesterday.

There is rather general agreement among economists on the effect that increased commodity futures margins would have on market participation and on the cost of doing business through a commodities market. Higher margins would decrease participation and increase costs of using the market. But there is not general agreement that higher margins would control the prices of commodities, or even commodity futures. In earlier debates on this subject, for example, Congressman Hale Boggs observed:

The idea that by controlling margins on commodity exchanges, price advances can be controlled has no foundation in fact (96 Congressional Record 11759).

I might add that at the time of Congressman Boggs' statement the identical margin authority sought here was thoroughly considered, debated, and rejected by the Congress.

It is true that raising margins is likely to decrease participation of the speculative interest in the market. But as the market becomes thinner it becomes more volatile. Price swings are greater and prices are much less stable.

In any commodities market, the interests of those who must use the market—farmers, elevator operators, processors, et cetera—are accommodated by the speculative interest, the traders who may buy or sell on differences of a fraction of a cent. In thin or inactive markets, such traders must take much wider profit margins than they otherwise would. They must do so because their volume of transactions is restricted and their risk is proportionately greater. They have to hold their contracts longer and are thus more exposed to unexpected price fluctuation.

It is demonstrable that a thin market increases the cost of doing business to the farmers, elevator operators, and others who must use the market to "hedge" as a form of business insurance. This increased cost hits such users with double impact; first, when their hedge is established; second, when it is eliminated. When such increased costs are added, they result—at the end of the line—in higher actual prices to consumers.

Even if the Secretary of Agriculture were all-knowing, and exercised perfect judgment in setting margins, this proposal would not be justified. It is clearly unnecessary for the purpose stated. In the considered judgment of Congress, and the best economic opinion as well, it would be an ineffective price control measure. Its maximum use could result only in a costlier market.

For these reasons we would urge that the untried and controversial device of Federal margin control not be imposed on the delicate mechanism that is the commodity futures market.

I should like to discuss next—and only very briefly—that provision of the pending bill which defines “manipulation.” If it is necessary to define “manipulation” in the statute, I would strongly urge that any definition be written with much more precision than that included here.

I think we could all agree that the very essence of manipulation must be intent. We all know that perfectly legitimate transactions can affect commodity prices. The likelihood of a transaction or series of transactions affecting price increases as the market becomes thinner, as the quantity bought or sold becomes larger, or as the delivery date approaches. Yet under the literal wording of the provision contained in this bill legitimate and unintentional conduct could be subject to prosecution and could be punished by imprisonment and heavy fine.

Although I am not a lawyer myself, this seems basically unjust and unfair to me. In explanation, I have heard that courts would always require some showing of intent. I think that makes this provision, as written, much worse. It is inexcusable that the law should say one thing and mean another. If intention is really an essential element of manipulation—as everyone would agree that it is—then this requirement should be written in plain language in any statute that defines the offense.

Beyond that, I am advised by legal counsel for the Board that they have found no statute and no decided case that attempts to define “manipulation” as a criminal offense without reference to intent. Such a definition, I am further advised, would be of questionable constitutionality because it would be too vague to inform a potential defendant of the offense with which he was charged.

Finally, I must admit to some question regarding the necessity for a statutory definition at this time. In more than 40 years under the Commodity Exchange Act, or its predecessor, the courts have had no difficulty in defining the crime. A substantial body of judge-made law had built up as a result, and I doubt that it could be improved by a new definition at this point. If “manipulation” is to be defined, however, it should be with fairness and precision.

There are several other aspects of the bill which raise substantial questions in the view of the Board.

Section 16(b) of the bill would authorize the Secretary of Agriculture to direct that certain terms and conditions be inserted in contracts of sale to be executed on the commodities exchanges and also to provide “bylaws, rules, regulations, and resolutions” relating to trade. This is a sweeping grant of practically unlimited power to the Secretary. It could spell the end of responsible self-regulation by the exchanges. I understand that similar authority in the Natural Gas Act allowing the Federal Power Commission to insert reasonable terms and conditions in certificates granted to natural gas companies is now used as the authority for establishment by the Commission of price conditions in certificates that it grants. This provision could establish federalization of the free commodity futures markets. We strongly urge that the committee eliminate this section entirely.

Section 21 of the bill would authorize the Secretary of Agriculture to issue cease-and-desist orders against any person engaging in “any unfair or deceptive act or practice” or “any action with the intention

or having the effect of restraining trade." Section 29 provides for broad injunctive powers. We would urge that the authority to issue cease-and-desist orders against "any unfair * * * act" would be so broad as to be almost without limit. The potential of such cease-and-desist orders to injure seriously the delicate balance of the commodities market is unlimited. The standards for this authority should be carefully stated in terms of the statute being administered and the "restraint of trade" objectives of the antitrust law should not be included in this statute if there is to be an orderly administration of Federal law. Like cease-and-desist orders, injunction proceedings can disrupt the market and throw it into chaos. Such disruptions can be harmful to everyone, not merely the party defendant. In our view these additional powers are dangerous and wholly unnecessary for proper administration of the act.

There are other provisions of the bill which seem to us unneeded and inappropriate. There are some to which we would certainly register objection if we were to treat the bill section by section. But beyond such specific and detailed comment, there are a few broad observations that I should like to make.

First, as I listened yesterday to Department witnesses testify in behalf of this bill, it seemed to me unusual that they were able to cite no specific market occurrence since 1947 that the bill was intended to correct. And this was resolved by the Board.

Second, I believe that the Commodity Exchange Act is effectively administered, and I was impressed that this has been accomplished with only 31 legal actions instituted in the past 30 years. That is a significant tribute to the self-regulatory activities of the exchanges themselves.

Lastly, we recognize, of course, that the exchanges are charged with a public responsibility. Their function affects farmers and the public generally. They are essential to the entire agricultural marketing system. From this broad spectrum of interests I know of no one who is coming here to urge passage of this legislation. Although there must be some such interests supporting the bill, I was surprised that none have been identified thus far.

In closing, let me again express our appreciation for the courteous hearing which you have afforded our views. If you have any questions, I will be glad to try to answer them now.

Thank you.

Mr. MATSUNAGA. Thank you. Thank you very much, Mr. Martin. We, certainly appreciate your contribution to our consideration of H.R. 11788. We appreciate the analysis of the bill, section by section, and the important sections of it. I am inclined to agree with you that thus far there has been no real need shown for the bill.

Are there any questions?

Mr. TEAGUE of California. I did not have any questions. I was going to make a very similar remark. I have an open mind on this whole subject.

I might compliment Mr. Martin on his statement.

So far as I am concerned, you have made a very much more convincing case against the bill than Secretary Mehren did yesterday for it.

Mr. MARTIN. Thank you.

Mr. MATSUNAGA. Mr. Hagen.

Mr. HAGEN of California. Mr. Martin, I understand that there are certain commodities which are specified in the statute. Is that correct?

Mr. MARTIN. Yes, sir.

Mr. HAGEN of California. Then, there are certain other commodities which are traded in on the futures market that are not specified?

Mr. MARTIN. Yes, sir. We call these regulated or unregulated commodities.

Mr. HAGEN of California. Some of them are regulated and others are not regulated?

Mr. MARTIN. Yes, sir.

Mr. HAGEN of California. Is not one purpose of this bill to give the Secretary of Agriculture the authority to determine which commodities would be regulated?

Mr. MARTIN. Which would be regulated, you mean?

Mr. HAGEN of California. Pardon.

Mr. MARTIN. Which would be regulated?

Mr. HAGEN of California. Would you object to that part of the bill?

Mr. MARTIN. All of our commodities regulated, say, except for our most recent one, steer carcasses. We, and our exchange, have no objections; no.

Mr. HAGEN of California. I see. Are there other provisions in here which are merely designed to guarantee to the people involved in the trading that the people they deal with be honest and solvent? Do you object to that provision?

Mr. MARTIN. No, sir; we do not. However, at the board of trade we have our own such requirement. I would think that it might be simpler and we might insert a clause here that the members of no organized exchange be licensed and inspected by the Department. There is a little concern that the Department could set standards, financial requirements so high that only large corporations could engage, or someone of very large financial standing would be able to engage in the trade. However, I am sure that the Department would cooperate. In this area, I say that we generally have no objections.

Mr. HAGEN of California. Also, it is my understanding that they are attempting to reach the people who are, perhaps, not members?

Mr. MARTIN. These are the people that we would hope that they would reach; yes.

Mr. HAGEN of California. And you would agree with that?

Mr. MARTIN. Absolutely.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Mr. Greigg?

Mr. GREIGG. No questions.

Mr. MATSUNAGA. Mr. Dole.

Mr. DOLE. You have presented a very fine statement, Mr. Martin. I agree with Mr. Teague and with the chairman that there has been no case made for the bill.

The primary concern, at least, one of them, is an attempt by the Department to write in a definition of the word "manipulate." That is, without any showing of intent.

As you point out in your statement and as was pointed out yesterday in other statements, this is a criminal statute and I doubt that anybody should ever be found guilty of a criminal act unless there was

intent. Apparently, the definition contained on page 2 would permit a finding of guilty of manipulating when, in fact, the accused may have been completely innocent in the case. You have covered that very well, starting on page 8 of your statement.

I would, also, add, the Department has, in effect, indicated there is not any real need for this legislation. As you point out, it was necessary to go back in 1947 to find an example.

What do you feel the real purpose of the legislation is?

Mr. MARTIN. Until yesterday, I would have said for price control, an ill-advised effort that would not have accomplished this mission but, an attempt at it. After yesterday's testimony, I do not know.

Mr. DOLE. You do not think that there is any purpose—that there is not any real need for it?

Mr. MARTIN. I could not presume just what lies behind it. I do not know.

Mr. DOLE. Thank you.

Mr. MATSUNAGA. Mr. Teague.

Mr. TEAGUE of California. I think that Mr. Dole should be cautioned about being a lawyer. Last week somebody in my district stated that I was a member of the most corrupt union in the world, the California State Bar Association.

Mr. MARTIN. Mr. Teague, if I might say this—

Mr. DOLE. That was in California.

Mr. MARTIN. Congressman Teague made the comment today and I noticed that yesterday 200 people disavowed being lawyers. I do not know exactly what that means. [Laughter.]

Mr. MATSUNAGA. Mr. Redlin?

Mr. REDLIN. No questions.

Mr. MATSUNAGA. If there are no further questions, we thank you again.

Mr. MARTIN. Thank you, sir.

Mr. MATSUNAGA. Is Mr. James M. Clark, president of the New York Coffee & Sugar Exchange, Inc., here? Mr. Clark has to attend a funeral of a friend today. Is there any objection to Mr. Clark testifying at this time ahead of the others? If not, Mr. Clark, will you take the witness stand and we will be glad to hear from you now.

STATEMENT OF JAMES M. CLARK, PRESIDENT, NEW YORK COFFEE & SUGAR EXCHANGE, INC.; ACCOMPANIED BY EARLE T. MAC HARDY, VICE PRESIDENT, REFINED SYRUPS & SUGARS, INC.; LEON ISRAEL, JR., PARTNER, LEON ISRAEL & BROS.; JOHN C. GARDNER, PRESIDENT, LOWRY & CO., INC.; AND EDWIN B. DEXTER, EXECUTIVE DIRECTOR, NEW YORK COFFEE & SUGAR EXCHANGE

Mr. CLARK. Mr. Chairman and members of the committee, I appreciate very much your allowing me to speak out of turn.

My name is James M. Clark. I am president of the New York Coffee & Sugar Exchange, Inc., located at 79 Pine Street, New York. In private business I am vice president of Anderson, Clayton & Co., of 120 Wall Street, New York. Here with me are my associates, three past presidents and active members of the exchange. They are Mr.

Earle T. Mac Hardy, vice president of Refined Syrups & Sugars Inc.; Mr. Leon Israel Jr., partner of Leon Israel & Bros.; and Mr. John C. Gardner, president of Lowry & Co., Inc. Also with me today is Edwin B. Dexter, rear admiral, U.S. Navy, retired, who is executive director of the New York Coffee & Sugar Exchange.

I have been directed by the board of managers of our exchange to make the following statement in opposition to passage of H.R. 11788—a bill to amend the Commodity Exchange Act.

The New York Coffee & Sugar Exchange, Inc. is a non-profit membership corporation. It exists to provide facilities for the trading in futures delivery contracts of coffee and sugar. These facilities are used extensively by the coffee and sugar trades of the world for hedging purposes.

Our exchange is managed by a board of managers—all members of the exchange and responsible members of the coffee and sugar trades—who serve without compensation. The board of managers provides for the maintenance and staffing of this trading place, and establishes and administers rules governing and trading. The exchange neither buys nor sells any contracts for its own account. The exchange does not make or fix prices for coffee and sugar contracts. It reflects prices resulting from transactions in the free market place.

All orders to buy or sell coffee or sugar futures contracts must be executed by members who have previously satisfied the board of managers as to their qualifications. The exchange also disseminates statistical information, maintains grading and inspection systems, and licenses warehouses where the delivery of the actual commodity against futures contracts can be accomplished.

The New York Coffee & Sugar Exchange provides facilities for trading in two sugar futures contracts and three coffee futures contracts—each of which is designed to serve a particular marketing function to the trade. The contracts differ from each other in some respects, but each contract has the following characteristics:

1. It involves the same basic unit of coffee or sugar.
2. The basic terms are identical.
3. Prices are made by open outcry publicly reported from the trading floor within prescribed hours.
4. It stipulates a basic grade and type but may have other grades deliverable at predetermined price differentials.
5. Delivery must be made during a specified period—usually in a single calendar month.
6. All transactions are recorded by the exchange and their performance is protected by the New York Coffee & Sugar Clearing Association.

Our exchange has been operating for more than 84 years. Our clearing association has been protecting our buyers and sellers for more than 50 years—and in all that time, there has never been a single default on any contract.

We feel that our performance is proof of the effectiveness and adequacy of our own regulatory and disciplinary machinery.

Our board of managers consists of 15 elected members. Our bylaws and rules empower the board to deal effectively with any situation affecting just and equitable principles of trade or any conduct detrimental to the best interests of the exchange and the public.

The board of managers sets minimum original margin requirements which must be charged by members. The board can raise this minimum requirement without notice if changing market conditions warrant.

The board of managers can discipline any member for improper conduct on the trading floor on the recommendation of the floor committee. Any member suspected of improper business conduct or dealings is subject to investigation by the business conduct committee. If found guilty, he may be disciplined by the board of managers. Such discipline could include expulsion from the exchange.

Any member accused of willful violation of the bylaws or rules, or of fraudulent breach of contract, or of any conduct detrimental to the best interests of the exchange is granted a formal hearing before the adjudication committee. On the basis of the report of the adjudication committee, the board of managers may censure, fine, or suspend the accused member. Should the circumstances warrant, the accused member may be expelled from the exchange.

If the board of managers believes that a trade situation may exist which might jeopardize the normal functioning of the exchange, the board can appoint a control committee which receives from the treasurer of the New York Coffee & Sugar Clearing Association information submitted by members with respect to their own and their clients' positions and accounts. The treasurer reports to the control committee, using numbers and symbols in place of names. If an examination of this report indicates that a market situation does exist which might jeopardize the normal functioning of the Exchange, or be prejudicial to the public interest, the control committee may obtain the names attached to any number or symbol and summon the affected member or members to appear with their records.

The control committee endeavors to bring about a voluntary correction of the situation, failing which the committee reports to the board of managers. The board of managers may require liquidation, within a specified time, of any portion of any member's open contracts. If any member fails to comply with the requirement of the board, he is subject to censure, fine, suspension, or expulsion.

Other active, working committees make recommendations to the board of managers concerning qualifications of applicants for membership, matters pertaining to storage and handling of coffee and sugar involved in exchange deliveries, needful rules governing commissions and the employment of agents and representatives, and all other matters affecting exchange management.

And if the committee would like, I would be glad to make a copy of our bylaws a part of the record.

Mr. MATSUNAGA. How long is that? It can be made available for the members of the committee?

Mr. CLARK. It will be made available to the committee; yes, sir. (The document will be found in the files of the committee.)

Mr. CLARK. We believe that trading in commodity futures contracts can be regulated and policed effectively only by responsible, experienced members of the trade served by the commodity market involved. For 84 years, the facilities of the exchange have been used extensively for hedging purposes by coffee producers, merchants and roasters, and by sugar producers, refiners, merchants, and industrial users; and we

submit that an impartial examination of our regulatory mechanism as outlined, and our record of enforcing it over the past decades will show that there is no necessity or justification for additional restrictive or hampering legislation, and that the exchange has been managed responsibly in the best interest of buyers, sellers, and the public.

Therefore we are opposed to the amendments to the Commodity Exchange Act—which would be made effective if H.R. 11788 were enacted into law. And we are particularly opposed to section 2 of H.R. 11788.

The New York Coffee and Sugar Exchange is not now subject to regulation by the Commodity Exchange Authority. The present act, however, does have a provision requiring specific examination by Congress of the trading situation in coffee, sugar, or any other unregulated commodity, and legislative action, before Government controls can be imposed. We do not consider this provision unreasonable as it permits the exchanges to have their “day in court.”

But the basic issue before this subcommittee is not whether coffee and sugar should be brought under the Commodity Exchange Authority by legislative enactment. The true issue is whether the Commodity Exchange Act is to be amended in such manner that the Secretary of Agriculture may, at any time, at his sole and personal discretion, and without legislative hearings, could subject trading in coffee and sugar futures contracts to regulation by executive government authority to an extent which could threaten the continued operation of the exchange as an organized commodity market. We are opposed to such change.

We are also opposed because of the nature of our commodities. All the coffee deliverable on the exchange is grown in foreign countries. Most of the raw sugar traded on our exchange is produced in foreign countries. There are well-organized markets in foreign financial centers for trading in both of these commodities. If trading in coffee and sugar on the New York Coffee and Sugar Exchange is subject to hampering regulations contemplated by H.R. 11788, in our opinion trading in New York will dry up. The business will move to London or Paris, or other foreign markets with the obvious effect of our nationals being forced to “hedge” in foreign markets with an adverse affect on the U.S. balance of payments.

Other sections of H.R. 11788, if enacted into law, would increase the power of the Secretary of Agriculture to interfere in futures trading on regulated exchanges in a manner we consider unnecessary and undesirable. A commodity exchange is the meeting place for worldwide buyers and sellers to exchange their goods and serves the trade as a means for hedging market risks. Hedging is, in the simplest terms, a means of spreading the risk of market, or price insurance. To be effective in performing these functions, the cost of trading must be reasonably low, trading rules and regulations must be promulgated, constantly scrutinized, and rigidly enforced in the interest of both buyers and sellers. There must be some price fluctuation to attract an active trading interest and to give the market breadth, which keeps costs low and price fluctuations reasonable. If these conditions exist, prices of the commodity will fluctuate with the impact of economic factors, international movement of the commodity will be accomplished in the most efficient and economical manner, and the hedging operations of trade firms will be facilitated.

It is difficult, if not impossible, to anticipate the fluctuation of prices in any commodity market for any substantial period of time. However, the amendments proposed in H.R. 11788 not only assume that the Secretary would be able to do this, but also assume that the Secretary of Agriculture would be able to take quickly the necessary corrective action. Such infallibility is impossible. Virtually all marketing situations are self-correcting through the discipline of a competitive market. We believe the management of a commodity exchange, constantly in touch with every detail of the trading situation, is in the best position to take appropriate action. The management of the New York Coffee and Sugar Exchange accepts this responsibility and is accountable for it.

In conclusion, we are sure that an impartial examination of the operation of the New York Coffee and Sugar Exchange will support our contention that the exchange is managed responsibly in the best interest of buyers, sellers, and the public. We are not subject to regulation by CEA and are opposed to regulation of trading in coffee and sugar futures, but we stand ready to cooperate at all times with congressional committees and Government agencies to the fullest extent.

Representatives of the exchange gave testimony and volunteered information in 1954 when coffee prices rose spectacularly. In 1963, when sugar prices doubled during the first half of the year, the exchange cooperated with the Commodity Exchange Authority and the Federal Trade Commission. In 1964, when the Consumer Affairs Subcommittee of the House Banking Committee inquired into a rise in the price of coffee, I presented testimony on behalf of the exchange, and we cooperated with the subcommittee in every way possible. We shall continue to cooperate with all public agencies without reservation.

We are proud of our record of responsible exchange management for 84 years. However, if there is any belief in informed quarters that the New York Coffee and Sugar Exchange is conducting its affairs in a manner not in the best interests of producers, consumers, and the general public, we want our day in court before the Congress of the United States. Our day in court is assured under the provisions of the present Commodity Exchange Act. It would be denied to us if section 2 of H.R. 11788 were enacted into law.

As you ladies and gentlemen know, our State Department and even our President have taken an active interest in the developing nations which produce most of the coffee and sugar, and have pledged U.S. cooperation and support. This would suggest that Congress may not want to abdicate its legislative powers to permit the Secretary of Agriculture to make sweeping changes in the present method of marketing these highly sensitive world commodities.

This completes our formal statement. My associates and I will be glad to try to answer any questions any of you may have.

Mr. MATSUNAGA. Thank you very much, Mr. Clark. Before we proceed, I would like to note the presence of our chairman, Mr. Cooley.

Mr. COOLEY. Thank you.

Mr. MATSUNAGA. I might say that you have a very highly disciplined setup here. Perhaps, the standards of it might be even higher than those proposed in H.R. 11788. I want to congratulate you. I did not realize that you had been in existence for 84 years, and that you

have not had any breach of contract in all of that time. That is quite a record.

Mr. CLARK. Thank you, sir. We think that it is a good one, too.

Mr. MATSUNAGA. Do you have any questions?

Mr. TEAGUE of California. No questions.

Mr. MATSUNAGA. Mr. Hagen.

Mr. HAGEN of California. I would like to ask one question about sugar, Mr. Clark. In the light of our sugar quotas and a separate domestic market, would there not always be an exchange in New York City or somewhere in the United States, regardless of what the regulation would be?

Mr. CLARK. Not necessarily. I am not a sugar expert and I would like to ask Mr. MacHardy to answer that one for you.

Mr. MACHARDY. Well, not necessarily. Our exchange deals in world sugar and foreign sugar, for distribution in the United States under the Sugar Act. We are firmly convinced that were these regulations effective with regard to sugar trading that any trading in world sugar futures would move to London or to Paris where there are organized exchanges, and the cost of trading in contracts would be increased to such an extent that the trading of sugar in the United States would not use the market for hedging purposes to the extent that they do now.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Mr. Greigg.

Mr. GREIGG. Did you hear Congresswoman Sullivan's testimony yesterday?

Mr. CLARK. Yes, sir; I did.

Mr. GREIGG. On page 8 of your testimony this morning you make this comment:

Virtually all marketing situations are self-correcting through the discipline of a competitive market.

Mr. CLARK. Yes, sir.

Mr. GREIGG. Some years ago in the situation that Mrs. Sullivan referred to yesterday, so far as coffee was concerned, what did you consider that discipline to be at that time?

Mr. CLARK. But as we talked about at that time, the rise in price of the coffee was due to crop conditions in Brazil—primarily in Brazil—drought and other conditions. And the competitive market was simply operating because there was a temporary shortage of coffee. Once the new crops came out and the trees in Brazil were covered, the price came down.

Mr. GREIGG. Mrs. Sullivan said yesterday that the whole coffee situation was a coffee hoax. Do you wish to comment on that?

Mr. CLARK. I cannot agree with her. I do not think that it was a hoax. I think the statistics of the Department of Agriculture itself will show what happened, that there was just not enough of coffee or a threat of not enough coffee for the world uses in 1954.

Mr. GREIGG. Thank you.

Mr. MATSUNAGA. Mr. Hagen.

Mr. HAGEN of California. Why do you object to being placed under the CEA when these other commodities which have world markets, too, are under it? And they, apparently, do not seek exclusion.

Mr. CLARK. First, I would say that we see no need for it, because we have been able to handle our own affairs pretty well for 84 years.

Secondly, our commodities are produced in foreign countries and are involved in foreign trade agreements, and so forth. And this makes control of them pretty difficult for our Department of Agriculture.

Mr. HAGEN of California. That would be true of coffee, but it would not be true of sugar. We have a world market in cotton and there is a future market.

Mr. CLARK. Yes, sir; but cotton is exported from here, not imported into here.

Now, in sugar, we deal in two kinds of sugar, one, the domestic sugar and the other, world sugar. There are 4 million tons of foreign sugar, I am told, which are dealt with in our exchange.

Mr. HAGEN of California. What is the country's domestic consumption of sugar? And how is that supplied?

Mr. GARDNER. The total consumption is approximately 10 million tons, with approximately 6 million tons produced by the domestic industry and 4 million are imported from foreign countries, including the Philippines.

Mr. HAGEN of California. Has any effort ever been made to include these commodities under the jurisdiction of the CEA?

Mr. CLARK. Yes, sir. We have been before several committees on this very problem.

Mr. HAGEN of California. Apparently, these other commodity groups that are under the CEA are seemingly satisfied, and I would think that you would be, too.

Mr. CLARK. Basically, we think that we can regulate ourselves. Frankly, the less regulation, the better we like it. We believe in the free enterprise system, unhampered by regulations as much as possible. If we misbehave, we expect you to call us up and give us our day in court and we will see where we come out.

Mr. HAGEN of California. You report to nobody now, is that—nobody looks at your operations?

Mr. CLARK. Yes; the Congress can look at our operations any time that it wants to do so.

Mr. HAGEN of California. That is not the same thing. It is not like some agency looking at you.

Mr. CLARK. We have visits by the Federal Trade Commission and by the CEA, and they have gone through our books and records, and have not come up with anything that they have told us about, that are not in the best interests of the public.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. With reference to the remarks of Mr. Hagen about the State of Hawaii, in order that there might not be any misconceptions, I might point out to the gentleman that Hawaii has in fact been meeting its quota on sugar. I say this to keep the record straight on that point. You've got to watch these beet sugar people. [Laughter.]

Had H.R. 11788 been the law in 1963 and 1964, when there were price fluctuations in sugar, would it have controlled prices or would it not have helped at all?

Mr. CLARK. In my opinion, Mr. Chairman, it would not have had the slightest bit of effect on it because the price rise in 1964 was

caused by natural causes and the price rise in 1963 in sugar was caused by the same thing. You had a bad crop of sugarbeets in New York and the Cuban crop was low. I think this is proven by the fact that the London Terminal market in sugar was always slightly higher than our market in the United States for No. 8 sugar.

Mr. MATSUNAGA. So that H.R. 11788 would not have served the purpose of controlling the fluctuations in the price?

Mr. CLARK. No, sir. I do not think that you can pass a law that will control prices when these prices are determined by supply and demand and, also, really, governed by what the Good Lord is going to do with the crop.

Mr. MATSUNAGA. Do you have any questions, Mr. Chairman?

Mr. COOLEY. No, thank you very much.

Mr. MATSUNAGA. Mr. Redlin.

Mr. REDLIN. No thank you.

Mr. MATSUNAGA. Mr. Grider.

Mr. GRIDER. I would like the privilege of introducing the next witness, but I have no questions.

Mr. MATSUNAGA. Thank you again, Mr. Clark. We certainly appreciate your being with us.

Mr. CLARK. May I leave our bylaws with the committee?

Mr. MATSUNAGA. Yes, please.

The next witness is Dr. Roger W. Gray of Stanford University, California, on behalf of the Food Research Institute.

Do you have any comments, Mr. Teague?

Mr. TEAGUE of California. I would like the privilege of meeting Dr. Gray. Perhaps, I should introduce him, because I spent many years at his university. So, I now present Dr. Gray, whom I have not met.

Dr. GRAY. Thank you.

Mr. MATSUNAGA. You are very ably represented on this subcommittee Dr. Gray. We have two Californians here. They sit to my right and to my left. You may proceed.

STATEMENT OF DR. ROGER W. GRAY, PROFESSOR, STANFORD UNIVERSITY, ECONOMIST IN FOOD RESEARCH INSTITUTE; ACCOMPANIED BY JAMES A. WALSH, VICE PRESIDENT, CONTINENTAL ILLINOIS NATIONAL BANK & TRUST CO. OF CHICAGO; AND MAURICE JOHNSON, EXECUTIVE VICE PRESIDENT, FIRST NATIONAL BANK, KANSAS CITY, MO.

Dr. GRAY. Mr. Chairman and members of the committee, my name is Roger W. Gray. I am a professor at Stanford University and an economist in its Food Research Institute. I am appearing here in behalf of the First National Bank of Kansas City; Commerce Trust Co., Kansas City; Continental Illinois National Bank & Trust Co. of Chicago; Northwestern National Bank of Minneapolis; First National Bank of Minneapolis; and the First National Bank of Chicago.

I should like to present to you the gentlemen sitting with me. To my right is Mr. Maurice Johnson, executive vice president of the First National Bank of Kansas City, Mo., and to my left is Mr. James A. Walsh, vice president of the Continental Illinois National Bank & Trust Co. of Chicago.

I am appearing to discuss some of the implications for commodity financing contained in H.R. 11788. While my prepared statement focuses upon the financing of the commodity trade, I am also conversant with other aspects of futures trading with provisions in this bill which do not directly affect financing; hence, I shall be pleased to respond to questions dealing with any parts of the bill.

Let us consider, in a simple illustration, why the banks are interested in seeing healthy futures markets maintained. Certain banks, such as those I am representing, are located or specialized in such a way that a large proportion of their business consists of loans to grain firms. Many small country banks also make loans to country elevators and producers. The owner of the grain presents to his banker a warehouse receipt, which serves as collateral for the loan. The value of this collateral is assured by evidence that the grain has been hedged on the futures market; that is, sold for future delivery. This hedge sale of a futures contract is an integral part of the financial transaction, and it requires active and fluid futures markets to accommodate hedging at low cost.

The late Lord Keynes, noted British economist and financier, stated the basic relationship between futures markets and the financing of commodity inventories as well as it has been said. Writing in the *Manchester Guardian Commercial* in 1923, he said in part:

The annual flow of commodities cultivated or extracted from the soil has a very large value in comparison with the capital resources of the cultivators and extractors. The value of the annual production is large even in comparison with the fixed capital required to raise it; and compared with the floating capital of the producers, available for financing the annual flow from the commencement of production up to the disposal of it to the consumers, it is very large. * * *

We must make, first of all, the obvious but important distinction between the extracted commodities which come into existence at a more or less even rate throughout the year, as, for example, metals, and the crops which are harvested at a particular season. The maximum financial facilities required for carrying the former during the interval between production and consumption are obviously much less, in a normal state of trade, than the maximum facilities required for the latter, the value of which just after the harvest season may amount to nearly a year's supply: * * *.

Thus, for one reason or another, in their passage from the first processes of production to the eventual consumer, some commodities are liable to throw a much greater strain than others on the credit and financial system, this strain being not necessarily proportionate to the value of the aggregate production of the commodities or to their importance in the economic life of the community. If I may venture to generalize without the support of precise data, I should say that an extraordinarily large proportion of that part of the demand for temporary credit, which arises out of the financing of goods, can be ascribed directly or indirectly to textiles and to food crops (including in the latter cereals, sugar, and oil seeds), and an extraordinarily small proportion to coal, transport, iron and steel products, and nonferrous metals, not nearly commensurate with the relative importance of the latter in the national economy.

He then proceeded to illustrate the enormous financial burden imposed by huge accumulations of annual crops, pointing out for example that, at the time he wrote, total world stocks of copper, tin, lead, zinc, aluminum, nickel, rubber, coal, and pig iron were altogether worth nowhere near the value of sugar in store. Or again, that all the ships in the world were not worth as much as the stocks of cotton on hand immediately after harvest. As to how this financial burden was carried, Keynes said:

The provision of short period credits for producing and carrying of stocks of commodities during the period before they reach the eventual consumer is rightly

regarded by banks as one of their chief duties, and such credits are made available on the most favorable possible terms and on narrow margins. * * * The banks are prepared to lend the money, or a considerable proportion of it, but they are not prepared (intentionally) to run the risk of a change in the price of a commodity between purchase and sale. This risk has to be carried between them by the producer, the merchant, and the professional speculator.

There has had to be developed in consequence, in the case of very big seasonal crops, such as cotton, wheat, and sugar, a special organization to deal with this; namely, the forward contract market.

The "professional speculator" of whom Keynes spoke is an investor in future values. Not unlike the entrepreneur who builds a factory or develops some land, he endeavors to profit from his studied forecasts of future supplies and demands. The arrangements which Keynes described are still the heart of the commodity marketing system; but with our vast expansion of exports of some basic commodities, and imports of others, present financing needs are the highest ever and promise to continue rising. As the world's leading consumer of coffee, sugar, wool, and cocoa; and the world's leading producer of cotton, wheat, corn, and soybeans; the United States is also the world's leading commodity market and center of commodity trade. This fact owes much to our institutional arrangements; particularly to the interdependence among the banks, the organized futures markets, and the commodity merchants and processors.

The efficiency of the system depends heavily upon three different kinds of margins. First of all, the profit margins per unit of product which are earned by the merchandising and processing firms. Secondly, the credit margins employed by the banks who finance these firms. Thirdly, the margin requirements on commodity futures positions. Any "fat" that exists in any of these three margins represents sheer economic waste and inefficiency. Moreover, any fat that exists in the latter two—credit margins and futures margins—is necessarily incorporated into the gross profit margins of merchants and processors as an added expense of doing business.

Let us consider a specific illustration. Banks customarily extend credit to grain merchandising firms, for example, on the most favorable terms available to any business—such firms literally exist upon credit. The basic reason for this is that they deal in commodities which are highly fungible, negotiable, and marketable. In other words, wheat, corn, and soybeans possess the chief characteristics of money itself; so that lending money on them is almost tantamount to lending money on money itself. Obviously, no matter who I am or what my business, any banker would be glad to lend me a thousand dollars if I were to leave a thousand dollar bill with him as collateral. The situation in grain financing is not quite this simple, but it is a close approximation. Grain in a warehouse is almost like money in the bank, and this fact owes primarily to the organized futures markets in two important ways.

First, the grain is highly marketable (negotiable) and hence serves as a store of value. The reason that the grain is so highly marketable, and at a well-known price, is that the entire network of prices is geared to the futures pits, in which a sale is always possible, literally within a fraction of a cent of the last sale. These sales are widely publicized as rapidly as modern communications permit.

Second, the banker need not be concerned about a future decline in the value of the grain, because the merchandiser protects against this

contingency by hedging on the futures market. A hedge is a bona fide sale in the sense that the merchant can always choose to deliver the grain against the contract, with assurance that a certified check will reach him within 24 hours. This latter assurance stems from the fact that his contract is with the clearinghouse, which must stand behind it—not with another party of unknown financial responsibility. In other words, the hedged grain in a warehouse is excellent collateral not just because it is highly marketable at a well known price, but because in fact it has already been sold at one certain price to a clearinghouse that represents the financial integrity of the market itself. Normally, the merchant expects to do better than to deliver on his futures contract, but it does represent a rock bottom backstop to him and his banker.

Both of these ways in which grain in a warehouse is made to resemble money in the bank depend upon very low, almost nominal, but still safe, commodity futures margins. The extremely high marketability of grains owes to the existence of a highly liquid market for them. Market liquidity, with many buyers and sellers participating on a continuous basis, depends upon the attraction of venture capital into investment in commodity price forecasting. One of the important inducements to such investment is the fact that it can be safely done on very low margins.

The hedging of grain in future contracts also depends upon very low margins. A hedge in futures is used as a temporary substitute for a later merchandising transaction. It thereby entails two transactions instead of one, with attendant extra transaction costs. These moderate extra costs are justified because, and only because, of savings incurred elsewhere—savings in the form of extra credit granted at lower cost due to the improvement in the collateral which the hedge affords. The grain merchant makes an “extra” sale of his grain in futures because by so doing he can, at very low cost, provide the safety which enables his banker to advance more credit on better terms, at the same time that the merchant can deal in large volumes at very low margins. The banker can safely afford this practice because the merchant or processor is able to establish his costs in futures contracts—costs which would otherwise be variable and unpredictable.

The emphasis throughout this discussion, and throughout the system, is on the lowest possible margins consistent with safety. Low margins mean low costs—higher credit margins or higher futures margins necessarily mean higher costs, reflected in higher gross margins of processors and merchants. The sole purpose of either credit margins or futures margins is to provide safety.

Considered against the background of even this minimal understanding of the system, the provisions of H.R. 11788 pertaining to margins must be unalterably opposed as reflecting lack of understanding, as ascribing to margin requirements a novel and alien purpose which they were never intended to serve; and as posing the threat of raising marketing costs and disrupting the marketing system, without offering any real prospect of accomplishing the purposes there ascribed to them. The provision reads:

Whenever the Secretary of Agriculture has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, or any other activity reasonably expected to restrain trade, in connection with the sale of any commodity for future

delivery, or in interstate commerce, under contracts made on or subject to the rules of any contract market, the Secretary of Agriculture may prescribe the minimum margins which such contract market and all futures commission merchants shall require to be initially deposited and subsequently maintained by each person in connection with speculative or hedging positions which may be held by such person under contracts of sale of such commodity for future delivery, or in interstate commerce, made on or subject to the rules of such contract market.

There are numerous objections to this provision, all stemming from considerations of efficient performance and regulation of the commodity marketing system.

1. Margin requirements, as noted above, have historically served only the purpose of assuring financial responsibility. The purposes stated in the proposed amendment are novel and alien.

2. Margin requirements provide an ineffective and inequitable means of controlling manipulative attempts. Such attempts are ordinarily undertaken by one trader or a small group of traders. Yet margin requirements apply to all, and would thereby penalize the innocent as well as those suspected of guilt. Margins also represent a perverse approach to manipulation. Low margins assure relative freedom of entry into marketing, which provides insurance against monopoly in the form of greater competition. Yet raising margins to deter manipulation would be intended to reduce competition at a time when it is most needed; that is, when someone is suspected of attempting a monopolistic practice. The best attack upon manipulation is a direct attack upon the manipulator.

3. Manipulation, being inherently difficult to define and establish, should be attacked after the fact, when sufficient evidence has become available to allow a judgment. It is unreasonable and unrealistic to credit the Secretary of Agriculture with the ability to anticipate manipulation. Whether or not a price change was warranted is difficult to establish even in retrospect; it is virtually impossible to establish in advance of the event. The very reason for the existence of the marketplace is ignored in the premise that manipulation, or unwarranted price changes, can be foreseen. The fact that manipulation is difficult to prove under existing law does not warrant the conferral of arbitrary power upon the Secretary to interfere with the market at an early stage on the basis of what he has "reason to believe."

4. Experience suggests that such a provision would inevitably lead to higher margins. The result would be higher marketing costs. Alternative constructive regulations are available which would not idle funds wastefully and raise marketing costs, as this provision would.

5. Even if a Secretary of Agriculture had understanding of the marketing system, such a proposal as this would necessarily disrupt its operation on occasion. The fact that the proposal is made betrays a lack of understanding of the system, however, which makes the augury of this provision more ominous.

6. Margin requirements could soon become prohibitive. Consider a merchant who carries large stocks of grain, hedged in futures contracts, margined with the clearinghouse at approximately 5 percent of the value of the grain represented in the futures contract. He borrows 90 percent of the value of the grain from his banker, on the

condition that it be so hedged. The alternative, if margin requirements raised hedging costs, is for the banker to extend credit on the basis of the merchant's balance sheet. Not only is this more cumbersome, but the value of his chief asset, the grain inventory, is less certain—in consequence the banker would have no prudent alternative to raising the credit margins or interest rates.

He, the merchant, prefers to hedge, of course, for other reasons than the lower margin requirements on bank credit which it assures him. So he might approach his banker and request some compensatory reduction in credit margins to enable him to continue hedging with higher futures margins. But his costs have been increased in any event, and if the futures margin were set still higher, at say 25 percent or more, he would almost certainly stop hedging. Then he might approach his banker to request lower credit margins on unhedged grain. The banker could conceivably respond to the merchant's plight by granting lower credit margins conditioned upon (1) hedging in forward commitments, instead of futures contracts, (2) relating gearing credit margins to price changes in the inventory, thus in effect taking on one of the functions of the grain trade, which is to watch grain prices.

These are of course backward steps in economic development; for these were the practices that had to be followed before the futures markets evolved. Forward sales are more costly and less reliable than futures contracts. A hedged position in futures is a much cheaper way for the banker to guard against inventory price fluctuations than actual day-to-day study of the prices of all the various categories of inventory that serves as loan collateral. Moreover, with the departure of the commercial firms from the futures markets, these markets would soon wither and die, so that the banker would have no reliable source of price information to watch, even if he chose to study prices.

7. In the face of the general inadequacy of speculation on many futures markets, concern over its excess seems misplaced. What does the Secretary propose to do about inadequate speculation, which raises marketing costs? There is good evidence that the most effective job of price determination is performed on those markets having the most speculation.

8. The impact of this provision would inevitably be to concentrate more business in the hands of larger firms. As hedging was discouraged, credit margins would necessarily rise. The firms having larger capitalization would benefit. Moreover, the larger, more diversified firms would be better able to make forward sales in place of futures contracts. The provision is anticompetitive in its implications.

9. Any such deterrent to the use of our futures markets as this provision implies would tend to encourage their development in other countries as the business declined here. Already many foreign sellers and buyers use our futures markets because of their higher development and greater convenience. If the use of our markets were discouraged, they would almost certainly patronize markets in other countries. The U.S. leadership in the world commodity trade would be threatened.

10. Margin requirements affect growers as well as merchants and speculators. One of the arguments made against the potato and onion futures markets before this committee, and other committees of Con-

gress, was that margin requirements were too high to enable growers to hedge economically.

Margin requirements also affect growers indirectly. With margins at reasonable and prudent levels, speculative investment in futures contracts is encouraged. There is ample evidence that this tends to sustain prices at harvest time, when most producers are urgent sellers.

In closing, mention should be made of some factors which have occasionally confused the discussion of margin requirements. Some of these Mr. Martin also addressed himself to. These may not have been suggested to this committee, but since they are common sources of confusion, it is perhaps well to bring them into this record. One of these is the policing of margins. It seems clear that the exchanges have generally done a good job in the establishment of margin levels; but in policing their enforcement at all levels and all branches of the trade it is likely that more laxity has prevailed. Provision for better policing of margins, once their levels are established on proper grounds, might be an appropriate amendment.

Another source of confusion is found in the comparison often drawn between stock margins and commodity margins. These are not comparable for several reasons, chief among which is the fact that a futures transaction or margin is not a credit transaction, whereas buying stock on margin is a credit transaction.

There is no transfer of ownership in a futures contract—only an obligation to transfer ownership at a later date, through the clearing house, for full cash payment at the time of transfer—and this obligation is nearly always canceled before a transfer occurs, by undertaking an opposite obligation vis-a-vis the clearinghouse. Thus a futures contract does not represent a credit transaction, in which ownership of an asset is transferred. The holder of a futures contract owns something of value insofar as he may be later entitled to receive a commodity of greater value, or to deliver a commodity of lesser value, than that agreed upon in the contract. He earns no right to the use or enjoyment of the commodity, or to income from it, so long as he holds the futures contract; nor does he earn such rights through the normal settlement of such contracts by offset.

Margin deposits on futures contracts are in no sense down payments on credit transactions. The margin deposit is intended to represent full payment at all times for the value of the futures contract, which inheres in the uncertain, but statistically definable prospect of price change. This is the most important of several reasons why commodity futures margins differ from stock margins. Purchase of a stock certificate does transfer ownership, and the margin on such a purchase is a down payment on a credit transaction. It is because stock purchases on margin are credit transactions, and because it is deemed to be in the public interest to control the amount and kinds of credit, that authority to establish margins on stock purchases is vested in the Board of Governors of the Federal Reserve banking system, and margin levels are much higher than those on commodity futures. The word "margin" has an entirely different meaning in the two contexts.

A major reason for controlling credit purchases of stock is the concern to prevent such a stock market collapse as occurred in 1929, after stock prices had been carried to very high levels, partly through purchases made on short-term credit. There are two reasons, in addition

to the fact that commodity futures transactions are not credit transactions, why a similar concern does not apply here. The first is that commodity futures transactions are absolutely symmetrical with respect to buying and selling, as stock transactions are not. Investment capital flows to the commodity futures markets on the selling side in exactly the same way as on the buying side, so there is no reason to fear inflationary consequences of such a flow. An increased flow of capital into the stock market, on the other hand, necessarily raises stock prices, as the new investment capital comes on the buying side. It is possible, in a rather cumbersome procedure, to sell stock short by borrowing stock certificates; but this device is by no means the equivalent of selling futures contracts.

The second reason why the inflationary concern does not apply to commodity futures transactions is that their prices must come to the actual commodity price from 4 to 12 times a year, depending upon the number of delivery months. The price-earnings ratio of the stocks in the Dow-Jones industrial average has ranged from 6.4 to 51.5 since 1933, indicative of how far stock prices can range from the true current earning capacity of the physical assets they represent.

Commodity futures prices can depart from the true expected earning capacity of the physical assets which they represent also; but this departure is necessarily temporary and limited because of the delivery provisions. Occasionally a commodity futures price is forced above the true economic value of the commodity in a delivery month squeeze; but such actions are severely punished on other than inflationary grounds, and indeed their general economic impact is trivial.

A third source of confusion is the misinterpretation of the infamous vegetable oil swindle that broke in 1963. The weakness in the system that this revealed had nothing to do with margins, as is sometimes alleged, but only with warehousing.

In order to confine this statement to the permissible time, I have been unable to cover some of these matters fully. I shall be pleased to discuss them further if the committee desires.

Mr. MATSUNAGA. Thank you very much, Dr. Gray. I am sure the gentlemen from California would like to ask you a question.

Mr. TEAGUE of California. I would like to compliment Dr. Gray on his fine statement and to express the hope that he will take care of recruiting Midwest football players for Stanford if he has any extra time.

Dr. GRAY. That is a good idea.

Mr. MATSUNAGA. Mr. Hagen.

Mr. HAGEN of California. I have two questions. On page 8 of your statement you discuss your opposition to giving the Secretary the authority to set the margins. Then you say:

Alternative constructive regulations are available which would not idle funds wastefully and raise marketing costs, as this provision would.

What are the alternative regulations to which you refer?

Dr. GRAY. That point, Mr. Hagen, is a follow-up on my previous point in which I am discussing what I think is the inappropriateness of margin controls as a device for controlling manipulation. My own view is that the best thing is the present system of direct attack upon manipulation when it is identified.

Mr. HAGEN of California. What is that present mechanism?

Dr. GRAY. That point, Mr. Hagen, is a followup on my previous complaint against a party whom he suspects of attempting to manipulate or is manipulating prices, and there have been a number of such complaints brought against people and always after the fact, and it can be appealed into the courts and one can ascertain whether or not this is a competent complaint.

Mr. HAGEN of California. That would relate only to the members of the commodity exchanges and would not affect these different commodities that are not under the CEA.

Dr. GRAY. That is true, sir.

Mr. HAGEN of California. And no one else would have the authority to move against them.

Dr. GRAY. One could, of course, go through the Department of Justice, I presume, to bring charges of monopolistic practices, but it is true that the Commodity Exchange Act has no application to such commodities so that the Secretary would not have authority to move.

Mr. HAGEN of California. Have they been very successful in the actions they have brought, or have they brought any actions?

Dr. GRAY. A number of actions have been brought, but I cannot say how many, offhand, sir.

Mr. HAGEN of California. Were they successful in them?

Dr. GRAY. To the extent that these have been determined and decided that the hearing level within the Department, I think, usually the finding has been against the respondent. There have been a few appeals of these cases into the courts, and I think that there have been, probably, more reverses than not when they were in the courts.

Mr. HAGEN of California. What have the exchanges themselves done to prevent manipulation?

Dr. GRAY. The exchanges have business conduct committees which maintain continuous surveillance over all sorts of market practices. I think one of the reasons, historically speaking, that very few cases have ever needed to be brought by the CEA or by the Secretary, is that the exchanges have done a rather exemplary job of keeping their own houses in order.

Mr. HAGEN of California. But you are advocating the status quo—you are not suggesting alternative legislation to this?

Dr. GRAY. No, insofar as controlled manipulation is concerned, I am inclined to feel that this can work pretty well the way it is now.

Mr. HAGEN of California. On page 10 of your statement, you say:

One of these is the policing of margins. It seems clear that the exchanges have generally done a good job in the establishment of margin levels; but in policing their enforcement at all levels and all classes of the trade it is likely that more laxity has prevailed. Provision for better policing of margins once that their levels are established on proper grounds might be an appropriate amendment.

Would you expand on that part of your statement as to why you think there has not been adequate policing and what would be necessary to secure adequate policing?

Dr. GRAY. The exchanges through the clearinghouse establishes marketing levels for the clearing members. There are members of the exchanges who are not, also, members of the clearinghouse. The exchange then establishes minimum margin requirements for other classes of trading, including nonmembers.

It is my impression, subject to correction by representatives from the exchanges, if need be, that by and large the exchanges have not gone, let us say, into where the records were audited as to their margins.

Mr. HAGEN of California. Do they have the authority to do that?

Dr. GRAY. The exchanges would have that authority over any of its members, yes. They can see to it that their members are using, or trading through the members, and they could see to it that their members do maintain margins where they are trading with nonmembers. This would be a rather expensive policing procedure and I think there is ample incentive on the part of most parties here to maintain the margins. It is in the interest of the commission firm, for example, to maintain margins at the appropriate levels in its own protection.

Mr. HAGEN of California. Then you think it objectionable for the Secretary of Agriculture to have this authority to police the margin levels established by the industry?

Dr. GRAY. I think it is, sir. That would be objectionable.

Mr. HAGEN of California. Then it would be objectionable?

Dr. GRAY. Yes.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Thank you. Mr. Dole.

Mr. DOLE. As I understand it, you are not in accord with the definition of the term "manipulation" that appears on page 2 of the proposed bill?

Dr. GRAY. No, I am certainly not. I think that if one were to attempt to define "manipulation" in the statutes, that the direction in which the definition ought to go is toward more precision. As we find it here, it is rather vague. I point out in my statement further that manipulation is inherently difficult to define and hence virtually impossible to anticipate or define in advance. It could be defined in retrospect when one can have the facts on the record. And, finally, I agree with what Mr. Martin said earlier this morning and I think other witnesses have said that, certainly, the element of intent is a key part of it.

Mr. DOLE. You do not feel manipulation or excessive speculation can be controlled by raising the margins?

Dr. GRAY. I think that this would be one of the most cumbersome devices for controlling manipulation or speculation imaginable. May I take a moment to give an illustration?

Mr. DOLE. We are very much rushed for time here but it would be helpful.

Dr. GRAY. Or a couple of just imaginary illustrations that might be given: that is, what I consider to be inefficiency of margin changes as to controlling manipulation. Supposing that you have the situation in which there are some people trying to manipulate. Let us suppose that they have short selling positions in the market. They want prices to go down.

Let us take a commodity like wheat. The price is \$1.52 currently. Supposing that this crowd that wants to manipulate has reasons to believe, which it should not have, but it might have reasons to believe that there are some stop loss orders at \$1.50, just 2 cents below the prevailing price, so that they put some sales into this market. They can push this down to \$1.50. Now, all of this goes on and the Secretary would have reason to believe that, if he had good surveillance in the market, that something like this was going on.

The last thing that you want to do is to raise the markets. These fellows who are trying to manipulate the prices downward are not going to be deterred, but the very fact that you have stop loss orders suggests that if you raise the markets you are going to run some other people out of the market, and, actually, contribute to the manipulative attempt.

There was a case, incidentally, which, of course, we cannot decide here and I would not pretend to go into the merits of the case, but, at this point, I think it is relevant to mention it. SCA 20 is a case which has been brought against a corporation for manipulation of the wheat prices, a very large merchandising corporation, but it has a position of approximately 2 million bushels which it was holding for some time in wheat future. And then on the last day prices went up, and this corporation was attempting to manipulate. And, as I say, I disagree with the charge in this. The point that I want to make here is that had you stepped in when you sensed that this was going on and had raised the margins, what makes you believe that this larger merchandising corporation would have been deterred by the increase in the margin compared to the other people that you might have driven out of the market?

So, once again, I think that it is a very perverse approach to controlling manipulation.

Mr. HAGEN of California. In bringing these actions what definitions of manipulations does the Government use?

Dr. GRAY. The Government has to rely essentially on case law in arguing these cases before hearings, I should think, because you have the definition established by tradition and case law. So that the Government is free, presumably, so long as it is not defined in the statutes—the Government is free to use its own definitions but it must recognize that at some point, if the definition it is using is not consonant with that established in the case law, that it might be upset.

The case which is currently extant is the *Volkart* case of a few years ago, and I think all parties are entitled to view that as the existing definition of “manipulating” in case law.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. I must say, Dr. Gray, that you have made a very scholarly presentation and I am sure that it will be helpful in our consideration of this bill. Thank you very much.

Dr. GRAY. Thank you.

Mr. MATSUNAGA. Our next witness is Mr. F. Marion Rhodes, president of the New York Cotton Exchange. We will have to limit you to 7 minutes, and if you can summarize your statement and, perhaps, even omit cumulative testimony that you find that other witnesses have presented relative to a particular point, it will help. Your statement will, in its entirety, be put into the record as if presented in full.

STATEMENT OF F. MARION RHODES, PRESIDENT, NEW YORK COTTON EXCHANGE

Mr. RHODES. Mr. Chairman and members of the committee, we appreciate the opportunity to appear before you on this subject and with me I have Mr. George Oberle, chairman of the board of the New York Cotton Exchange, and on my left is Mr. Maurice Mounds, our

attorney, and the secretary of the New York Cotton Exchange is Mr. Donaghy.

We appear to register the objection of the New York Cotton Exchange to H.R. 11788. We are not opposed to all of the changes proposed in the bill. And since I am limited in time, it will be impossible for me to cover what we had hoped to be able to present to the committee.

We are very definitely opposed to the margin section. It is, probably, the most damaging section in the entire bill. We think, however, that it has been covered by these preceding witnesses and, particularly, Dr. Gray, who has just preceded me.

We are, also, opposed to the section pertaining to contract movement, which is found in sections 15 and 16 of the bill, the terms for giving the Secretary of Agriculture the power to make the rules of an exchange, including the rules concerning the terms and conditions of futures contracts and the methods of executing the contracts on an exchange.

The power prescribing the margin is, also, included in this. I have already mentioned that.

If this amendment were adopted, the governing boards of futures markets might as well retire. Their power to make bylaws or rules respecting their contracts and their trading methods would be seriously diminished, because anything they did could be overridden by the CEA. The proposal is a radical departure from the plan of the existing Commodity Exchange Act.

At the present time an exchange can be designated as a contract market under section 5 of the act, if, among other things, it has rules respecting the making of reports of contracts and the keeping of records.

The prevention of the dissemination of false or misleading reports, the prevention of manipulation and cornering, and in making effective the decisions of the Secretary of Agriculture. While an exchange must have such rules to qualify as a contract market, it is the exchange which makes all the rules within the framework of the requirements of the act. Under this proposed amendment the CEA would have the power to make the exchange rules on the most vital matters concerning the market, such as the provisions of the contract traded in and the manner in which it is executed. If you are to go this far, you might as well abolish section 5 of the act and simply provide that an exchange can be designated as a contract market if it complies with the rules made solely by the CEA.

I will skip through and touch a few other points.

We, also, object to the sections of the bill which define the term, "manipulate." The definition of "manipulation" proposed by the Department of Agriculture is clearly wrong. It is not accepted by the trade. It has been rejected by the Federal court of appeals and it is manifestly a misunderstanding by the officials of the CEA of the proper functioning of a futures market.

I will have to give you a little background to explain our position. In 1958 the CEA charged one of our most respected members, Volkart Bros. Co., with manipulation of the price of cotton futures. They had a long position on the exchange and had simply sold out their contracts at a price arrived at by the pressures of supply and demand.

The price obtained was slightly higher than the price immediately prior thereto, because the holders of the short positions, who were speculators, had taken steps to deliver these commodities. A committee of the exchange charged with the duty of alleviating congestion, which come about when shorts do not prepare for delivery, had passed upon the situation at the time and found it proper but the CEA nevertheless charged Volkart with manipulation. The charge was a shock to the entire cotton trade and was opposed by the cotton futures exchanges, regional cotton associations, and the American Cotton Shippers Association. It was opposed because an exchange could not operate under the CEA's theory, and any person trading on an exchange with the idea of taking delivery would be in jeopardy of a charge of manipulation.

The Department of Agriculture held Volkart guilty of manipulation. The case was appealed to the U.S. Court of Appeals for the Fifth Circuit, and the court reversed the decision of the Department. The Department did not appeal to the U.S. Supreme Court and it was thought that the trader could rest on the court's interpretation of the word "manipulation." The CEA now comes forward with the definition which would overturn the decision of the court on every point raised by it in that case.

The proposed amendment defines "manipulated," in effect, as action which raises, lowers, or stabilizes the price of a commodity, irrespective of intent, and the last sentence provides that such action shall be recorded as manipulation irrespective of the acts or omissions of the holders of futures contracts on the other side. Thus, if holders of long positions stand for delivery and prices increase because the holders of the short positions fail to make preparation for delivery, the increase in the price would be charged to the longs and they would be guilty of manipulation.

In the decision in the *Volkart* case the court stated that the increase in price could be charged to the longs only on the assumption that the shorts should not be held to their contract obligations to deliver cotton; that the shorts should not be excused from the exercise of due diligence to that end; that for the Secretary of Agriculture to proceed on the assumption that the shorts should not be required to deliver at maturity would be to put him in the position of regulating a gambling institution rather than a legitimate futures exchange. That was not, of course, the intention of the statutes prohibiting manipulation.

Yet this is exactly what the Department of Agriculture proposes when it suggests a definition under which the omission of the holders of the adverse futures contracts; that is, the shorts, shall not be considered, so that the price increase, by statute, will be charged to the longs even though the responsibility, in fact, lies with the shorts.

According to the first sentence of the definition, any course of action which results in a price different from what it should otherwise be, in the opinion of the CEA, is manipulation irrespective of intent to manipulate. The court required intent as an element of manipulation and this has always been the rule. For a charge of manipulation to be sustained it must be established that it was "intentionally brought about by planned action," said the court.

The definition is so broad that if a committee of an exchange in accordance with its duty invited merchants into the market to relieve

a congestion or squeeze and they acted on the invitation and took a short position to alleviate the congestion and the effect was to stabilize the price which would otherwise be excessive, the merchants and perhaps even the members of the committee would be guilty of manipulation.

Mr. MATSUNAGA. Your time has expired. If you wish to conclude in one sentence, fine.

Mr. RHODES. I would like to conclude, Mr. Chairman, by saying that the New York Cotton Exchange has the highest regard for Mr. Caldwell, the Administrator of the CEA, and the other members of the staff in the Department of Agriculture. In this case, we are sure they put these proposals forward with all good intentions but we believe that they are wrong, and that we appreciate having had this opportunity to explain our position to the committee. We thank you very much for giving us this opportunity to do so.

(The prepared statement of F. Marion Rhodes follows:)

STATEMENT OF F. MARION RHODES, PRESIDENT OF THE NEW YORK COTTON
EXCHANGE

Mr. Chairman and members of the committee, I appear here as president of the New York Cotton Exchange to register the objections of the exchange of H.R. 11788. This bill which was introduced at the request of the Department of Agriculture would drastically amend the Commodity Exchange Act.

The bill contains 30 sections. Some changes on the same subject matter appear in several sections. The significant changes are digested in excellent form in the explanation of principal changes which appears on pages 12 and 13 of the committee print. I will address myself to the changes in the order in which they appear.

We do not oppose all of the changes. Our principal objections are directed to items 1(a), 1(c), 7, 9, and 10 of the amendments set forth in the explanation.

MARGINS

Under item 1(a) which is found in section 13 of the bill the Secretary of Agriculture seeks the power to fix minimum margins on commodity exchanges in order to prevent manipulation, unwarranted changes in price or excessive speculation. We vigorously oppose this amendment. The grant of power which is sought appears to be based upon a lack of appreciation of the economic function of a futures market and a misconception of the purpose of margin in a futures transaction. Control over margins will not prevent manipulation; it will not reduce unwarranted changes in price; and if it reduces speculation it will interfere with the proper functioning of a futures market.

The function of margin on a futures exchange is entirely different from its function on a stock exchange. Control over margins may affect prices on a stock exchange but have little effect on prices on a commodity exchange. If however higher margins discourage speculators from coming into a futures exchange, the market will suffer thereby.

In order to develop my argument on this point I would like to outline briefly the operations of a commodity futures exchange. It is recognized by economists and by the Department of Agriculture that a futures exchange performs a valuable economic function in the public interest. Risks in business must be paid for. They are generally passed on to the consumer. To the extent that they can be eliminated or reduced, the consumer benefits. It is the function of a commodity futures market to eliminate or reduce the risk of price fluctuations in the process by which a commodity moves from grower to consumer. This is done by hedging on the exchange. I believe it will be conceded that the hedging facilities afforded by a futures market reduce the cost of marketing and thereby permit the farmer to obtain a better price for his produce and enable the consumer to obtain products at lower cost.

Among those who use a futures exchange for hedging are growers, shippers, merchants, and manufacturers. Since there are not an equal number of hedgers taking long and short positions on the exchange, speculators are necessary to a

futures market and, for an expected profit, they act as insurers for those who deal with the actual commodity.

The hedger who purchases, sells, or holds a commodity obtains protection against a change in price by taking an opposite position on a futures exchange. If he is a farmer or a merchant who holds cotton he hedges by selling a futures contract. If the price of his cotton goes down he liquidates his futures contract and what he loses on his cotton he makes up on his futures transaction. It is the speculator who generally takes the position opposite to the hedger and performs the function of the insurer. Markets which enjoy higher levels of speculative participation provide more reliable price protection. A market with fewer speculators is less effective, less liquid and less useful to a hedger. If margins are increased to drive out the speculators the functioning of the futures market will be impaired and the benefits of hedging to the country's economy will be lost.

There is little similarity between the operation of a stock exchange and a commodity exchange. On a stock exchange when a person buys a security he receives it within a few days and must pay the seller the full price in cash. If he requires credit to finance his purchase he borrows from his broker. The margin is the amount of cash he puts up which is the difference between the purchase price and the amount borrowed. Lower margins mean higher buying power. Thus when margins are low there is a greater demand for stock and this has a tendency to increase prices. Control over margins on a stock exchange is in the hands of the Federal Reserve Board. When prices get too high margins are increased and it is believed that the effect is to reduce the demand for stocks and thus stabilize the market.

Margin on a futures exchange is based on an entirely different concept. It has nothing to do with the amount of money made available to purchase commodities. It is not a downpayment on the price. A futures contract is a contract to purchase and sell a commodity for delivery in the future. Most contracts are liquidated by offsetting contracts before the delivery date. Delivery is the exception. In those cases where delivery is made the purchaser pays cash and the margin put up on his futures trade has little relation to the cash which he pays. The margin on a futures exchange is merely security for the clearing member to guarantee the obligations of the trader when he buys or sells a futures contract. What is that obligation? At the time he buys a futures contract he owes nothing. If the price changes in his favor he owes nothing. It is only when there is an adverse change in price that he incurs an obligation.

If a trader buys cotton on a futures exchange and the price decreases by 1 cent per pound he loses 1 cent per pound; if he sells cotton—that is takes a short position—and the price increases 1 cent per pound, he loses 1 cent per pound. When he offsets his contract by a contracontract he must pay his loss. The margin is to guarantee to the clearing member that he can pay this loss. The amount of the margin is fixed in relation to the loss which he may sustain as a result of an adverse change in price. When the price changes so that the margin is partially used up additional margin is called for and this additional margin is also merely to guarantee to the clearing member that the customer will be able to pay the loss resulting from an adverse change in price. When the governing board of an exchange sees a likelihood of large price fluctuations, initial margins are increased by the exchange because it is anticipated that there will be a larger obligation to pay for an adverse variation in price.

I have talked about the margin applicable to the buyer. Every transaction on a futures exchange involves a seller and buyer. Generally both parties are required to put up margin. In a normal transaction on a stock exchange, margin is required only of the buyer because the seller's transaction is completed. In a day on the New York Stock Exchange when 10 million shares are traded, comparatively few transactions involve a short sale. On a futures exchange every single transaction involves a short sale and there are speculative shorts as well as speculative longs. The amount of the margin is and should be geared to the obligation of the trader which is to pay for the variation in price when he closes out his transaction whether he is long or short.

When the purpose of margin on a commodity exchange is understood—that it is not a downpayment on the price—it should be apparent that an increase or reduction in margins will not be effective to control prices. However, any increase in margins beyond the point necessary to guarantee the obligation of the trader may interfere with the operations of a futures exchange in facilitating the marketing of agricultural products by discouraging speculators from performing their functions as insurers of the risk of a change in price. And, if

higher margins were applied to hedgers as well as speculators it would be more expensive for the farmer and others who deal in commodities to protect the value of their crops and products.

In addition if higher margins are imposed to discourage the use of futures exchanges in this country the business of hedging might be transferred to futures markets which exist or can be established in foreign countries to the detriment of the American economy.

The history of trading on the New York Cotton Exchange does not bear out the contention that prices rise when speculation increases. Cotton prices have risen when the speculative interest has been low. And when margins have been increased by the board of managers of the exchange prices have gone higher.

The manner in which a futures market operates requires special knowledge and it is not surprising that Government officials, able in their fields, are not experts on this subject. A few months ago when the Government was attempting to roll back an increase in copper prices the Secretary of Defense announced a four-point program for reducing the inflationary pressures on copper prices. One of his proposals was that margins for copper on the Commodity Exchange be made "more comparable to that required for trading on the New York Stock Exchange" which is now 70 percent. Such a margin would put the futures markets out of business and without futures markets prices would tend to be higher.

In transmitting this bill to the House, the Secretary of Agriculture stated that the effects within the economy resulting from the failure of a large vegetable oil refining company in November 1963 would have been greatly lessened had there been adequate margins required on the positions carried by that firm in the futures markets. This is open to question. The published reports of this failure disclose that the losses were sustained not by reason of low margins but because the firm involved covered its margins by warehouse receipts which were unsupported by oil in the warehouse as well as by forged warehouse receipts. When one uses forged warehouse receipts as security for margins it is doubtful that he will be deterred if the margin is higher. He will simply forge more warehouse receipts.

CONTRACT RULES

The next section of the bill to which we object is found in paragraph 1(c) and paragraph 7 of the explanation and in sections 15 and 16 of the bill. These sections give the Secretary of Agriculture the power to make the rules of an exchange including rules respecting the terms and conditions of futures contracts and the method of executing contracts on an exchange. The power to prescribe margins is also included and I have said enough on that subject.

If this amendment were adopted the governing boards of futures markets might as well retire. Their power to make bylaws or rules respecting their contracts and their trading methods would be seriously diminished because anything they did could be overridden by the CEA. The proposal is a radical departure from the plan of the existing Commodity Exchange Act.

At the present time, an exchange can be designated as a contract market under section 5 of the act, if, among other things, it has rules respecting the making of reports of transactions and the keeping of records; the prevention of dissemination of false or misleading reports; the prevention of manipulation and cornering; and the making effective of decisions of the Secretary of Agriculture. While an exchange must have such rules to qualify as a contract market, it is the exchange which makes the rules within the framework of the requirements of the act. Under this amendment, the CEA will have the power to make exchange rules on the most vital matters concerning the market such as the provisions of the contracts traded in and the manner in which they are executed. If you are to go this far, you might as well abolish section 5 of the act and simply provide that an exchange can be designated as a contract market if it complies with the rules made solely by the CEA.

The entire plan of the Commodity Exchange Act is based on the principle that the rules will be made by the exchanges but that they must have rules to enforce certain principles deemed important in the public interest. If there are matters other than those now set forth in the act on which the exchanges should have rules let them be stated and if they are appropriate let the act be amended to require the exchanges to make such rules, but let not the governors of the exchanges be deposed and supplanted by the Administrator of the Commodity Exchange Act.

FELONIES

Our next objection deals with item 9 of the explanation which is set forth in section 28 of the bill. This amendment would make manipulation and other offenses felonies instead of misdemeanors. While a futures exchange is not affected by this provision we believe it is unwise legislation and not in the public interest. Anything which discourages people from trading on an exchange narrows the market and diminishes the benefits which commodity exchanges afford to the economy.

We can understand the desire of the CEA to increase the penalties applicable to certain evil practices arising out of the *Salad Oil* case but we doubt the efficacy of this measure. Any person engaging in the activities reported in that case involving spurious and forged warehouse receipts would have committed many crimes which are now felonies. To add to his offenses another felony under the Commodity Exchange Act would not prevent the crime.

It will be noted that of all the violations of the act which might be committed by a person only two are denominated felonies: (1) manipulation and (2) transmission of false information.

(1) Manipulation should not be made a felony because there is too much doubt about what it means. Various officials of the CEA and the Department of Agriculture have one view and the trade and the court have another view. According to the CEA, a person who stands for delivery of a commodity against a diminishing long position and a limited supply of stock might be guilty of manipulation. It is difficult enough for a person to trade on an exchange with the possibility of a charge of manipulation hanging over his head under the CEA's conception of that term without also putting him in jeopardy of being branded a felon.

(2) As to false information, there is no quarrel with the penalty. But we believe the words need clarification. The activity which is made a felony is "knowingly or *carelessly* to deliver or cause to be delivered for transmission * * * false or misleading or knowingly *inaccurate* reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity * * *." I do not know how one can *carelessly* transmit *knowingly* inaccurate information.

MANIPULATION AND WEIGHT OF EVIDENCE

There are two points in item 10 of the explanation to which we strongly object. One which is set forth in the first section of the bill defines the term "manipulate." The other which is found in sections 19 and 20 of the bill would change the law to provide that decisions of the Department of Agriculture would be conclusive if supported by "substantial evidence" instead of the "weight of evidence." I will discuss each point separately.

The definition of manipulation proposed by the Department of Agriculture is clearly wrong. It is not accepted by the trade; it has been rejected by the Federal Court of Appeals; and it manifests a misunderstanding by certain officials in the CEA of the proper functioning of a futures market. I will have to give you some background to explain our position.

In 1958 the CEA charged one of our most respected members, Volkart Bros. Co., with manipulation of the price of cotton futures. Volkart had had a long position on the exchange and had simply sold out its contracts at a price arrived at by the forces of supply and demand. The price obtained was slightly higher than the prices immediately prior thereto because the holders of the short positions, who were speculators, had not taken steps to deliver the commodity. A committee of the exchange charged with the duty of alleviating congestions which come about when shorts do not prepare for delivery had passed upon the situation at the time and found it proper. The CEA nevertheless charged Volkart with manipulation. The charge was a shock to the entire cotton trade and was opposed by the cotton futures exchanges, regional cotton associations, and the American Cotton Shippers Association. It was opposed because an exchange could not operate under the CEA's theory, and any person trading on an exchange with the idea of taking delivery would be in jeopardy of a charge of manipulation.

The Department of Agriculture held Volkart guilty of manipulation. The case was appealed to the U.S. Court of Appeals for the Fifth Circuit and the court reversed the decision of the Department. *Volkart Bros. v. Freeman* (311 F. 2d 52 (1962)). The Department did not appeal to the U.S. Supreme Court and it was thought that the trade could rest on the court's interpretation of the

word "manipulate." The CEA now comes forward with a definition which would overturn the decision of the court on every point raised by it in that case.

The proposed amendment defines "manipulate" in effect as action which raises, lowers or stabilizes the price of a commodity, irrespective of intent, and the last sentence provides that such action shall be regarded as manipulation irrespective of the acts or omissions of the holders of futures contracts on the other side. Thus, if holders of long positions stand for delivery and prices increase because the holders of the short positions fail to make preparation for delivery, the increase in the price would be charged to the longs and they would be guilty of manipulation.

In the decision in the *Volkart* case the court stated that the increase in price could be charged to the longs only on the assumption that the shorts should not be held to their contract obligation to deliver cotton; that the shorts should not be excused from the exercise of due diligence to that end; that for the Secretary of Agriculture to proceed on the assumption that the shorts should not be required to deliver at maturity would be to put him "in the position of regulating a gambling institution rather than a legitimate futures exchange. That was not, of course, the intention of the statutes prohibiting manipulation." I am quoting from the court's decision, 311 F. 2d at 60.

Yet this is exactly what the Department of Agriculture proposes when it suggests a definition under which the omissions of the holders of the adverse futures contracts, that is, the shorts, shall not be considered, so that the price increase, by statute, will be charged to the longs even though the responsibility in fact lies with the shorts.

According to the first sentence of the definition, any course of action which results in a price different from what it should otherwise be, in the opinion of the CEA, is manipulation irrespective of intent to manipulate. The court required intent as an element of manipulation and this has always been the rule. For a charge of manipulation to be sustained it must be established that it was "intentionally brought about * * * by planned action" said the court. (311 F. 2d 59.)

The definition is so broad that if a committee of an exchange in accordance with its duty invited merchants into the market to relieve a congestion or squeeze and they acted on the invitation and took short positions to alleviate the congestion and the effect was to stabilize the price which would otherwise be excessive, the merchants and perhaps even the members of the committee would be guilty of manipulation.

The CEA proposed a definition of manipulation in bills previously submitted to Congress. There they defined "manipulate" "to include the causing or maintenance of an artificial price by action intended for that purpose." This is in keeping with the meaning of the word as interpreted by the courts and is exactly how the court defined it in the *Volkart* case. However the statute should say what "manipulation" is and not what the word includes. If it includes this meaning we will not know what it means since we do not know what else it includes.

The proposal to substitute "substantial evidence" for "weight of evidence" is an attempt to prevent the court from righting a wrong which may be committed by Department officials. If this amendment had been in effect during the time of the *Volkart* case it might have been more difficult for the court to overturn the erroneous decision of the Department.

The amendment proposed is to make it more difficult to appeal a decision of the Secretary of Agriculture when he suspends or revokes the designation of an exchange as a contract market and when he suspends or revokes the registration of a commission merchant or floor broker or denies trading privileges to others. It is expensive to appeal from a decision of the Secretary of Agriculture after extensive hearings within the Department. When an appeal is taken there is no justification for limiting the power of the court to correct a wrong decision.

REVOCATION OF DESIGNATION AS CONTRACT MARKET

Section 19 of the bill contains another objectionable feature. It gives the Secretary of Agriculture power to suspend or revoke the designation of an exchange as a contract market not only when the exchange fails to enforce its rules—which is proper—but when any director, officer agent, or employee of an exchange violates any provision of the act or the rules of the Department. Thus an exchange could be put out of business if its vice president or bookkeeper violated the Commodity Exchange Act in a private transaction not connected with

the operation of the exchange. This proposed amendment should be reconsidered by the Department of Agriculture.

In conclusion I would like to say that the New York Cotton Exchange has the highest regard for Mr. Caldwell, the Administrator, and Mr. Grosstephan, Deputy Administrator of the Commodity Exchange Authority, and for other officials of the Department of Agriculture. We are sure that they have proposed these changes because they believe them to be sound in the public interest. We think they are wrong and have tried, with all due respect, to show why.

Mr. MATSUNAGA. Our next witness is Mr. Edward W. Cook, vice president of the American Cotton Shippers Association of Memphis, Tenn. Mr. Grider.

Mr. GRIDER. May I have the privilege, Mr. Chairman, of introducing Mr. Cook, who is the president of Cook & Co. of our city, the largest cotton company in Memphis. His credentials are included in his testimony, therefore, it will not be necessary for me to give them.

Mr. Cook is a good citizen. I have seen him participating in community affairs throughout all of his adult life. He puts the welfare of the community before his company. I am grateful for the opportunity to present him to you.

Mr. MATSUNAGA. I am sure that Mr. Cook puts the welfare of his State above that of his company. You may proceed, Mr. Cook.

STATEMENT OF EDWARD W. COOK, VICE PRESIDENT, AMERICAN COTTON SHIPPERS ASSOCIATION, MEMPHIS, TENN.

Mr. COOK. Mr. Chairman and members of the committee, I am not going to read my statement. I will try to get through in the shortest time I can, because I do not anticipate that my testimony concludes anything which has not already been touched upon.

We are opposed to manipulation, that is, the new definition of it.

We are opposed to any attempt to legislate out of the case law the effect of the *Volkart* case which Mr. Rhodes touched upon, and which I assure you will not have anybody's objection except those people who fail to perform properly and who are on the short side.

I would like to emphasize briefly Dr. Gray's testimony about manipulation on the down side which is every bit as prevalent as manipulation on the up side. In any society, such as the commodities futures market, this is true.

There seems to be very little attention paid to the downside manipulation in all of these hearings and the testimony that has been given.

There are many other things that we disagree with in this proposed bill, particularly, the substitution of the substantial evidence rule for the weight of the evidence rule. We do not think that is fair.

There are some other things that are covered in my statement which I have filed with Mrs. Gallagher, the clerk, and I do not see any necessity to repeat things that have already been said.

Thank you.

(The prepared statement of Edward W. Cook follows:)

STATEMENT OF EDWARD W. COOK, VICE PRESIDENT, AMERICAN COTTON SHIPPERS ASSOCIATION

I am Edward W. Cook of Memphis, Tenn., and am associated with the firm of Cook & Co. of that city, and have been engaged in the cotton merchandising business since 1945, and in exporting grain since 1961. In connection with these

operations, we have utilized the various commodity exchanges, particularly the New York Cotton Exchange for cotton futures and the Chicago Board of Trade for grain futures.

I am appearing here for the American Cotton Shippers Association of which I am vice president. That association has as its members most U.S. cotton merchants and exporters and is actively interested in a useful and functioning cotton futures exchange—which we hope will be possible under the 1965 Farm Act. This should happen, if, as we hope, the price-support level is reduced sufficiently to permit a return to a market price system.

Very little use can now be made of the cotton futures exchange, but it has been an extremely useful merchandising facility in the past, and we are opposed to any new statutory provisions which will make it less useful when it again can function.

With some of the provisions of H.R. 11788, which you might call management or procedural questions, we are not concerned.

The first major point that does concern us is the proposed definition of the word "manipulate" beginning on line 8, page 2. We think it is objectionable because it eliminates any question of "intent"; because it embodies an unrealistic and purely subjective test, applied by an interested rather than an impartial officer acting as accuser, judge, and jury; and because the second sentence relieves one party to a futures contract of any responsibility whatsoever to perform his contract obligation. Its effect and we presume its intent is to reverse such decisions as that of the Fifth Circuit Court of Appeals in the *Volkart* case, 311 F. 2d 52.

The members of this association were greatly concerned and disheartened with the attitude taken by the CEA and the Department in the *Volkart* case which was decided in 1962. Actions taken by a cotton merchant in asking for delivery on futures contracts regarded by the trade generally as necessary and useful to the utilization of cotton futures contracts in the cotton merchandising business were simply regarded as manipulation. We believe the CEA position, there meant:

- (1) That a merchant may not choose for himself which spot cotton purchases or sales he wishes to hedge by sale or purchase of futures contracts, or when and at what price he wishes to close out his hedge contracts; and
- (2) That he may not hold for delivery contracts in excess of the previously certificated stock, but must liquidate such contracts at not more than the published spot quotations plus delivery costs, regardless of his view as to the value of spot cotton, of his need for it, or of what he is paying for it.

Fortunately, upon appeal the Court of Appeals for the Fifth Circuit reversed the decision. *Volkart Brothers, Inc. v. Freeman*, 311 F. 2d 52. The court held that the weight of the evidence did not support the accusation that Volkart's action in asking either for delivery, or a price they thought was its value, constituted manipulation, particularly where the shorts made no real effort to effect delivery. If the new definition proposed here and the new rule of law proposed, i.e., that any substantial evidence rule proposed at line 4, page 15, had been in effect the court would have been unable to reverse an action quite contrary to the views of a whole trade and harmful to the future operations both of the exchange and the merchants using it.

We urge that the proposed redefinition of the word "manipulate" be eliminated.

We do not understand what the purpose or effect is of the changes proposed by sections 4 and 6 in section 4a(2)B or section 4a(3) of the Commodity Exchange Act, but if there is to be any change we think that, either by extending the definition of "bona fide hedging" or by applying similar limitations to the regulatory power, the same protection should be given to a merchant's reasonably anticipated requirements for sale to his customers as is given to a mill's anticipated requirements by section 4a(3)C.

We are also puzzled by the amendment proposed by section 8 to substitute any "person" for any "member" of a contract market, etc. Is it intended to make this a general criminal statute applicable to all sales in interstate commerce? Differences in cotton classing are notorious and it would be pretty terrible if any representation as to grade, which might turn out to be erroneous, constituted a felony.

We have no objection to sections 9 and 10, relating to treatment of customers funds and financial responsibility of brokers, nor to section 11 dealing with transaction reports. We can see important benefits from a more careful policing than CEA's present staff permits.

Unless these are records kept in the ordinary course of business, we object to the proposed requirement to be added by section 12 requiring that detailed records of all spot transactions and inventories be maintained.

The American Cotton Shippers Association has opposed a number of times legislation giving the Secretary of Agriculture or anyone else the right to use minimum margins to control prices or speculative activity. Margins should be adequate to protect the market and to protect the contracts and the interests of exchange members is directly involved in seeing this is the case. While the De Angelis affair caused untold hardship to certain brokers, the commodity futures market itself was adequately protected in spite of the very extensive fraud practiced. We are aware that the Federal Reserve Bank has certain powers to prescribe margins for stock transactions, and that this has been used to cool speculative activities in stocks. To our mind speculation in commodities is quite a different animal, and a major difficulty is the lack of sufficient speculation to assure a really effective market for hedging purposes.

We are in doubt as to what the change in the language of section 5(b) proposed by section 14 of H.R. 11788 is intended to accomplish. Certainly the language "subject to the rules of a board of trade" can be rather extensive.

Section 16 is objectionable because it gives to the Secretary of Agriculture full control of margin requirements and of the form and manner of execution of purchases and sales of any commodity in interstate commerce or for future delivery. We think neither is necessary. There is adequate authority in existing law to prevent abuses in the execution of orders and the exchanges are quite able to decide what margins are required for legitimate protective purposes.

We oppose sections 20 and 21. We do not believe the Secretary should be given authority to enjoin on 3 days' notice the transactions of any person he suspects may be attempting to manipulate the market price of any commodity in interstate commerce or for future delivery. Tremendous losses can be imposed on a trader leaving him with no remedy whatsoever. Under the present law and, with reasonable cooperation of the CEA with the exchange committees, adequate and reasonable steps can be taken to avoid or liquidate situations which are regarded as questionable. A little cooperation can be far more effective than any amount of regulatory power. Section 29 also is not justifiable though it is far preferable to require court action to permit application of the drastic remedies proposed in this bill.

We have already indicated our objection to the provisions of section 20(b) which would substitute the "substantial evidence" rule for the "weight of the evidence" rule. Certainly, so long as the Department is to be district attorney, judge and jury, the present rule which gives a court of appeals some reasonable discretion should be maintained.

Section 23 making it a crime for any officer or director of an exchange not to enforce its rules seems unnecessary and insulting.

Section 24 seems to give the Secretary full authority to investigate everybody in the commodity business and turn the information to any other Government agency or department. "Any person subject to any provision of the act" is rather broad. Anyone who sells a bale of cotton in interstate commerce could be covered.

We see no excuse for increasing the penalties for offenses under the Commodity Exchange Act as provided in section 28. This is particularly true if the functions of district attorney, judge and jury are to be combined in the Department, and if court review is to be limited to determination of whether there is any substantial evidence to support the decision.

We do not think some of the powers suggested in this bill should be conferred on any governmental agency, but if any such powers as those suggested in this bill are to be given to any governmental body it should be an entirely independent one.

To turn complete control of a futures market over to the Secretary of Agriculture is equivalent to turning complete control over to the largest speculator in agricultural commodities, with no very specific guidelines.

The Department of Agriculture is simply no place for such authority. At one moment it is directing all its efforts to raise and maintain prices, and at another it is, at least in the view of many, endeavoring to restrain prices. Both efforts are directed to market control, the very antithesis of a free commodity market.

Mr. MATSUNAGA. You are generally in support of the statements made by the earlier witnesses, Mr. Cook?

Mr. COOK. I am in support of the statements made by Mr. Martin. I am a member of his exchange. I am in support of the statement made by Mr. Rhodes. I am a member of his exchange. I think that Dr. Gray presented, as you said, a very scholarly dissertation of the functions of the futures market and I am generally in support of his statement.

Mr. MATSUNAGA. As already stated, your statement will appear in full in the record.

I wish to thank you for your cooperation.

Mr. COOK. I should introduce, if you will allow it, our attorney, Mr. White, of Fulbright, Crooker, Freeman, Bates & White, a Washington law firm of considerable renown and no relation to other people whose names appear to be similar.

Mr. MATSUNAGA. Thank you.

Our next witness is Mr. Roy F. Hendrickson, accompanied by Mr. Bicknell, Mr. Andreas and Mr. Catron. We shall be glad to hear from you now.

**STATEMENT OF ROY F. HENDRICKSON, EXECUTIVE SECRETARY,
NATIONAL FEDERATION OF GRAIN COOPERATIVES, WASHINGTON, D.C.**

Mr. HENDRICKSON. Mr. Chairman and members of the committee, in view of the time limitations I would like to say that the four of us have each a prepared statement and I would like to have those filed as a part of the record, with the opportunity to make notations or corrections in the record as they develop.

I will make one or two points, and then suggest that you question us.

From my statement, I would like to say that our federation, the National Federation of Grain Cooperatives consists of some 26 regional grain cooperative associations, to which belong some 2,700 local associations. And two of the members of your committee here, Mr. Redlin and Mr. Dole, are very familiar with our operations, I think.

To the extent that hedging markets are available, these regional associations and the locals utilize them to reduce inventory risks and to facilitate the sale of grain for farmer members. In cases where properties and facilities are cooperatively owned, they are also used to insure against risk resulting from changes in prices. In some areas, such hedging facilities are not available, and there the risks are much higher.

The other point that I would like to make is simply that we have not seen the necessity for this new legislation. We do favor the Commodities Exchange Act. In fact, we owe a great deal to it, because it was as a result of this act that the recognition of cooperatives was supplied, eliminating what had been some degree of discriminatory treatment prior to 1936.

I am very familiar with the development and the record of this law. At one stage in my career, in the Department of Agriculture, I had general supervision of this particular agency. I do not consider myself an expert, but I learned then, before and since, to have a very high regard for the personnel associated with it.

I would simply like to have with my presentation here, because of the shortness of time, to identify these men who are associated with

me. On my right here is Mr. George R. Bicknell, who is assistant general manager in charge of marketing for the Farmers Union Co-operative Marketing Association of Kansas City, Mo., who is familiar in detail with this type of operation. On my left at the end of the table here is Mr. L. W. Andreas, who is chairman of the board of directors of the National Soybean Processors Association, and also president of Honeymead Products Co., which is a division of the Farmers Union Grain Terminal Association of St. Paul. He is located at Mankato, Minn. And, then, immediately to my left is Mr. William G. Catron, who is executive vice president of the Illinois Co-operative Futures Co. of Chicago, Ill., which is owned by a number of Midwest cooperative associations. I regret very much that these men, all of whom came here yesterday, will not have an opportunity, due to our time schedule, to present their statements in full, in person, but we will appreciate, of course, if they are included in the record.

With that, I will close and entertain any questions which you might have.

(The prepared statements of Roy F. Hendrickson, George R. Bicknell, William G. Catron, and L. W. Andreas follow:)

STATEMENT OF ROY F. HENDRICKSON, EXECUTIVE SECRETARY, NATIONAL FEDERATION OF GRAIN COOPERATIVES

Mr. Chairman, my name is Roy F. Hendrickson, executive secretary, National Federation of Grain Cooperatives, Washington, D.C. I appear in connection with amendments proposed to the Commodity Exchange Act contained in H.R. 11788.

The association I represent consists of 26 regional grain cooperative marketing associations which are, in turn, owned by more than 2,700 local grain marketing cooperative associations. These serve farmers in all of the principal grain and oilseed producing areas of the Nation, something over a million farmers in all.

To the extent that hedging markets are available, these regional associations and many local associations utilize them to reduce inventory risks and to facilitate the sale of grain for farmer-members. In cases where processing facilities are cooperatively owned, they are also used to insure against risks resulting from changes in prices. In some areas such hedging facilities are not available and risks are much larger.

Personnel representing cooperatives are members of the major grain exchanges where futures trading is provided—at Chicago, Kansas City, and Minneapolis.

Cooperative associations do not solicit the business of the general public, such as persons engaging in speculative buying or selling. We have no interest whatever in earning commissions from the business of speculators.

Cooperatives need lively, liquid markets where grain can be bought and sold in large or small volume fast and efficiently and at the lowest possible risk. Reason: To keep the marketing costs involved in the transfer of ownership between producers and consumers as low as possible. This is consistent with the public welfare and national farm policy objectives of long standing.

With me today are three executives serving farmer-owned cooperatives. These are:

George R. Bicknell, assistant general manager—sales, Farmers Union Co-operative Marketing Association, Kansas City, Mo.

Lowell W. Andreas, chairman of the board of directors, National Soybean Processors Association, and president, Honeymead Products Co., division of Farmers Union Grain Terminal Association, Mankato, Minn.

William G. Catron, executive vice president, Illinois Co-operative Futures Co., Chicago, Ill., owned by a number of Midwest grain cooperative associations.

These gentlemen will read prepared statements, and all of us, individually or as a group, will be glad to answer questions.

First, let me report that at our annual spring conference in Washington, last week, our board of directors met, and we discussed H.R. 11788, the bill before this committee which proposes to amend the Commodity Exchange Act.

Remember that cooperatives were very active in urging the passage of this act in the 1930's and of the Grain Futures Act which preceded it. It was the Commodity Exchange Act which finally brought to a close the anticompetitive discrimination under which, for various and sundry weak excuses, the farmers were denied seats on grain exchanges for the cooperatives they organized and supported.

So cooperative representatives are appreciative of this act and respect the excellent work carried on in administering it. We do not lightly dismiss the amendments proposed. We favor the extension of the act to all commodities traded in futures markets in which we trade, the grain and oilseeds. We believe that experience has proven the need of regulatory work to prevent abuses.

After discussion it was agreed that no need, urgent or otherwise, presently exists to justify enactment of these amendments without more and closer study in which the Department could usefully confer with all elements of the grain marketing industry.

Neither the Department nor the Commodity Exchange Authority nor any of the officials bothered to consult with our federation or its officers representatives in regard to this legislation. I think this failure to utilize the consultative method is contrary to the Department's best traditions with which I am very familiar. I think a far better bill, with wider support, could be thus developed without undue delay.

In this discussion of the amendments I found that federation directors were very much opposed to the proposition that there should be vested in the Secretary of Agriculture the authority to fix trading margins. They felt that this would add a new uncertainty, an additional degree of risk, to the marketplace for grain.

It should be added that while they have confidence in Secretary Freeman, they are aware that there will be other Secretaries in the future. They may prove to be less patient perhaps, less wise, less infallible.

I have seen a number of occasions when grain market behavior has caused some violent outbreaks of name calling and a rush to find a "devil" to whom the blame could be passed. In every instance the "speculator" came in for scorn, and in every case the idea of vesting in the Secretary the authority to fix minimum margins was trotted out as a panacea. I saw it in 1933 before the present act was passed. In 1947, there was an almost festive cussing out of speculators for advances in wheat prices. At that time, anyone who could read or listen to a radio was on notice that the Department of Agriculture was buying large quantities of wheat to ship to postwar Europe where farm production recovery was slowed by drought and many other things.

So the organized markets were asked to boost margin requirements to 25 percent of the value of a futures contract, then to 33 $\frac{1}{3}$ percent. Still the price went up because margin manipulation, no matter how hopefully undertaken, does not repeal the law of supply and demand. When the Government, without notice, suddenly stopped buying, the price fell sharply. The short-selling speculators cashed in on that because speculators seem to be both buyers and sellers.

A full-dress review of this episode was provided at hearings in February 1948, conducted by the Senate Committee on Agriculture and Forestry and presided over by the late Senator Capper of Kansas. At that time, the position taken by grain marketing cooperatives was similar to that we have today.

We believe that the Commodity Exchange Commission (consisting of the Secretaries of Commerce and Agriculture and the Attorney General) should not be abolished. The fact that the Commission evidently never meets is not necessarily proof that the Commission is a failure. Rather it is proof that the problems that have arisen have been few and not in need of a great deal of action. But like a quiet police station inaction does not prove the station should be closed.

We believe that these hearings have brought out clearly that the matter of defining manipulation needs restudy.

Finally, I believe that in our society the role of such voluntary groups as organized markets should be encouraged to exercise self-regulation and self-discipline.

The role of the Secretary of Agriculture and the Commodity Exchange Commission in relation to markets should be that of umpire or referee. He should be authorized to step in when really needed but not before capacity for self-regulation has been exhausted or proved inadequate.

STATEMENT BY GEORGE R. BICKNELL, ASSISTANT GENERAL MANAGER IN CHARGE
OF MARKETING, FARMERS UNION COOPERATIVE MARKETING ASSOCIATION

Mr. Chairman, my name is George R. Bicknell. I am assistant general manager in charge of marketing for the Farmers Union Cooperative Marketing Association, headquartered in Kansas City, Mo. The 520 member-stockholder elevators of this cooperative are located in Kansas, Colorado, Nebraska, Iowa, Missouri, and a limited number in Oklahoma. The farmers, who are the stockholder patrons of our member elevators, will number about 50,000 cooperators.

CMA, as our organization is informally known, is a marketing organization serving the cooperative elevators of the five-State area in the Missouri valley. We operate terminal elevators in Kansas City and Topeka, Kans.; Denver, Colo.; Omaha, Nebr.; and St. Joseph, Mo., with a total licensed capacity of over 40 million bushels. The division at St. Joseph, Mo., also operates a soybean processing plant, with a capacity of 750 tons of meal per day, and a feed manufacturing plant.

We are members of the Kansas City Board of Trade and the Board of Trade of the City of Chicago, both of which are licensed as contract markets. In addition, we have memberships in five other boards of trade and exchanges in order to market the cooperative grain to the best advantage of the producer.

In all of the various phases of grain marketing—sales and processing—we use the futures market in our hedging and processing whenever it is feasible and workable in our best business judgment. Quite often we are able to insure a satisfactory processing margin in our soybean operation by buying current beans on the board and selling the products—oil and meal contracts—on a deferred basis, lifting the hedges by reversing our positions as actual cash beans are available. This, of course, is a processor's conversion hedge used by the entire industry. Being a cooperative, our business operation in many respects is quite unlike those of private or old-line corporations. We are the marketing arm of our cooperative elevators—we must be ready and willing at all times to buy either small or large quantities of various grain at a bid that reflects the current market even though circumstances sometimes indicate that it is not in the best of business judgment—even at times when noncooperative buyers have withdrawn from the market, temporarily. Through the use of the options we have been able to reduce our possible losses to a minimum by hedging our purchases. In recent months the inability to obtain railroad equipment on schedule has practically eliminated our making sales of cash grain for deferred delivery since we cannot be assured of meeting the terms of shipping contracts, thus making the use of futures market as a hedge the only alternative; and this, sometimes, is not even workable. From a practical standpoint, being assured of having sound hedging privileges is the only marketing tool that we have available that reduces our grain sales cost. We have no interest in the contract market as to the commission received for handling speculative trades. In fact, we do not solicit this type of business. Our interests are as a vital cog in the marketing machinery of the present distribution system which we use in marketing the farmers' grain.

Seventeen of my 30 years of employment at CMA have been as a member of the Kansas City Board of Trade. During this time I have had many opportunities to observe and study the mechanics of the contract futures market, how it works, the supervision of the present staff of Commodity Exchange Authority, and I am thoroughly convinced that it would be hard to improve the present program. This program provides the machinery so that the farmer who produces our food and fiber gets distribution domestically and internationally at the cheapest cost possible.

It would be chaos if the farmers' market was placed in a position that our contract markets did not have fluidity. If we as grain marketers had to depend on a contract market for our hedges that was supported only by the milling industry, commission merchants, exporters, and domestic merchants, and did not include the speculator, who is an individual risk dealer, we would not have a fluid, stable market. The placing and lifting hedges would be strictly dependent on the needs of the other segments of the grain industry, hoping that these firms would be in need of taking the opposite position needed by us; and, conversely, these millers, exporters, etc., would need our support in adjusting their hedge positions—the speculator fills in the very vital element of market volume that gives the "futures contract" market the strength and life needed by the industry, of which we are now assured.

Any variance of standard requirements as to higher margins, trade volume curtailment that could be levied without notice would undoubtedly cause this individual to consider again the further risk that he would be assuming financially in taking speculative positions and could force the speculator to retire from the market and agriculture would lose the fluid market we so emphatically need to keep marketing costs down.

People and corporations dealing in the futures contract markets plan and trade months in advance, and I am sure it would be most difficult for all of us to program our activities knowing that one individual could change, shall we say, the rules of the game at his own discretion however sincere he might be in his action. Policies and views differ from one person to another, and no one knows the availability of a man holding a public office or life itself. Too much power and authority in the hands of one man would discourage those who make our contract markets what they have been for many years; it would appear to be too risky to experiment with something with so many unknowns compared to a proven system that has very few shortcomings, if any, that possibly could be corrected within the present Commodity Exchange Authority.

The producers of agriculture are operating under a series of controls set down by the Agriculture branch of our Government to the point that the grain trade has very little room to operate and conduct a business. Giving individual authority to this Department, enabling them to keep records of cash transactions and positions, to determine rules of Boards of Trade, financial requirements of future commission merchant registrants, margins, interpretation of terms, etc., would further this control to the point that it is not analogous to the Government principles that we have always respected and cherished, but borders on those ideas we have learned are not synonymous with our way of life.

In conclusion, we want to reemphasize that the marketing system we have now is the best and most adequate of any system we have heard proposed and serves the American farmer well—if there is any misunderstanding of the market operations by the public, it is only due to a lack of a public relations program on the part of the grain trade.

STATEMENT BY WILLIAM G. CATRON, EXECUTIVE VICE PRESIDENT,
ILLINOIS COOPERATIVE FUTURES CO. OF CHICAGO

Mr. Chairman, my name is William G. Catron. I am executive vice president of the Illinois Cooperative Futures Co. of Chicago, Ill. The Illinois Cooperative Futures Co. is a registered futures commission merchant operating on the Chicago Board of Trade and is wholly owned by farmer-owned cooperatives. Our members are both local and State regional cooperatives and are based in 15 States. They range from local country elevators to subterminal and terminal elevators and also include mixed feed manufacturers, soybean processors, and export interests, all farmer owned.

The function of the Illinois Cooperative Futures Co. is to handle the hedging operations of our members in the commodities traded on the Chicago Board of Trade. These remarks will be directed mainly to the proposed change in the control of margin requirements of futures markets—section 4j of H.R. 11788, the bill before your committee.

The proposed new section granting the Secretary of Agriculture alone the power to set minimum margin requirements when he "has reason to believe that there is danger" of certain stipulated situations developing, we believe to be not in the best interests of farmers, agricultural business, or the consuming public.

The availability of futures markets as a hedging medium allows our farmer-owned cooperatives to be in the market daily at a fair market price for the grain and soybean production moving from the farms of America. The passing along of a substantial part of the risks of ownership by means of hedging permits the entire chain of purchasing, handling, storing, or processing to be done at a minimum cost factor to the ultimate consumer.

Without this risk-bearing insurance system each phase of ownership of commodities would necessarily have to be handled at a higher protective cost.

Although our company handles only hedging transactions resulting from the various functions of our members, we fully realize that only through adequate liquidity can a futures market function satisfactorily. For a useful futures market the need for volume of trade engendered by the speculative element is

almost self-evident, as without it a market is not broad enough at all times, in the sense of participation by interested persons, to provide for the ebb and flow of forces which properly affect pricing. The fear of additional margin requirements could lead to a declining participation in futures markets by both hedging and speculative interests as the threat of forced liquidation in legitimate market positions of anyone involved would become an additional risk.

We believe that organized futures markets have proven their ability to properly diagnose, supervise, and control the vital matter of a proper level of margins to protect trading volume. As an example, the directors of the Chicago Board of Trade are always from the various segments of the marketing system, and each is vitally interested and concerned in the maintenance of a sound facility for trade. By their very name margins are a safeguard to the persons involved in futures trading, and we believe this is the true and only function they should serve. Protection of the financial standing of the transaction involved and not pricemaking should be the measure of margin control.

In view of the delicate balances involved in the proper functioning of a commodity futures market, we strongly urge that it is not in the best interests of our farmer-owned and farmer-controlled cooperative members or of agricultural interests in general to give to any one person, now or in the future, the power to arbitrarily set margin requirements with the possible result of destroying the usefulness of a time-tried price risk insurance system.

STATEMENT BY L. W. ANDREAS FOR THE NATIONAL SOYBEAN PROCESSORS
ASSOCIATION

Mr. Chairman, I am chairman of the board of directors of the National Soybean Processors Association, which represents 95 percent of the soybean processors in the United States, and also president of the Honeyamead Products Co., division of the Farmers Union Grain Terminal Association, a regional grain and oilseed processor cooperative headquartered in Minnesota.

There are some aspects of this bill that are salutary and that will work for better functioning of the various commodity exchanges. Among these are the elements of reports, floor broker activities, consolidation of controlled accounts, bank depositories, and financial standards of clearing members. However, there are some aspects that we feel will have serious adverse effects on the marketing system.

We, as processors, buy soybeans at a fixed price from the farmers. Since we cannot sell every day the same equivalent volume of soybean oil and meal as we buy soybeans, we sell (hedge) soybeans in the Chicago Board of Trade for future delivery. This, then, eliminates the risk of market change between that day and the day we can sell our products. When we sell our products we buy back our future sales in Chicago. Thereby, we can determine our soybean cost at the same time that we determine our product recovery price. There are, of course, many combinations to this hedging process, but all of them are executed in order to protect ourselves from market risks. Hedging is simply a method of buying insurance against market risks.

The soybean processing industry is heavily dependent on this hedging operation. Without liquid and free trading markets in the commodity exchanges our operations would take on a wholly new concept.

One more point needs making about the liquidity of the markets for hedgers. Without the speculator we would have no hedging market. If the speculator is not there to take the heavy surge trades of the market, it is the farmer who suffers. Someone must absorb the market risks. If the speculator does not, the processor must reduce his price for soybeans to the point where he can absorb the price valleys of the market. Therefore, for the sake of the farmer, the speculator must be courted, and the operations of the commodity exchanges must be so conducted.

Liquid hedging facilities (that is, markets with a large volume of speculative and hedge trading) have served to greatly narrow the spread between the farm price of soybeans and the consumer price of our products. Without the hedging medium, we would be forced to widen that spread in order to protect ourselves from sharp market fluctuations.

There are three principal proposals in the CEA bill, H.R. 11278, which we are convinced will seriously hamper the liquidity and function of the hedging facilities:

(1) The definition of "manipulation" as presented in the bill fits every trade. There is never a time when a trade does not move the price "to a level different than that which would otherwise prevail."

Therefore, we would have to seriously consider whether we dare trade in any commodity exchange. Current verbal indication by the Department of Agriculture of its "intent" on enforcement is hardly consolidation. Administrations and administrators change. This bill gives the Secretary of Agriculture the authority to place criminal charges against any trader at any time for any trade.

(2) The bill authorizes the Secretary of Agriculture to set margin requirements for many reasons, including his determination of "unwarranted changes in the price of any commodity." This is, in our opinion, an improper use of margin requirements and has the effect of giving the Secretary of Agriculture power to try to decree prices. It means that we as hedgers must, in advance of a hedge, judge what the risk is of the Secretary of Agriculture, by arbitrary action, converting a hedge into a speculation. This is a risk that the industry cannot afford to take.

As a matter of fact, no one individual, even the Secretary of Agriculture, has all the facts to determine in advance, whether a price change is "unwarranted."

(3) The replacement of the Commission (Secretary of Commerce, Secretary of Agriculture, and Attorney General) with only the Secretary of Agriculture eliminates one of the cardinal features of our form of government. Checks and balances on judgments of Federal employees, whether elected or appointed, is a basic part of our system. The industry cannot rely on a hedge that may be subject to the judgments of one man.

In general, we are in favor of legislation that preserves and advances fair, efficient, and liquid marketing through the commodity exchanges. We are opposed to legislation that inhibits fair, efficient, and liquid marketing through the commodity exchanges.

Mr. MATSUNAGA. Thank you very much.

Mr. Teague?

Mr. TEAGUE of California. Just one question.

Are you and your associates in general agreement with the testimony of the others who have appeared here in opposition to the bill?

Mr. HENDRICKSON. Yes; that is correct. Is there any difference on that?

Mr. ANDREAS. That is exactly right. We are concerned primarily in the Soybean Processing Association with the liquidity of the hedging facility. We think that the bill seriously hampers the liquidity, or will hamper the liquidity of the trading in soybeans. And in two particular instances, the manipulation—that is, the definition of it, and the margin controls. And we are fearful of hampering the liquidity, so that we will not be able to properly hedge our commodity.

Mr. HENDRICKSON. I might add one point. Our position on this was reviewed only last week by the board of directors, and is consistent with that which we took in 1948 when a full-dress review of this whole situation and most of these ideas was undertaken by the Senate Committee on Agriculture, under the direction of Senator Capper, then chairman. That followed a situation which occurred during 1947-48. I am very familiar with this development in 1947 and 1948, during which time the Commodity Exchange Administration did ask that margins be increased, first, to 25 percent, and then to 33.3 percent. Still the price of wheat went right on up because the changing of the margin requirements in nowise repeals the law of supply and demand.

Mr. MATSUNAGA. Mr. Greigg?

Mr. GREIGG. Thank you, Mr. Chairman, no questions.

Mr. MATSUNAGA. Mr. Redlin?

Mr. REDLIN. May I say that I am very happy that Mr. Hendrickson and his associates are here, having known him for the period be-

fore and after 1948, and that this federation, which represents such a large segment of the grain business, more particularly, would make this positive statement.

Might I ask Mr. Andreas just one question? There has been reference to the fact that the oil scandal would have been avoided had there been this kind of a bill in operation. Do you see any relationship at all to the help this bill would have given that situation?

Mr. ANDREAS. I see none whatever. If anything, the implementation of parts of this bill would have made it worse.

Mr. REDLIN. Thank you.

Mr. HAGEN of California. You have an interesting statement on page 4, Mr. Hendrickson, of your statement:

We believe that the Commodity Exchange Commission (consisting of the Secretaries of Commerce and Agriculture and the Attorney General) should not be abolished. The fact that the Commission evidently never meets is not necessarily proof that the Commission is a failure.

Mr. HENDRICKSON. That is correct.

Mr. HAGEN of California. If they never meet, how can they do anything?

Mr. HENDRICKSON. Evidently there were few problems grave enough to justify a meeting. I have never seen the minutes of such meetings.

Mr. HAGEN of California. They have never met?

Mr. HENDRICKSON. So far as I know they have not.

Mr. HAGEN of California. They are supposed to police these markets, yet they never meet.

Mr. HENDRICKSON. The reason for such a meeting would come from a call or motion by the Department of Agriculture somehow, some way. There are certain types of questions which could be referred to the full Commission and perhaps there have been. In the case in 1947 or 1948, as I remember it—

Mr. HAGEN of California. But they do have a professional staff that meets, I am sure.

Mr. HENDRICKSON. So far as I know, not on this subject. They did not formally meet when I was familiar with the detail of it. I simply do not know of any such meetings—in fact, I asked informally the other day if there was any record of any meetings and any minutes which I might inspect or examine, and I was informed that there had not been any such meeting. Well, I am not sure if they should meet—maybe they have not had any problems to have an occasion for the need for a meeting.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Is there anyone here from the Department of Agriculture?

Will you state your name for the record.

Mr. GROSSTEPHAN. My name is Arthur R. Grosstephan, Deputy Administrator of the CEA.

Mr. MATSUNAGA. What about the statement here, "The fact that the Commission evidently never meets is not necessarily proof that the Commission is a failure"? Is it true that the Commission has never met?

Mr. GROSSTEPHAN. The Commission has met at least twice. It met once a few years ago to listen to oral arguments in the complaint which was brought against the Kansas City Board of Trade. Oral arguments were presented in that case before the CEC. All three

members were required to attend. They wanted to send some deputies, but the act would not permit this, and so the Attorney General, the Secretary of Commerce, and the Secretary of Agriculture met in person at that time.

Then they met once a number of years ago in a case which was brought, I believe—I am going back now in memory—I do not have any real personal memory on this—I was not engaged in it—they met because a firm had brought a complaint itself against the Chicago Board of Trade. I believe I am right on this. And I believe that they had to meet in this connection. This was not something that the Department of Agriculture had initiated, as I recall it.

Mr. MATSUNAGA. What is the reason for the lack of meetings?

Mr. GROSSTEPHAN. That they have only a few functions, sir. The most usual function which they have is the setting of limits on speculative trading in regulated commodities. This they do without having the necessity of a meeting.

The Secretary of Agriculture conducts hearings. Usually, the staff of the CEA operates as the staff of the Commodity Exchange Commission. We hold hearings, or we receive views of the trade as to the limits on speculation. And then a recommendation is forwarded to the Commission individually without the necessity of a meeting. If they agree, then they adopt the limits that we have recommended.

Mr. MATSUNAGA. There is no requirement that they meet as a Commission to make decisions?

Mr. GROSSTEPHAN. Not in these situations; no, sir, but there is this requirement in certain situations, such as the case against the Kansas City Board of Trade.

Mr. MATSUNAGA. Thank you very much.

Mr. DOLE. This might be a good rule for the Congress to follow. Maybe the country would be better off.

Do you share the views as expressed by Mr. Hendrickson in his statement? You have your own separate statements. Specifically, do you feel changes are needed now in the Commodity Exchange Act?

Mr. BICKNELL. Mr. Dole, I agree wholly with Mr. Hendrickson's statement. I do not see that so far as the cooperatives are concerned, associated with the farmers direct in marketing their grain—we can see nothing that would be gained in changing the present CEA form that we have now. There might be some adjustments that I am not familiar with which might help the Commission—that they might do within their own organization. But from a legislative standpoint I see that it will not do anything for our marketing distribution.

Mr. DOLE. Thank you.

Mr. MATSUNAGA. Thank you very much, gentlemen.

Without objection, as already stated, your statements will appear in the record as though presented in full.

Mr. HENDRICKSON. Thank you very much.

Mr. MATSUNAGA. Our final witness for this morning is Mr. J. S. Chartrand, executive vice president of the Kansas City Board of Trade.

Mr. CHARTRAND. If it pleases the committee, the time assigned to me will be taken by Mr. Willis C. Theis, vice president of the Board of Trade of Kansas City, Mo.

Mr. MATSUNAGA. Without objection, you may proceed, sir.

STATEMENT OF WILLIS C. THEIS, VICE PRESIDENT, BOARD OF TRADE, KANSAS CITY, MO.; ACCOMPANIED BY J. S. CHARTRAND, EXECUTIVE VICE PRESIDENT, BOARD OF TRADE

Mr. THEIS. Mr. Chairman and members of the committee, I will paraphrase the prepared statement.

The Kansas City Board of Trade has reviewed this House bill very diligently and with a great deal of thought. We have come up with a few ideas. There are amendments with which we feel that we could live. There are certain amendments which we believe to be detrimental to our markets, as well as adverse to the public interest which we serve. I will quickly go over these few items with you. We have them numbered in the testimony.

Starting with No. 1, we are opposed to the definition of "manipulation" as it appears in the bill.

No. 2, we are opposed and we really do not quite understand what they mean by "minimum financial requirements of futures commission merchants." We do not know what these minimum financial requirements would be, how they would be imposed. We do not know if they would be broken down into categories, whether they could cover the small operator as well as the large operator. If by chance they were one and the same, it well could be that the smaller man could be administrated out. We believe that it should be understood by your committee that as a board of trade we have a good surveillance over the minimum financial requirements of our members. On their applications for membership they must file with us a certified financial statement. This is gone over very closely. It pertains to the types of operation that the prospective member says he will engage in.

Then after he has been a member, in our business conduct committee, we have continued surveillance.

One of the rules of the business conduct committee is not only to watch, but to act.

No. 3, we are opposed to the margins proposals as spelled out in the bill and the setting of margins by the Secretary. For your information, I have included in the statement a short history of the grain margins, so far as Kansas City is concerned, and I have attached appendix A, a history since 1939 of the effective changes of margins.

I would like to point out at this point, not only do we change these when necessary under certain circumstances, but we have mechanisms for quick revisions when the circumstances no longer require that we maintain such a level.

After a history in our statement on margins, we get further into our opposition to the margins controlled by the Secretary. I think that it would be well for me to say to you that we believe that the stipulations as they appear in the bill allow the Secretary, no matter who he may be—no matter which Secretary of Agriculture is in office—just peering into the future with preconceived ideas of stocks and too much discretion to set minimum margins.

We are a little bit concerned about the enforcement of the Secretary's rules and regulations. I am speaking now of the rules and regulations which would be promulgated by the Secretary of Agri-

culture. Under this bill this would mean that we would be obliged to police it. We have a feeling that if these rules of the regulatory agency are set, they should be policed by that agency. We are opposed to one-man control versus the Commission as you know it today in CEA. Again we allude to the fact that within this area they can change from time to time, from Secretary to Secretary.

So far as matters pertaining to the burden of proof are concerned, we are also opposed to the amendment in the pending bill, where they have asked to have a change of evidence from the weight of evidence to substantial evidence.

We are also in agreement with the other gentlemen who have testified; i.e., the procedures on manipulation should be after the fact and not before the fact.

Here I might say very quickly to you that we also are concerned that we might have a trigger-happy Secretary who could come along and take action, and then after the facts were found, would be proven that he was wrong. The damage would have been done to our markets, to our members, and we would have a bad situation.

As the last point in my testimony, it has to do with the lack of intent. We believe that the words of "willfully, knowingly, or intentionally" should be inserted after the pronoun "who," wherever it appears.

I thank you very much for this time, sir. If there are any questions we will be very happy to try to answer them.

(The statement of Mr. Theis is as follows:)

STATEMENT OF WILLIS C. THEIS, VICE PRESIDENT, BOARD OF TRADE OF
KANSAS CITY, MO.

My name is Willis C. Theis, and I appear in behalf of the board of trade of Kansas City, Mo., a contract market regulated under the provisions of the Commodity Exchange Act. The board of trade of Kansas City, Mo., was officially designated as a contract market under the original Grain Futures Act on May 5, 1923, by Henry C. Wallace, then Secretary of Agriculture.

We have analyzed the proposed amendments to the Commodity Exchange Act in H.R. 11788 and found some of the changes we can accept; others merely incorporate into the law what our board of trade has been doing for the past 90 years; and those that would be highly detrimental to our market, even to the point of causing its demise. With the view of conserving time, we confine this presentation to that portion of H.R. 11788 that is detrimental to our market and adverse to the public interest it serves.

DEFINITION OF "MANIPULATION"

H.R. 11788 (p. 2, line 8 of the bill) defines "manipulation" as follows:

"The word 'manipulate' shall be construed to mean the exacting, causing, or maintaining of an abnormal or artificial price by any action or course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to a level different than that which would otherwise prevail. Any such exacting, causing, or maintaining of an abnormal or artificial price shall constitute manipulation irrespective of any acts or omissions by the holders of futures contracts adversely affected thereby."

We object to this provision because it lacks the element of "intent" which must be specifically included due to the criminal charge attached thereto. "Manipulation" under section 9(a) of the act (p. 21 of the bill) makes it a felony punishable by fine of not more than \$10,000 or imprisonment for not more than 5 years, or both, which requires a clear showing of intent before punishment of that magnitude can be imposed. The present act has numerous provisions reflecting knowledge by the acting party by the inclusion of words such as "wilful, knowingly, falsely to represent, false or misleading, carelessly," but here the term "manipulate" is left to cover any and all conduct, intentional or

otherwise. We maintain that before a person can be guilty of a felony and suffer the penalties attached thereto, he must have intended to do the act alleged instead of leaving it open to cover the full gamut of his business activities. The foregoing is particularly true because of the vague and uncertain actions which are included within the definition to which we now turn your attention.

Section 2(a) (p. 2, line 9 of the bill) amends the act to enumerate types of conduct that would constitute manipulation. As submitted, that conduct includes:

"* * * exacting, causing or maintaining of an *abnormal or artificial prices* by any action or course of action which raises, depresses, fixes, pegs or stabilizes the price at or to a level different than that which would otherwise prevail." [Italic ours.]

Because of the seriousness of the charge involved, there must be a clearer definition of unlawful conduct than the causing or maintaining of an "abnormal or artificial price," which can mean many things to many people. Since, under the terms of the bill, all allegations of "manipulation" would be left to the Secretary of Agriculture, no member of the public has any idea of what he might consider "abnormal" or "artificial."

Citizens are entitled to a more precise definition of unlawful acts than these uncertain terms. Further, future Secretaries may have an altogether different idea of "abnormal or artificial prices," and, therefore, those doing business in the contract markets will have their guidelines changed from Secretary to Secretary. The act by which they are governed should be so clear as to spell out in undisputable terms specific conduct that shall be deemed unlawful under any administration.

The foregoing language is vague and uncertain when it states "to a level different than that which would otherwise prevail." There is no means of ascertaining what the price would be had it not been for the alleged conduct of an individual. This provision contemplates crystal-ball gazing to guess the level a commodity would have maintained had not a particular course of action been taken. A criminal charge directed to an individual based upon an assumption that his conduct resulted in "a level different than that which would otherwise prevail" falls far short of the definiteness to which he is entitled. The act should be clear with regard to the course of conduct that a citizen is obliged to follow and not leave him open to the uncertainties of the proposed legislation.

II. MINIMUM FINANCIAL REQUIREMENTS OF FUTURES COMMISSION MERCHANTS

Section 4f(2) (p. 6, line 24 of the bill) has been amended to read as follows: "Any person desiring to register as future commission merchant shall meet such minimum financial requirements as the Secretary of Agriculture may by regulation prescribe as necessary to insure his meeting his obligations as a registrant, and if registered shall at all times continue to meet such prescribed minimum financial requirements."

In our opinion, the foregoing amendment to the act is deficient in that it does not spell out the minimum requirements that would be imposed, broken down into the numerous classifications of future commission merchants. There is a great deal of difference in the range of activities engaged in by future commission merchants, and unless some allowance is made for the smaller scope of activities engaged in by some, an undue minimum financial requirement would result as to them. The Kansas City Board of Trade polices the minimum financial requirements of its members, including futures commission merchants, and due allowance is made to the scope of the individual's activity in connection with the financial requirements demanded of him. We also supervise the financial position on a continuing basis, and if there is any reason for our business conduct committee, to believe that those requirements should be reviewed or changed as a result of a different range of activity, our business conduct committee acts accordingly. The size of a futures commission merchant's activities is under the surveillance of our clearinghouse to whom his daily business is reported within minutes after the close. We maintain that the respective boards of trade have shown themselves fully capable of policing the financial requirements of their members, and there is no need to place that power in the Secretary and his subordinates who are located thousands of miles away. If the Secretary sets minimum financial requirements so low as not to work a hardship on the small commission merchant, it would be inadequate for all scopes of

activity. Further, we are able to police this area on a continuing basis. Our business conduct committee, composed of the president of the board of trade, the president of the clearinghouse, plus three other members, are on the trading floor daily and in a position to observe firsthand the activity of the market and are empowered to supervise the financial condition of all members. The Department cannot maintain those close contacts.

III. HISTORY OF MARGINS

The word "margin" is a trade term denoting a sum of money deposited with a commission merchant to assure the fulfillment of a contract to purchase or sell a commodity for future delivery upon an exchange. Its need arises from the fact that the values of grain fluctuate and the necessity of protecting the other party to a contract to the extent that there is a difference or margin between the contract price and the current value of grain. There is nothing new about margins nor their application to futures contracts. As long ago as 1877 the Kansas City Board of Trade had a rule regarding margin requirements which were changed from time to time as current conditions required. The duty and power to establish appropriate margins are lodged with the board of directors. In addition, our business committee supervises the observance of rules and regulations pertaining to margins.

The Kansas City Board of Trade has continued to operate under these rules and regulations, and its Board of Directors has from time to time established and modified margin requirements depending upon the circumstances existing at a particular time. We respectfully refer the committee's attention to appendix A which shows the initial margin requirements of our exchange since 1939 and the numerous changes that have been made and the dates on which they were imposed. It is to be noted the fairly low and consistent level attached to hedging and spreading trades whereas "other trades" covering speculation were increased to meet a particular occasion and thereafter reduced to meet normal trading requirements. The important point is that the Kansas City Board of Trade was quick to increase margin requirements on speculative trades when the need arose and was just as prompt in reducing them when the particular incident had passed.

For example, on November 9, 1962, the initial margins on speculative trades were 7 cents on wheat and 5 cents on corn. On May 16, 1963, we raised margins on 1964 May and July wheat futures to 40 cents due to the announced certificate plan which would increase the cost to holders of long wheat futures contracts 70 cents or 35 cents per bushel, depending upon whether ultimate use was in domestic or export channels. It will be further noted that on May 28 the situation had cleared somewhat, warranting a reduction in the margins on wheat to 12 cents, and by June 26, 1963, the 7 cents margin requirement on wheat was restored.

One of the unhealthy situations that will result under the proposed bill is the provisions in section 4j (pp. 8-9 of the bill) which give the Secretary of Agriculture power to prescribe minimum margins whenever he "has reason to believe that there is danger of * * * sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity * * *." In order to be on the safe side, it can be expected that he will set margin requirements that are higher than necessary under the circumstances. There will not be a distinction made between the various commodity markets concerning the conditions existing thereat which would warrant different margins on the same commodity. There is nothing to indicate that he will be in any hurry to reduce previously prescribed margin requirements when he no longer "has a reason to believe that there is a danger of sudden or unreasonable fluctuations * * * or unwarranted changes in the price of any commodity." This is a perfect mechanism for price control by the Secretary of Agriculture who has already given evidence of exercising much power in this direction by either withholding or dumping surplus Government stocks upon the open market for whatever reason he might have to believe necessary.

Mandatory margin requirements have been in effect in the Kansas City market for many years and have been determined and enforced by the board of trade. Obviously, as the practice of requiring mandatory margins is now well established, embodied in the permanent rules of our exchange and enforced by resolutions, no legislation is needed to require the practice; and there is no need to put it in the hands of a Government agency.

IV. MARGIN CONTROLS BY SECRETARY OF AGRICULTURE

Section 4j (pp. 8-9 of the bill) reads in part as follows:

"Whenever the Secretary of Agriculture has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, or excessive speculation in any commodity, or any other activity reasonably expected to restrain trade, in connection with the sale of any commodity for future delivery, or in interstate commerce, under contracts made on or subject to the rules of any contract market, the Secretary of Agriculture may prescribe the minimum margins which such contract market and all futures commission merchants shall require to be initially deposited and subsequently maintained by each person in connection with speculative or hedging positions which may be held by such person under contracts of sale of such commodity for future delivery, * * *. Because of the nature of futures trading and the necessity for expeditious action in imposing margin requirements, such rules may be made effective upon actual or constructive notice to persons affected thereby. It shall be unlawful for any futures commission merchant having notice of such a rule to fail to require its customers to meet the margin requirements thereof, or for such contract market having notice of such a rule to fail to enforce it against its members." [Italic ours.]

The foregoing language empowers the Secretary of Agriculture to establish margin requirements under vague and uncertain terms. That terminology includes:

- (1) "Whenever the Secretary of Agriculture has reason to believe that there is danger * * *."
- (2) " * * * sudden or unreasonable fluctuations * * *."
- (3) " * * * unwarranted changes in the price of any commodity * * *."
- (4) " * * * excessive speculation in any commodity * * *."
- (5) " * * * other activity reasonably expected to restrain trade * * *."

Here the Secretary, located thousands of miles from the intensive activity, will peer into the future and if he "has reason to believe that there is danger" or if it can "reasonably be expected to restrain trade," he will be empowered to establish "minimum margins." This contemplates acting on a preconceived notion of what is a "sudden or unreasonable fluctuation" or "unwarranted change in the price of any commodity" or "excessive speculation in any commodity," and if he "has reason to believe" that any of those possibilities exist, he can with actual or constructive notice issue orders imposing margin requirements to become effective immediately. We maintain that the circumstances under which the Secretary of Agriculture would be able to impose margin requirements operate into the future under vague and indefinite guidelines, rendering his prescription of margins wholly unpredictable. The meaning of "Whenever the Secretary of Agriculture has reason to believe" will vary with the Secretary then in office, leaving the grain trade in a state of uncertainty as to their future. The whole import of section 4j (pp. 8-9 of the bill) concentrates upon the imposition of margins under a nebulous set of circumstances, and nothing is said with regard to the duty upon the Secretary to remove those margin requirements when the assumed danger of manipulation, sudden or unreasonable fluctuations, unwarranted changes in price, excessive speculation, or the other activity reasonably expected to restrain trade have disappeared. Our experience in the past leads us to the conclusion that once the Secretary established a margin requirement, it would be on a continuing basis. We see nothing to indicate that those controls would be removed, permitting margins to return to normalcy with the same speed and precision that they were imposed.

We now refer the committee to the term "minimum margins" which the Secretary of Agriculture would be empowered to levy. This contemplates that minimum margins might be imposed upon dozens of different commodities presently traded in the various contract markets over the country, which will not be a menial task. It is impossible to comprehend that margin requirements emanating from Washington, D.C., will be what they should on the wide range of commodities involved traded upon contract markets spread over the continental United States. To be candid, we believe that the imposition of margin requirements under these circumstances can be deemed to be nothing more than a price control mechanism. Margins are designed to guarantee performance of the contract, and if established by anyone for any other purpose will result in "manipulation" as defined in this proposed amendment to the act. If not handled with the

greatest care, it will result in the "exacting, causing or maintaining of an abnormal or artificial price by raising, depressing, fixing, pegging, or stabilizing the price at or to a level different than that would otherwise prevail." High margins will drive the public from the marketplace, and the contract markets will not be able to function and serve the public as they have for nearly a century. Since the proposed amendments are being extended to include all "other persons" in section 9 (a) (p. 21, line 11 of the bill), the Secretary of Agriculture would be just as guilty as anyone else in violating the Commodity Exchange Act. There is no immunity granted the Secretary under the act.

In addition to the foregoing, section 4j (pp. 8-9 of the bill) has numerous provisions which are indefinite and vague, including "special or different margin requirements," "appropriate provision with respect to carrying of under-margined positions," "for limited periods," and "under specified conditions." Also, the formula for prescribing margins is vague by providing that "Such rules may specify * * * the basis and methods to be used in calculating margins, and similar administrative adjustments and details." It is obvious that the formula to be used in calculating margins and similar administrative adjustments and details will vary from Secretary to Secretary, and what was an inadequate margin under one administration might be more than adequate in another. The commodity markets cannot operate with any degree of stability under the uncertainties of these guidelines.

Last, but not least, we make strong objection to binding us with the inadequacies of "constructive notice." This section of the act demands that a contract market having notice of a rule established by the Secretary of Agriculture enforce it against its members. If this is to be the case, we must be given "actual notice" and not merely constructive notice. Constructive notice might well be posting of an order on a bulletin board in the office of the Secretary, but the markets cannot and should not be expected to hire someone to examine such posting for duties imposed by law.

The Board of Trade of Kansas City, Mo., wishes to go on record as opposed to the provisions of section 4j (pp. 8-9 of the bill) in its entirety.

V. ENFORCEMENT OF THE SECRETARY'S RULES AND REGULATIONS

Section 5a (8) (p. 11, line 6 of the bill) states:

"Each contract market shall * * * make such terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market and make and enforce such by-laws, rules, regulations, and resolutions relating to margin requirements and the form and manner of execution of purchases and sales of any commodity, in interstate commerce, or for future delivery on or subject to the rules of such contract market, as the Secretary of Agriculture, to effectuate the provisions of this act, may direct by rule furnished to such contract market and published in the Federal Register."

The foregoing imposes the entire burden upon the contract market to police every rule or regulation promulgated by the Secretary of Agriculture, thereby placing an undue policing burden upon the contract markets. The Commodity Exchange Authority would be able to sit back with only their attention focused upon us. Throughout the Commodity Exchange Act there are innumerable duties imposed upon every segment of the trade, and it would appear that some statutory responsibility should be placed upon the CEA to police its own law rather than throwing the entire burden upon the commodity exchanges. The markets would be in constant jeopardy in that section 5b presently provides:

"The failure or refusal of any board of trade to comply with any provisions of the act, or any of the rules, regulations, or orders of the Secretary of Agriculture shall be cause for suspending or revoking the designation of such board of trade as a contract market in accordance with the procedure and subject to the judicial review as provided in paragraph (a) of section 6 of the act."

Throughout the past the Commodity Exchange Authority has made investigations into the activity of traders on the futures markets and has policed many of the provisions of the act with their own organization. Not too long ago the General Accounting Office admonished the Commodity Exchange Authority for not policing the Commodity Exchange Act to a greater degree, and the answer was given that the CEA did not have sufficient money or personnel to do a better job. Instead of asking for appropriations in order to obtain additional personnel to carry out the provisions of the act, the proposed legislation would thrust the entire burden upon the commodity exchanges and suspend them or revoke

their license if they did not perform the policing duties to the satisfaction of the Secretary of Agriculture.

We maintain that this is an undue burden to place upon the markets and that the Secretary of Agriculture should, instead, obtain such appropriations as are necessary to carry out the provisions of the act.

VI. A COMMISSION VERSUS ONE-MAN CONTROL

Section 6(a) (p. 12, line 5 of the bill) would change the authority presently lodged in a Commission comprised of the Secretary of Agriculture, Secretary of Commerce, and Attorney General to complete control in one person, the Secretary of Agriculture. This section enumerates the powers presently lodged in the Commodity Exchange Commission and, as amended, will include authority: "to suspend for a period not to exceed 6 months or to revoke the designation of any board of trade as a 'contract market' upon a showing that such board of trade is not enforcing or has not enforced its rules of government made a condition of its designation as set forth in section 5 of this act or that such board of trade or any director, officer, agent or employee thereof otherwise is violating or has violated any of the provisions of this act or any of the rules, regulations or orders of the Secretary of Agriculture thereunder."

The Kansas City Board of Trade is not adverse to enforcing its rules of government provided that such requirement is under the jurisdiction of a Commission and not a single individual who would be the legislator, prosecutor, judge, and jury as contemplated by the act taken as a whole. We strongly object to these combined powers in the Secretary of Agriculture and maintain that there should be a separation of those powers as is presently maintained by other administrative agencies. There should be an opportunity to appeal from any ruling or conclusion by the Secretary of Agriculture to an impartial Commission to avoid an arbitrary exercise of authority by a single executive officer. If written into the law as proposed, it would set up the present and future Secretaries of Agriculture as a czar over the commodity markets.

VII. BURDEN OF PROOF

In addition to the foregoing, no order of the Secretary of Agriculture could be modified or set aside unless it is shown by a board of trade that the order is unsupported by "substantial evidence." The present language requires a showing that such order must be supported by "the weight of the evidence," which is entirely different. Rather than an order of the Secretary of Agriculture being supported by a preponderance of proof, it could be supported by the nebulous range from a bare minimum of evidence to that supporting an arbitrary and capricious action. Any order that would result in suspending or revoking the designation of any board of trade as a contract market should be supported by undisputed proof of its violation of the law rather than minimum requirements. Our objection with regard to changing the burden of proof from "weight of evidence" to "substantial evidence" is also directed to section 6(b) (p. 15, line 4 of the bill) where it likewise appears.

VIII. RESTRAINT "BEFORE THE FACT"

Section 9a (p. 22, line 8 of the bill) reads in part as follows:

*"Whenever it shall appear to the Secretary of Agriculture that any contract market or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act, or any rule, regulation, or order thereunder, the Secretary may notify the Attorney General, and the Attorney General may bring an action in the proper district court * * * to enjoin such act or practice and to enforce compliance with this Act * * *"*

The foregoing italicized language would permit the Secretary of Agriculture to start legal action against any contract market whenever it "appeared" that such market was engaging in some unlawful act. This results in a "before the fact" action which might be based on crystalball gazing, assumptions, or intuition of whoever might be Secretary of Agriculture at the time or subordinates to whom he has delegated authority. It is not enough to say after an entire proceeding has been completed that the Secretary of Agriculture is "sorry" that a bad name had been given the contract market because from the market's standpoint it would have been subjected to irreparable injury by a loss of the public's confidence. A criminal proceeding against an exchange or any other

person must be limited to an "after the fact" situation and not merely because "it shall appear to the Secretary of Agriculture" that they are "about to engage" in any violation of the law.

IX. LACK OF INTENT

Section 13 (p. 23, line 16, of the bill) provides in part:

"Any person who aids, abets, counsels, commands, induces or procures the violation of any of the provisions of this Act or any of the rules, regulations, or orders issued pursuant to this Act or who acts in combination or concert with any other person in such violation * * * shall be held responsible under this Act for such violation as a principal." [Italic ours.]

Other sections of the act insert the element of intent with regard to an enumerated violation of the law by including such words as "wilfully, knowingly, falsely to represent, falsely or misleadingly, or carelessly," whereas section 13 (p. 23, line 16, of the bill) makes any of the enumerated actions a violation of the law whether or not it was intended to be violated. We maintain that the element of intent must be included therein by adding the words, "wilfully, knowingly, or intentionally," after the pronoun "who" where it appears. Therefore, "any person who wilfully, knowingly, or intentionally aids, abets, counsels, commands, induces, or procures the violation * * * or who wilfully, knowingly, or intentionally acts in combination or concert with any other person * * * shall be held responsible under this act for such violation as a principal."

This language must be incorporated into any bill to remove the vague and uncertain standards of conduct with which a person might be accused. Section 13 (p. 23, line 16, of the bill) covers the entire act, and intent must be shown to sustain the institution of a criminal proceeding.

The Board of Trade of Kansas City, Mo., thanks your honorable committee for the opportunity to appear and express its views with regard to this important legislation and respectfully requests that it be withdrawn and canceled.

Thank you.

APPENDIX A

Prescribed minimum initial margins on transactions for future delivery on the Kansas City Board of Trade

Effective	Hedging trades	Spreading trades ¹	Other trades
Jan. 10, 1939	W&C 2	2	3.
Sept. 5, 1939	W 5 C 4	W 5 C 4	W 7 C 4.
Sept. 6, 1939	W&C 5	5	W 12 C 8.
Sept. 7, 1939 ²	W&C 5	5	W 15 C 12.
Sept. 16, 1939 ²	W&C 5	5	W 12 C 9.
Oct. 10, 1939	W&C 4	4	W 10 C 8.
Nov. 1, 1939	W&C 3	3	W 6 C 4.
Dec. 7, 1939	W&C 3	3	W 8 C 5.
Dec. 20, 1939	W&C 3	3	W 10 C 6.
Aug. 7, 1940	W&C 3	3	W 6 C 5.
Mar. 31, 1941	W&C 3	3	W 8 C 5.
May 29, 1941	W&C 3	3	W 10 C 5.
Sept. 6, 1941	W&C 3	3	W 12 C 7.
May 27, 1942	W&C 3	3	W 10 C 7.
May 18, 1946	W&C CH	CH	10% value.
July 3, 1946	W&C 5	5	10%.
Mar. 17, 1947	W&C 5	5	W 25% C 10%.
May 14, 1947 ²	W&C 5	5	W 25% C 10%.
Sept. 6, 1947 ²	W&C 5	5	W 25% C 35¢.
Sept. 13, 1947 ²	W&C 5	5	W 45¢ C 45¢.
Sept. 29, 1947 ²	W&C 5	5	Sliding scale.
Oct. 7, 1947 ²	W&C 5	5	33 1/4% of value.
Nov. 13, 1947	W&C 5	5	33 1/3% of value.
May 26, 1948	W&C 5	5	W 55¢ C 50¢.
June 16, 1948	W&C 5	5	W 40¢ C 40¢.
Aug. 11, 1948	W&C 5	5	W 25¢ C 25¢.
Nov. 4, 1948	W&C 5	5	W 20¢ C 15¢.
Dec. 7, 1949	W&C 5	5	W 15¢ C 12¢.
July 21, 1950	W&C 5	5	W 20¢ C 12¢.
July 29, 1952	W&C 5	5	W 15¢ C 12¢.
Aug. 12, 1953	W&C 5	5	W 20¢ C 12¢.
Aug. 18, 1953	W&C 5	5	W 15¢ C 12¢.
July 28, 1955	W&C 5	5	W 12¢ C 10¢.
Sept. 14, 1956	W&C 5	5	W 15¢ C 15¢.
Jan. 24, 1958	W&C 5	5	W 10¢ C 7¢.
Dec. 16, 1958	W&C 5	5	W 7¢ C 5¢.

See footnotes at end of table.

*Prescribed minimum initial margins on transactions for future delivery on the
Kansas City Board of Trade—Continued*

Effective	Hedging trades	Spreading trades ¹	Other trades
Mar. 11, 1959.....	W&C 5.....	5.....	W 10¢ C 5¢.
Dec. 2, 1959.....	W&C 5.....	5.....	W 7¢ C 5¢.
Oct. 24, 1962.....	W&C 5.....	5.....	W 12¢ C 10¢.
Nov. 9, 1962.....	W&C 5.....	5.....	W 7¢ C 5¢.
May 16, 1963.....	W&C 5.....	5.....	W 40¢ C 5¢. ³
May 28, 1963.....	W&C 5.....	5.....	W 12¢ C 5¢. ³
June 26, 1963.....	W&C 5.....	5.....	W 7¢ C 5¢.

¹ Except on same grain in Kansas City market, 1 cent.

² Maintenance margins also prescribed.

³ May or July 1964 wheat.

[W—Wheat; C—Corn; CH—Clearinghouse]

Mr. MATSUNAGA. Thank you. We are very appreciative of your very brief summary of your statement. As stated, without objection, your statement will appear in the record in full as though presented in full.

Mr. THEIS. Thank you.

Mr. MATSUNAGA. Are there any questions?

Mr. DOLE. I certainly feel your statement is an excellent one. You are opposed to the bill, I take it?

Mr. THEIS. Yes.

Mr. DOLE. You suggest the words "wilfully and knowingly," and so forth, might be added to the definition of "manipulation." But you are opposed to the bill?

Mr. THEIS. Yes, sir; definitely.

Mr. DOLE. As I understand it, the Kansas City Board of Trade does police its exchange.

Mr. THEIS. We do.

Mr. DOLE. Does it work very satisfactorily?

Mr. THEIS. We have a history of very satisfactory operation—extremely satisfactory.

Mr. DOLE. So you feel this can be done effectively by the industry?

Mr. THEIS. On the spot where the action is and where we know what is going on and not a thousand miles away by someone peering into the future and thinking that something might happen.

Mr. CHARTRAND. We have done it successfully for 90 years.

Mr. MATSUNAGA. For 90 years?

Mr. CHARTRAND. Yes.

Mr. TEAGUE of California. What does one have to do to become a member of the Kansas City Board of Trade?

Mr. THEIS. First, you have to avail yourself of the membership if it is available, and when you have availed yourself of the membership, you fill out an application for membership which stipulates who you are, what you are, what you intend to do and you have with it a financial certified statement of your company or yourself, as an individual, and then you go before this membership committee. If you get by the membership committee, as such, your name is posted for 10 days. And after posting for 10 days your application is brought before the board of directors, and they take action at that time.

Mr. HAGEN of California. How many members do you have?

Mr. THEIS. 211.

Mr. HAGEN of California. Has that number increased over the years?

Mr. THEIS. Yes, sir. It increased by 15 in 1946, I believe it was.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Thank you very much again.

Mr. THEIS. Thank you.

Mr. CHARTRAND. Thank you.

Mr. MATSUNAGA. We have some 13 witnesses scheduled to appear tomorrow. We do not have any voting on the floor this afternoon, so that if you would like to appear this afternoon, if there is no objection, we can meet at 2:30 again this afternoon.

Are there any here who are scheduled to appear tomorrow who would like to appear this afternoon? Would you like to testify this afternoon instead of tomorrow?

Mr. PARROTT. I am scheduled to appear as the first witness tomorrow morning. We would very much prefer if we could be permitted the afternoon to review our statement in line with the testimony given here this morning, to eliminate repetition and, therefore, we would prefer to appear in the morning.

Mr. MATSUNAGA. Is there anyone who would like to appear this afternoon?

If not, it might be preferable then to start at 9:30 in the morning. Would that be objectionable? Is there any objection by anyone? There are 13 witnesses, which will mean about 10 minutes each in the time we have allotted for the hearing. Will you bear that in mind in summarizing your statements please. Of course, your complete statement will appear in the record as though presented in full. We have conscientious members on this committee, and your statements will be read by them, I am sure.

Mr. MARKS. I represent the board of governors of the Commodity Exchange, Inc., of New York. If we would not be imposing upon the committee we would prefer to have you hear us this afternoon. We are well down on the list for tomorrow. And judging from yesterday and today, I would rather imagine that our time and our statement will be compressed into about 2 minutes.

Mr. MATSUNAGA. All right, we will meet at 2:30 this afternoon. Any others who wish to present their statements this afternoon at 2:30 may do so. And you may have a little more time accordingly, instead of being rushed tomorrow morning. You will be most welcome to appear this afternoon at 2:30 o'clock.

(Whereupon, at 12:10 p.m., the subcommittee was in recess, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

Mr. MATSUNAGA. The chairman will come to order. [Laughter.] May we have the names of those who will be testifying?

Mr. DONAGHY. Mr. James J. Caires, president of the Wool Associates, who was scheduled as third speaker for tomorrow, is here.

Mr. MARKS. Matthew S. Fox, president of the Commodity Exchange, Inc.

Mr. MATSUNAGA. You are appearing in place of Mr. Donald Marks, is that it?

Mr. Fox. That is correct, Mr. Chairman.

Mr. MATSUNAGA. Then our first witness this afternoon will be Mr. James J. Caires, president of the Wool Associates, New York Cotton Exchange.

I must apologize for the tardiness of the other members. I do not know whether they are coming or not. If I knew they were coming, I would hold it up, but I do not know whether they are coming or not.

You may proceed, Mr. Caires.

STATEMENT OF JAMES J. CAIRES, PRESIDENT OF THE WOOL ASSOCIATES, NEW YORK COTTON EXCHANGE; ACCOMPANIED BY J. WILLIAM DONAGHY, ASSISTANT SECRETARY

Mr. CAIRES. Mr. Chairman, with me is Mr. William Donaghy who is the secretary of the cotton exchange and also the assistant secretary of the Wool Associates of the New York Cotton Exchange.

I appear, of course, as president of the Wool Associates of the New York Cotton Exchange, Inc., to register the opposition of the exchange to H.R. 11788 which drastically amends the Commodity Exchange Act.

Although the bill is replete with changes to the act, in the interest of brevity I shall express our objections only to those changes which we feel will most seriously damage the functioning of futures markets.

First, I want to direct my remarks against the provision which would give the Secretary of Agriculture power to fix the margin requirements on commodity futures markets. This request for power is not a new one, but has been put forward by the Government off and on since 1947. To date Congress, in its judgment, did not think it desirable to grant such control to the Secretary of Agriculture. While economic conditions over these years have changed, the services of the futures markets have not. They still are the vehicles by which growers, wool dealer, topmakers, and manufacturers in the wool industry, and comparable businessmen handling other commodities, can and do hedge their price risks with speed and efficiency. What I wish to stress is that a hedger who owns or buys a commodity can get protection against adverse price change by offsetting his position in the futures market. If he is a grower of wool or a wool dealer who has wool in storage, he protects himself against price changes by selling futures contracts in an amount equal to the quantity of wool he holds. If the actuals market; that is, if the cash prices go against him, the loss he sustains on his actuals sales will in a large manner, if not all, be offset by the profits he will realize when he buys back his futures contracts. Reciprocally, when trade sales commitments are made for forward delivery and either before the actual commodity is available or is not needed for immediate use, such commitments are protected by the purchase of futures and held until the actual commodity is available and needed.

Then the long futures are liquidated after having served the necessary price protective service. Thus, a futures market serves for both short and long hedging to enable the trade to function in the most economical method by insuring all segments of the trade, from grower to user, against losses consequent upon adverse price fluctuations.

Here we must assume that there is a properly functioning futures market. I say this because should it happen that the power to fix margins be given to and used incorrectly by a person who does not fully understand the true purpose of margins, then there would not be a properly functioning futures market. For instance, margins fixed comparable to stock exchange requirements would drive the speculator from the market, reducing its liquidity to the minimum, and making it useless as a hedging tool.

The level of margins has not, and will not, prevent wide fluctuations in price paid for wool or any other commodity.

It is axiomatic that the forces of demand and supply will govern how high or low the prices will go but if a futures market is available and properly functioning, the people in the trade can protect themselves from bad losses as a result of these wide swings and thereby prevent consumers from being forced to pay unreasonable prices for the finished products. Margins have to be realistic. They are not a down payment but only a deposit to protect the broker and the clearinghouse from a loss if and when the price levels change.

Next I would like to express our opposition to the definition of "manipulation" as contained in the bill. This definition obviously is designed to overturn the 1962 decision of the circuit court of appeals in *Volkart Brothers, Inc. v. Freeman*. The first sentence of the definition states that "Any action or course of action which raises, depresses, fixes, pegs or stabilizes the price at or to a level different than that which would prevail if the action had not been taken is manipulation." Intent to manipulate is not required.

Thus, when our control committee—and we have several committees, of course. We have the control committee and the good business conduct committee, and we have the supervisory committee.

Thus, when our control committee invites wool dealers into the market to relieve a congestion and they act on the invitation and take short positions to alleviate the congestion with the effect of stabilizing the price which otherwise would have run away, the wool dealers and perhaps even the members of the control committee will have taken action which falls within the definition of "manipulation." This would be so even if the action were taken to relieve a "squeeze" caused by a strike or some other unplanned event.

The effect of the second sentence of the definition is that if the holders of the short position take no steps to prepare for delivery and the price increases as a result of such omission to act, the increase in price will be charged solely to the holder of the long position as proof of his manipulative activity.

The CEA apparently believes that since there are few deliveries on a futures market, that when they do occur, manipulation is likely to be present. Such a feeling may prevent aggressive and constructive use of the market.

The proposed definition of "manipulation" is so broad it confers arbitrary price control powers on the Secretary of Agriculture which could result in innocent and small price fluctuations being the cause of punishment as a felony and would certainly tend to force large hedging users of futures contracts out of the market.

Mr. Chairman, we recommend that the definition of "manipulation" be deleted from the proposed bill and be left up to the courts

to define on the basis of the facts before them. The mere fact that the CEA has proposed widely different definitions of "manipulation" during the past few years has convinced us that it is not feasible for Congress to define this term.

Our next objection relates to sections 15 and 16 of the bill. These sections will give the Commodity Exchange Authority the power to make the rules of our exchange. This power now rests within the scope of our Board of Governors; 15 experienced trade people who live and work with the changing supply, price and consumption factors in the marketing of wool every business day. If these amendments were to be adopted, the Administrator of the Commodity Exchange Authority would be in a position to decide what the terms and conditions for delivery of wool on a futures contract would be. Also, he would have the power to dictate the manner and method of trading futures contracts in our market. In a sense it would mean our board of experts would be pushed aside, and one man would rule over the life or death of our Exchange. This is indeed a radical change.

Currently we are a designated market and have rules which fall within the requirements of the Commodity Exchange Act. These rules in particular comply with section 5 of the act in every respect. If all rulemaking power were to be given to the Administrator of the Commodity Exchange Authority, we would then question the reason for keeping section 5 in the act. It would indeed be a farce as contract markets would have to comply with the rules dictated by the Administrator.

For the reasons given, we strongly urge that those sections of the bill relating to margins, the definition of "manipulation" and the power to make rules on a commodity market be eliminated from H.R. 11788.

Thank you, Mr. Chairman.

Mr. MATSUNAGA. Thank you very much, Mr. Caires.

Mr. CAIRES. Thank you, Mr. Chairman, and Mr. Teague and the other members of the committee.

Mr. MATSUNAGA. Your recommendation is that we delete those sections relating to margins, definitions of manipulation, and power to make rules. Are you for the rest of the bill?

Mr. CAIRES. I have no objection to the rest of the bill except what other members of this meeting here have advised on their own objections and, of course, as far as we are concerned, we think that those three main features of the bill would be detrimental to the existence of the exchange.

Those are the three principal things that we object to strenuously.

Mr. MATSUNAGA. Do you find any need for any bill such as this in the wool industry? Do you feel that there needs to be a change from the Commission of three men to the Secretary of Agriculture where the power is vested?

Mr. CAIRES. Would you restate that again, please?

Mr. MATSUNAGA. Do you feel that there is a need for this bill that would make a change in the vesting of the power from a Commission of three men to one man, the Secretary of Agriculture?

Mr. CAIRES. We feel that there is absolutely no need, that all the alterations suggested are completely redundant and are not necessary.

Mr. MATSUNAGA. Any questions?

Mr. TEAGUE. No thank you, Mr. Caires. You have made your position abundantly clear. It is concisely stated.

Mr. CAIRES. I may make a further comment. There are wool exchanges. It is a world commodity. There is a Greece exchange, one in Sydney, Australia, one in Antwerp. There is a London exchange. And our prices are really governed and modified in every respect by the world price of wool which is determined every minute of the trading day, and we find that all of the exchanges are extremely useful and the less interference they have in establishing their own procedure, the better for not only the wool trade but all those who are particularly interested in growing wool the world over.

Mr. MATSUNAGA. Mr. Greigg?

Mr. GREIGG. Mr. Chairman, I read the summary paragraph and it is consistent with the testimony we heard this morning.

Mr. MATSUNAGA. Well, thank you very much. We certainly appreciate your being with us this afternoon.

Mr. CAIRES. Thank you, Mr. Chairman and members of the subcommittee.

Mr. MATSUNAGA. Our next witness is Mr. Matthew Fox of the Commodity Exchange, Inc.

STATEMENT OF MATTHEW S. FOX, PRESIDENT, COMMODITY EXCHANGE, INC.; ACCOMPANIED BY DONALD MARKS, BOARD OF GOVERNORS, COMMODITY EXCHANGE, INC.

Mr. MATSUNAGA. You may proceed.

Mr. FOX. Mr. Chairman, due to the change in our position, Mr. Green, vice president of the Board Metal Trade Group, and Mr. Westheimer, of the Board Hide Trade Group were unable to appear. I have with me Mr. Donald Marks, counsel for the exchange.

My name is Matthew S. Fox. I am president of Commodity Exchange, Inc., 81 Broad Street, New York City. I reside at 201 East 19th Street, New York City.

I have been authorized by the Board of Governors of Commodity Exchange, Inc. to appear before this committee to express the views of the board with respect to H.R. 11788. Before doing so, I should like to give the committee a brief picture of the operations of our exchange and its background.

The exchange is a nonprofit membership corporation which operates a trading floor at 81 Broad Street, New York City, for the conduct of the purchase and sale of futures contracts for the following commodities: copper, lead, silver, tin, zinc, hides, and rubber. The exchange does not buy or sell commodities or futures contracts for its own account. It merely provides the trading floor and facilities for the operation of a futures market.

The exchange is the outgrowth of separate futures markets for rubber, hides, silk, and nonferrous metals which were organized in the period between 1925 and 1929 and which united in a single organization by merger in 1932. Since that time trading in silk has ceased as an after effect of the Second World War.

The exchange has a membership of 380 which includes representatives of trade interests who use the exchange for hedging purposes.

Election to the exchange requires approval by an admissions committee and the board of governors.

I have added that. That is not in the statement.

The membership also includes floor brokers, floor traders, representatives of brokerage houses, and other individuals of no particular affiliation.

By that I mean no association with firms or corporations of any kind.

Transactions executed on the floor of the exchange are reported by ticker service to all areas of the United States and other countries so that there is instant dissemination of information as to the price of each purchase and sale. This provides trade interests and others with continuous price quotations as a guide to marketing policy.

The exchange is maintained by annual assessments on memberships which are intended merely to cover the costs of operation.

The exchange is administered by a board of governors in accordance with written bylaws, rules and regulations. The bylaws include detailed provisions for the supervision of the various commodity futures contracts by standing committee and for the supervision and discipline of members in the performance of their functions as members of the exchange.

The exchange has operated since its inception free of regulation by Commodity Exchange Authority since none of its commodities is within the category of those which have been subjected to regulation. The exchange has policed itself and its members and is justifiably proud of the fact that at no time in its 34 years of existence have there been complaints made to public authorities which have involved the exchange either in investigation or in proposals for public regulation.

In those 34 years, Mr. Chairman, there were two instances. One gentleman was a member of the exchange. He traded against a customer—this was some 20, 25 years ago when I was acting chairman of the business conduct committee, and we decided to give him 10 days to either dispose of his membership or appear before the board and suffer the consequences of expulsion.

The other incident occurred about 2 years ago while I was president. This was a man who had been a member, sold his membership. We heard nothing until he came back a few years later. During that time he had traded in Canadian mining stocks, had been indicted by the Federal authorities of the United States upon his return here, falsified his application, and when he applied for membership the matter was drawn to my attention and he was given a short period of time—although he had been indicted, he had not been convicted—to dispose of his membership, which he did.

In 34 years we had two instances which we alone policed.

The exchange operates upon the theory that the markets for its commodities provide a true reflection of the relative demand and supply at any given moment. Thus, in the truest sense, the exchange provides the best example of the free marketing system.

All transactions on the exchange are the result of free, open and competitive bidding and offering at auction. Each commodity is traded at a ring on the floor at which brokers who hold orders to buy or sell make their bids and offers by open outcry. Such markets have—in the past—been destroyed by price regulation as has been

the case with the cotton futures market of the New York Cotton Exchange and in years past with the silver futures market of our exchange.

The latter market has, however, been revived in a small way since the repeal of the silver transactions tax which had been imposed upon the purchase and sale of silver bullion. The effect of price floors or ceilings upon the futures market is evident, however, at the present time in the low level of activity in the existing silver futures market. Since the scarcity of silver has brought the price up to the Government ceiling there is little interest in silver futures contracts as a hedging medium for users or producers of silver. A similar condition occurs when a price floor provides a base upon which the price of a commodity rests.

It is our belief that the economy of this country can best be served by the maintenance of free and open markets, particularly with respect to commodities which are the subject of world price influences. A good example of this is found in a recent action of the copper futures market on our exchange.

It is commonly known that the production of copper has been severely curtailed by strikes and political disturbances in Chile. The political situation in areas in Africa adjacent to the copper producing centers has contributed to the concern of copper users that supplies from that area might be curtailed. They are now being curtailed, Mr. Chairman, by strikes in the copper belt, in Zambia and Northern Rhodesia.

As a result of these influences, the world price of copper, as reflected in Europe, has risen sharply in the past year. In the United States copper producers have maintained a price of 36 cents per pound to their regular customers, but the price of copper in the secondary market in the United States has tended to rise toward the level of the world price.

The steady rise in the price of copper for the past year or more led to an increase in activity in the copper futures market maintained by Commodity Exchange, Inc. The volume of trading reflected both participation by trade interests wishing to hedge their forward requirements for the metal and the operations of investors who bought copper in anticipation of a continuance of the price trend.

During the month of November 1965 the exchange was invited by Secretary of the Treasury Fowler to send representatives to Washington for a conference. The Treasury Department at that time indicated its desire to guard against any inflationary tendencies and particularly to preserve supplies of copper for defense purposes; and asked the representatives of the exchange to cooperate in measures to avoid excessive speculation in copper futures. The exchange pointed out that the price of copper futures in New York remained at a considerable discount below the world price of copper as reflected on the London Metal Exchange, but it nevertheless agreed to take steps to comply with the request of the Treasury Department.

Accordingly, the exchange board adopted a scale of margin requirements for speculative trades substantially in excess of the margin requirements for trade interests. The action taken curtailed the volume of trading on the exchange substantially, but did not bring about a reduction in the price level.

In other words, the price of copper on the exchange, representing the consensus of trade interests primarily, was not materially affected by the elimination of speculative interests in the market. The primary effect of the curb on speculative trading was to reduce the volume of trading and, therefore, to impair the effectiveness of the market as a hedging facility.

If the reduction of volume had served the Treasury's purpose of restricting the price of copper, the sacrifice made by the exchange might have been justified. However, the lower trading volume had no effect on price. And incidentally, Mr. Chairman and member of the committee, a new high price for copper, an alltime high, was reached in London today at 790 pounds per ton and 82¾ cents per pound for the May delivery in New York. And the variation there is a premium in London of some 10 to 12 cents per pound.

A secondary effect of the diversion of interest in our copper futures market was to transfer the trading activities in copper to London. On the London Metal Exchange hedgers could find a market with greater liquidity than ours and hence much of the trading which had used our market was transferred to London. Stocks of copper which would have been stored in the United States for delivery upon our copper futures contract have diminished in volume. Trading in London inevitably draws copper to that point in connection with the activities of trade interests in that market.

Thus, the action taken in response to the Treasury Department's suggestion has helped to defeat one of the basic purposes of the Government which was to conserve our supplies of copper for domestic consumption. The part played by the exchange in attracting supplies of copper to our domestic market is illustrated by the fact that since January 1, 1965, a total of 41,100 tons of copper placed in exchange-licensed warehouses in this country. Much of this copper was required and used for deliveries upon exchange contracts and substantial amounts have been withdrawn from warehouse for domestic consumption.

Hedging is the economic reason for the existence of futures markets. The function of hedging is to enable producers, dealers, fabricators, and consumers to reduce or eliminate the risk inventory losses of their basic industrial operations. A fabricator of machinery having a copper inventory may protect himself against substantial loss through a decline in the price of copper by selling futures short against the inventory of the actual metal or his contractual commitments for forward delivery of the metal. By so doing, he is able to profit on his short futures position to offset his loss in inventory value.

Hedging may involve purchases of futures contracts as well as sales; but in every case the basic objective is the same; namely, to secure a degree of price insurance.

It goes without saying that a broad and liquid futures market is essential to a satisfactory hedging operation. The hedger must be able to get in or out of the market without undue impact upon the prevailing price of futures. It is a generally accepted premise among economists that investment activity, as well as trade participation, is essential to the maintenance of free and open markets. To the extent to which Government regulation or restrictions curtail the free

expression of demand and supply as reflected in the price of a commodity the risks of those who must handle the commodity are increased. Thus, in the long run the public must pay the cost of these increased risks.

We believe thoroughly in our economic system and in the principles upon which it is based. No principle is more deeply rooted than that of free marketing. It is for this reason that we oppose basically any extension of Government regulation over the futures markets. We believe that we have policed ourselves in the past with complete commitment to the public service which we perform and that we have demonstrated our ability to continue such self regulation without the necessity for Government restriction.

I am not going to address myself to any of the specific provisions of H.R. 11788 other than to agree with representatives of other markets in their objections to the provisions of the bill giving the Secretary of Agriculture power to fix margins, power to extend the authority of the CEA over commodities not now subject to regulation, power to issue cease-and-desist orders, and such ambiguities as the authority to define what constitutes manipulation.

I trust that the foregoing statement may serve to provide a clear picture of the structure, operation, and functions of the futures markets maintained by our exchange.

Mr. Marks and I are prepared to answer any questions which a member of the committee may have.

I am grateful for the opportunity to appear before the committee and for its courteous consideration of my statement and, with your permission, would ask that it be made part of your official record.

Incidentally, Mr. Chairman, with your approval I should like to submit a book of our rules and regulations so that your committee may be able to judge the extent to which we police our own activities, if you so desire.

Mr. MATSUNAGA. It may be made available for the members of the committee. But you are not asking that it be made a part of the record, are you?

Mr. Fox. No, no. I want it made available for the committee. I am asking for my statement to be made a part of the record.

Mr. MATSUNAGA. Yes. Your statement, of course, will definitely be a part of the record.

Mr. Fox. Now, to my ability, since I am not a copper man, if there are any questions with reference to copper I would be happy to answer them. Crude rubber, natural rubber, is my business and I think that I can answer rather handily.

Mr. MATSUNAGA. Any questions?

Mr. TEAGUE. No questions.

Mr. MATSUNAGA. Questions, Mr. Greigg?

Mr. GREIGG. No questions, Mr. Chairman.

Mr. Fox. Thank you very much.

Mr. MATSUNAGA. I wish to thank you again, Mr. Fox, for your fine statement and I wish to commend you and your exchange for having had such a wonderful record.

Mr. Fox. Thank you very much, Mr. Chairman.

Mr. TEAGUE. Mr. Chairman, this is off the record.

(Discussion off the record.)

Mr. MATSUNAGA. Well, unfortunately we have a limited time in which we must listen to a number of witnesses and the time will come when we have to limit the witnesses to so many minutes just as we are limited sometimes even to one-fourth of a minute on the floor of the House. So certainly we appreciate the cooperation.

Any other witness here this afternoon who would like to testify at this time?

Mr. GREIGG. Mr. Chairman——

Mr. MATSUNAGA. Mr. Greigg.

Mr. GREIGG. I would like to ask a question off the record.

(Discussion off the record.)

Mr. MATSUNAGA. Are there any other witnesses? If not, the committee stands adjourned until 9:30 tomorrow morning.

(Whereupon, at 3:07 p.m., the committee recessed to reconvene at 9:30 a.m., on Wednesday, April 6, 1966.)

TO AMEND THE COMMODITY EXCHANGE ACT

WEDNESDAY, APRIL 6, 1966

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DOMESTIC MARKETING AND
CONSUMER RELATIONS OF THE COMMITTEE ON AGRICULTURE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 9:30 a.m., in room 1301, Longworth House Office Building, Washington, D.C. Hon. Spark M. Matsunaga (chairman of the subcommittee) presiding.

Present: Representatives Matsunaga, Hagen of California, Redlin, Greigg, Teague of California, Mrs. May, Findley, Dole, and Burton of Utah.

Also present: Christine S. Gallagher, clerk; Hyde H. Murray, assistant clerk; Fowler C. West, staff; Betty Prezioso, staff; and Martha Hannah, staff.

Mr. MATSUNAGA. The meeting of the Subcommittee on Domestic Marketing and Consumer Relations will come to order.

This morning we have a continuation of the public hearings on H.R. 11788. Because of the limited time and the number of witnesses scheduled this morning, we are going to have to limit each witness to 10 minutes in order to get through, and if there are others who are scheduled to testify who are willing to surrender their time to one who may require more than 10 minutes, you can make arrangements between yourselves and so notify the chairman when you are called to testify.

Our first witness this morning is Mr. Robert B. Parrott, director of the Grain & Feed Dealers National Association.

Mrs. May, I understand, desires to introduce the witness.

Mrs. MAY. I would like to say Mr. Parrott is a director of and represents the Grain & Feed Dealers National Association, an organization with members throughout the United States. They also represent the dealers of my State of Washington, too, many of whom have contacted me and wanted me to get into the record that they express the most sincere and complete agreement with what he has in his statement and that he expresses their viewpoints for them.

It is a pleasure to present Mr. Parrott to you.

Mr. MATSUNAGA. We will be glad to hear from you now.

STATEMENT OF ROBERT B. PARROTT, DIRECTOR, GRAIN & FEED DEALERS NATIONAL ASSOCIATION; ACCOMPANIED BY WILLIAM J. KEATING, COUNSEL FOR PUBLIC AFFAIRS

Mr. PARROTT. Mr. Chairman and members of the committee, I am Robert B. Parrott, executive vice president of Central Soya Co., Inc.,

Fort Wayne, Ind. I am also a director of the Grain & Feed Dealers National Association, for whom I make this appearance today.

I would like to introduce to you my associate on my left, Capt. William J. Keating, U.S. Navy (retired), counsel for public affairs of our association, who will assist me in this presentation today.

It is a privilege to appear before you. It is my sincere hope that these remarks will be of value and assistance.

My prepared statement has been developed over a period of four months by a special task force of the Grain & Feed Dealers National Association.

We offer this statement for inclusion in the record and ask that it be given consideration by your committee.

Many of the points covered in my statement have been developed by previous witnesses, and therefore, I will refer to them only briefly. On other points, however, I will develop them at greater length because we feel that they have not been covered as clearly as we would like to see them treated.

The Grain & Feed Dealers National Association comprises 1,800 members ranging in size from the smallest country elevators to the largest grain and oilseed marketing and processing complexes. Fifty-three State and regional grain and feed associations are affiliated with the national association, and they represent 17,000 grain and feed firms.

Many of our members are members of and active participants in contract markets governed by the Commodity Exchange Act and the Commodity Exchange Administration. All of our members rely on and benefit to varying degrees from the functions of these institutions. We are thus in a position to speak to the effects of H.R. 11788 on the entire industry.

Unfortunately, the economic function and benefits of futures markets to producers, the process of distribution, and consumer are not generally well understood.

Incidentally, I am working from a manuscript that is somewhat different from what you are referring to, and I will try to cross-reference. This is necessary, because of major deletions we have made in originally developed testimony. What I am trying to develop here verbally today is different.

Forward sales always have been necessary to assure producers an outlet and processors and consumers supplies throughout the marketing year. Future markets arose out of the need for a better mechanism for pricing these forward sales or transactions.

The essential distinction between futures markets and earlier forms are that futures markets involved organized and supervised open trading compared to private negotiation; they interject a clearinghouse between buyers and sellers and specify a standard form of commodity for delivery, thereby eliminating the need to negotiate any contract terms save price alone and permitting a degree of liquidity and economy otherwise impossible. The importance of this observation is that any time use of a futures market declines, whether because of inherent flaws or misunderstanding of those who regulate it, forward sales do not cease; rather, they revert to the less desirable form that preceded the futures market, with flaws that are larger but better hidden. Undoubtedly there are flaws in futures trading, but it would be ironical if futures trading in markets which represent the closest approxima-

tion of the textbook version of perfect competition, should be impaired—as a result of overzealous efforts at regulation—simply because no perfect textbook version exists.

Our interest, as important users of futures markets, is in merchandising, warehousing, distributing, and processing grain and oilseeds at the lowest possible cost. Futures markets, which originated in our trade, have been the single most important factor contributing to this end. Futures trading allows us to carry enormous inventories at very low cost; it allows us, by always providing a reliable price guide, to merchandise continuously; and it allows great flexibility in the timing and direction of product movements—very important consideration to low-cost distribution. The marketing margins for grains are remarkably low in view of the substantial risk of price change inherent in grain merchandising because futures markets allow us to hedge at very low cost.

Futures markets are now flourishing as never before which suggests participants have high confidence in their governing rules and regulations. Admittedly at times, heavy traffic at these major intersections of supply and demand gives rise to congestion and multiplies opportunities for anticompetitive practice. It is therefore proper that their rules and regulations, and procedures for enforcement, be subject to review. Effective and vigilant regulation of commodity futures markets is essential.

We are very concerned that misconceived efforts at regulation may prompt more harm to the public interest than they prevent. We are involved here with conflicting public interests; on interest, on the one hand, served by broad participation in the market and facilitated by ease of entry; and an interest, on the other hand, requiring protection of the public from the consequences of nonperformance or anticompetitive acts, which protection often limits free entry. We are concerned that proponents of this bill, charged with protecting the public interest, tend to resolve this conflict heavily in favor of protection at unacceptable costs in terms of free entry. Successful experience under the present system of resolving the conflict—evident in the fact that futures markets are thriving and enjoy unprecedented record of performance—causes us to wonder if there are not other underlying motives for the bill.

In analyzing this bill, we wish to call your particular attention to the following provisions of the bill:

First regarding the extensions of coverage: Certain extensions, both as to individuals and commodities are proposed in the coverage of the act. Persons who aid or abet violations are to be held responsible as principals; denial of trading privileges is to be directed against individual violators instead of directing others to deny them privileges. We concur in these extensions. They are clearly in the interest of better enforcement.

We are concerned, however, about what seems to be an effort to extend the Commodity Exchange Act and the jurisdiction of the Commodity Exchange Administration to cash sales of grain which, for regulatory purposes, have no significant relationship to futures trading.

The legislative history of the Commodity Exchange Act indicates that it derives from findings by Congress that futures transactions

are carried on in large volume by the general public as well as by persons engaged in cash sales. Cash sales, on the other hand, do not involve any large such public participation. Furthermore, because these cash transactions contemplate delivery and use, terms of sales must be very flexible to permit processors and other consumers a broad selection of class, quality, delivery, and payment terms. These sales do not lend themselves to the uniformity which is both practicable and necessary in futures transactions. Therefore, extension of the act to cash trading would require more evidence of need and purpose than has been presented to date.

The proposed amendments would extend coverage of the act to all agricultural or forest commodities not now subject to the act, presumably on the theory that futures trading in commodities not now subject to the act, require regulation fully as much as those which are. Since we are not involved in marketing commodities which would be brought under the act by this amendment, we defer to those who are. But we observe that another provision of the bill would transfer to the Secretary of Agriculture authorities he now holds jointly with the Secretary of Commerce and the Attorney General. We then note that the rationale for extending coverage to other agriculture commodities would also support its extension to nonagricultural commodities, such as metals. If this be intended, either now or later, we suggest it is neither wise nor opportune to vest this authority and responsibility solely in the Secretary of Agriculture. In that case, indeed, it might be argued that the Commodity Exchange Administration should be taken out of the Department of Agriculture and established as a separate, autonomous agency.

The proposed bill makes certain provisions concerning financial responsibility. We will omit comment on this because the point has already been well made. We are concerned that such regulations might exclude responsible small traders whose record of performance has been excellent.

The bill provides for more severe penalties: Under the bill certain offenses which are now misdemeanors would be made felonies and elsewhere in the bill heavier fines or penalties are proposed. In principle, we endorse heavier penalties as a deterrent to violations, insofar as (1) violations are described in clear and meaningful terms; (2) enforcement procedures are consistent and recognize uncertainty inherent in futures trading; and (3) respondents are accorded a fair hearing. The act, however, as the Secretary proposes it be amended, does not meet these tests, in our opinion.

In a number of instances the bill would permit the Secretary to act against traders involved in practices described only in vague terms. For example, the Secretary could prosecute a trader for any activity which in his judgment has or may have the effect of "restraining trade." Thus the bill incorporates basic prohibitions of the Sherman Act and the Federal Trade Commission Act without incorporating the "rule of reason" tests the courts have read into those acts and without providing a correlative grant of immunity from those statutes. We know of no precedent for such a comprehensive grant of power to a single administrative official.

Under other proposed sections the Secretary need not delay such action but may issue a cease and desist order or seek an injunction, without bond protecting the respondent, upon belief that such activity

is contemplated, thereby depriving respondent of evidence not then available which could subsequently exonerate him.

Finally, the bill proposes a revision in the powers of a reviewing court which would require it to uphold a ruling of the Secretary if the ruling is supported "by substantial evidence on the record considered as a whole," even though the "weight of the evidence" supports the respondent. This new evidence test being proposed has been criticized by the courts and by such respected commentators as the Hoover Commission on organization of the executive branch of the Government as being unduly narrow.

There would be less concern about changing the rules for appeal if it were certain that respondents receive a fair and unbiased hearing by the Secretary in cases involving charges under the Commodity Exchange Act. The facts are that no respondent so charged ever has been exonerated when the matter went to final determination by the Secretary's judicial officer. Yet, under present "weight of the evidence" test, a number of these orders have been reversed by appeals courts.

Under these circumstances—and until determinations are made on several other matters—we are reluctant to support provisions for heavier penalties.

Fourth, cease and desist orders—injunctions: The bill confers upon the Secretary the power to issue cease and desist orders or to seek injunctions from the Attorney General in various circumstances. We have no objection to such legal procedures so long as they are applied to identifiable and clearly defined present violations. We oppose this authority with respect to violations which can not be judged until after the fact. We treat this category at greater length under the heading "Margin Requirements, Manipulation and Excessive Speculation."

Fifth, authority to prescribe rules: This has been covered. However, in the absence of a showing that his present authority is inadequate or that contract markets have rejected reasonable requests from the Secretary for rules he deems necessary, we see neither advantages nor necessity in giving him authority to initiate rules for individual markets.

Sixth, margin requirements, manipulation, and excessive speculation: We have carefully reviewed Dr. Roger Gray's statement before this committee yesterday on these elements of the bill. We regard this particular portion as the most important and troublesome part of the bill. Dr. Gray's thoughts parallel those of ours closely. We urge the committee to study carefully this part of our statement.

It has been suggested that the Secretary seeks standby authority to specify margin requirements to control prices in the event of a national emergency. This raises questions concerning both the nature of such an emergency and the effectiveness of margin controls for this purpose. In the event of a national emergency there is ample precedent for direct price controls. But it has not been the prerogative of the Secretary of Agriculture to declare such a state of emergency. If it is the desire of the Secretary to create standby price control, this should be clearly stated and discussed here on its merits.

We must question the effectiveness of margin requirements to control price. Margin requirements have never been used for such a pur-

pose, hence there is no direct evidence of their effectiveness. There are several reasons to believe that they would be quite ineffective.

First, prospective buyers and sellers are more influenced by prospects of price change than by the margin requirements. If they believe in the Secretary's forecasting ability, his action in changing margin requirements might well induce rather than discourage trading.

Second, even if trading were discouraged by higher margins, price change would not necessarily be inhibited. Wide price fluctuations often occur where there is only limited trade.

Third, if future purchases are discouraged by increased margin requirements, buyers will increase their forward purchases in the cash market. The price control objective would thus be frustrated. The futures market would simply be deprived of its capacity to anticipate the ultimate real value of cash grain.

We believe that margins, at appropriate levels and serving their true purpose, should be adequately policed. We see no objection, for example, to the CEA audit of margin accounts at levels established by the contract markets. We also believe that some guidance to contract markets might be found in a study of margin levels for various commodities, which would relate margins to the statistical record of price change. Margin levels should be high enough at all times to guarantee contract performance and they should be established with no other purpose in view.

The second misconception: The proposed amendment clearly assumes that the Secretary has the ability to foresee "unwarranted or unreasonable price change."

The Secretary of Agriculture has at his disposal the information and resources which enables him to learn whether a price change which has occurred seems to have been warranted by the facts as they unfolded. He can also endeavor to ascertain whether any unwarranted changes seem to have resulted from honest mistakes in judgment or from deliberate manipulation. This is his proper role in the interest of fair and efficient marketing. To go further in influencing price change would be to control prices. Already, in existing price support and related legislation, the Secretary is empowered to control certain prices within certain limits; but it has never been the intention of Congress in regulating commodity futures markets that he be given additional authority to control prices through margin requirements.

It is common knowledge, and no criticism of the Secretary that his price forecasts have been inaccurate on occasion. In the circumstances surrounding the defeat of the wheat referendum in 1963, he predicted wheat prices much lower than those which occurred, and much lower than those predicted on the futures markets. The Secretary's opinion, of "warranted price change" differed from market opinion, and the Secretary was proved to be wrong. Given the authority to act upon such beliefs, the Secretary could prevent warranted price changes, thus compounding the error.

If the Secretary had the ability to anticipate unwarranted or unreasonable price change he would, by the same token, know what price changes were warranted and reasonable. Under these circumstances, there would be no need for markets. The Secretary simply would be empowered to set prices at appropriate levels.

The third misconception: The same considerations apply to excessive speculation as to the prospect of warranted price change. In addition, we question CEA definition of excessive speculation. Actually, many futures markets have inadequate speculation; yet, by CEA standards, speculation always is adequate and commonly excessive. The CEA has on occasion assessed the "adequacy of speculation to carry the hedging load," implying a definition of adequacy which limits speculative positions to the size of the net hedging position, and has referred to "excesses" above that level.

The very restrictive definition of speculative adequacy altogether ignores the price determining role of futures trading and limits the role of futures markets to that of accommodating hedging. The most important function of futures markets is price determination, which facilitates and is facilitated by hedging.

To be sure, excessive speculation can cause unwarranted price change on occasion, but if it is impossible to anticipate unwarranted price change, it is likewise impossible to anticipate excessive speculation. Inadequate speculation—the more common condition, has price effects also—prices are poorly defended on markets with inadequate speculation—but these are not recognized in the bill.

Eighth, manipulation: We strongly support the expressed opposition to the proposed definition of "manipulation." We believe the standards in the *Volkart* case are fair and well accepted by people who trade.

We believe that manipulation and attempts to manipulate are serious offenses against the marketplace which should be severely punished. We believe, however, that the proposed amendment defines "manipulation" so loosely and arbitrarily as to enhance the prospect that ethical participants in the markets would be falsely accused and convicted, without in any measure enhancing the prospect of proving real guilt. The proper direction in which to carry a definition of manipulation is toward greater refinement and precision. Instead, this proposed definition is much broader and looser than the one currently established in case law. It is a blunderbuss approach by which the accuser cannot wholly miss, but by which he really does not improve the odds that the real offender will be hit.

In conclusion: We do not question the desire of the Commodity Exchange Administration to improve performance of futures markets in the public interest.

However, it seems clear that this bill would contribute little to that end. We urge this committee to reject the bill in its entirety. Although some of its provisions may bring improvement, on balance, the bill so completely misconceives the CEA's regulatory responsibilities, we believe it should be returned to the Department for complete overhaul.

We also urge the committee to consider steps needed to improve the performance of the Commodity Exchange Administration. Specifically, we suggest that the Congress impose high standards for the CEA's professional staff, insist on the assembly and the interpretation of evidence needed to provide a more reliable guide to its enforcement activities, and, finally, provide sufficient funds to permit it to perform all its functions fully and efficiently. We believe that implementation of these proposals would solve many of the enforcement problems

which underlie the CEA's request for broader permit to regulate futures markets.

The CEA has a very difficult and complex assignment. We are most sympathetic to the position they find themselves. A study of price formulation is critical to intelligent enforcement. This can only be accomplished with qualified people and adequate facilities.

(The prepared statement submitted by Mr. Parrott follows:)

STATEMENT OF ROBERT B. PARROTT, DIRECTOR, GRAIN & FEED DEALERS NATIONAL ASSOCIATION

I am Robert B. Parrott, executive vice president of Central Soya Co., Inc., Fort Wayne, Ind. I am also a director of the Grain & Feed Dealers National Association, for whom I make this appearance today. It is a privilege to appear before you. It is my sincere hope these remarks will be of value and assistance.

The Grain & Feed Dealers National Association comprises 1,800 members ranging in size from the smallest country elevators to the largest grain and oilseed marketing and processing complexes. Fifty-three State and regional grain and feed associations are affiliated with the national association, and they represent 17,000 grain and feed firms.

Many of our members are members of and active participants in contract markets governed by the Commodity Exchange Act and the Commodity Exchange Authority. All of our members rely on and benefit from the functions of these institutions. We are thus in a position to speak to the effects of H.R. 11788 on the entire industry.

Unfortunately, the economic function and benefits of futures markets to producers, the process of distribution, and consumer are not generally well understood. For this reason, I would like to preface my comments on the bill now before this committee with observations about futures markets—their origins, their importance and their requirements to function.

Forward sales always have been necessary to assure producers an outlet and processors and consumers supplies throughout the marketing year. Futures markets arose out of the need for a better mechanism for pricing these forward sales.

The essential distinctions between futures markets and earlier forms are that futures markets involved organized and supervised open trading as opposed to private negotiation; they interject a clearinghouse between buyers and sellers and specify a standard form of commodity for delivery, thereby eliminating the need to negotiate any contract terms save price alone and permitting a degree of liquidity and economy otherwise impossible. The importance of this observation is that any time use of a futures market declines, whether because of inherent flaws or misunderstanding of those who regulate it, forward sales do not cease; rather, they revert to the less desirable form that preceded the futures market, with flaws that are larger but better hidden. Undoubtedly there are flaws in futures trading, but it would be ironical if futures trading in markets which represent the closest approximation of the textbook version of perfect competition, should be impaired as a result of overzealous efforts at regulation, because no perfect textbook version exists.

FUTURES ADVANTAGES

Futures markets offer four important advantages lacking in earlier marketing forms from which they evolved:

First, pricing: Futures markets provide reliable forward pricing guides, introduce price stability and reduce the opportunity for price manipulation. A futures price is characteristically more "real" than other prices in several respects. It is a more representative price because it refers to a standard, commercially acceptable grade in broad demand and supply. And it is usually a better reflection of supply and demand because it is the product of more open and general negotiation.

The second advantage is reliability: Futures markets, which evolved from situations in which more dependable contracts were needed, reveal a historical record of performance unmatched in other commerce.

The third important advantage and characteristic is economy: Futures markets facilitate an enormous volume of trade at low transaction cost. They are an

efficient device for attracting low-cost risk capital to the commodity sector, and they are the central coordinating device within this sector.

Finally, a fourth and important consideration and advantage is information: Because all futures transactions are made in a public market by open outcry and because resulting prices are promptly recorded and widely disseminated, futures markets provide the best current source of information on present values of commodities for future delivery.

Our interest, as important users of futures markets, is in merchandising, warehousing, distributing and processing grain and oilseeds at the lowest possible cost. Futures markets, which originated in our trade, have been the single most important factor contributing to this end. Futures trading allows us to carry enormous inventories at very low cost; it allows us, by always providing a reliable price guide, to merchandise continuously; and it allows great flexibility in the timing and direction of product movements—important considerations to low-cost distribution. The marketing costs for grains are remarkably low in view of the substantial risk of price change inherent in grain merchandising because futures markets allow us to hedge at very low cost.

EFFECTIVE REGULATION

Futures markets are now flourishing as never before which suggests participants have high confidence in their governing rules and regulations. Admittedly at times, heavy traffic at these major intersections of supply and demand gives rise to congestion and multiplies opportunities for anticompetitive practice. It is therefore proper that their rules and regulations, and procedures for enforcement, be subject to review. Effective and vigilant regulation of commodity futures markets is essential.

We are aware of a longstanding belief by the Commodity Exchange Authority that some revision of rules, extension of authority, and enlargement of staff is required if the markets are to be regulated in the public interest. We also are aware that the vegetable oil scandal of 1963 was interpreted in some quarters as a reflection of loose practices on commodity exchanges, although few if any who were involved would accept this interpretation.

We have studied the Comptroller General's report to the Congress on the need to strengthen regulatory practices and to examine certain trading activities related to commodity futures markets. We feel the study's revelation of loose practices on some exchanges does indeed suggest the need for more frequent and extensive investigation by the CEA. We do not condone any violations of established rules, however innocuous some may appear under the circumstances; nor do we condone rules which allow conspicuous loopholes, nor rules which confer special advantage on any participants in the marketing process.

However, we are very concerned that misconceived efforts at regulation may prompt more harm to the public interest than they prevent. We are involved here with conflicting public interests: an interest, on the one hand, served by broad participation in the market and facilitated by ease of entry; and an interest, on the other hand, requiring protection of the public from the consequences of nonperformance or anticompetitive acts, which protection often limits free entry. We are concerned that proponents of this bill, charged with protecting the public interest, tend to resolve this conflict heavily in favor of protection at unacceptable costs in terms of free entry. Successful experience under the present system of resolving the conflict—evident in the fact that futures markets are thriving and enjoy unprecedented record of performance—causes us to wonder if there are not other underlying motives for the bill.

ANALYSIS OF THE BILL

Our analysis of H.R. 11788 leads us to conclude that, generally, its purpose is to improve and tighten regulation—a goal in which we concur. Our observations, under several headings, endorse some objectives of the bill, but occasionally we propose a different approach to the same end. We also make certain recommendation not covered in the bill. Finally, we discuss at some length portions of the bill which reflect a disturbing lack of understanding of futures trading.

First, regarding the extensions of coverage.

Certain extensions, both as to individuals and commodities, are proposed in the coverage of the act. Persons who aid or abet violations are to be held

responsible as principals; denial of trading privileges is to be directed against individual violators instead of directing others to deny them privileges. We concur in these extensions. They are clearly in the interest of better enforcement.

We are concerned, however, about what seems to be an effort to extend the Commodity Exchange Act and the jurisdiction of the Commodity Exchange Authority to cash sales of grain which, for regulatory purposes, have no significant relationship to futures trading.

(By "cash sales" we mean sales of physical commodities under agreed terms specifying quantity, quality, delivery, and payment and contemplating delivery and use.) The legislative history of the Commodity Exchange Act indicates that it derives from findings by Congress that futures transactions are carried on in large volume by the general public as well as by persons engaged in cash sales. Cash sales, on the other hand, do not involve any such large public participation. Furthermore, because these cash transactions contemplate delivery and use, terms of sales must be very flexible to permit processors and other consumers a broad selection of class, quality, delivery, and payment terms.

These sales do not lend themselves to the uniformity which is both practicable and necessary in futures transactions. Therefore, extension of the act to cash trading should require more evidence of need and purpose than has been presented to date. (In passing, we note that the Commodity Exchange Authority, in its response to the Comptroller General, contends that its inability to discharge authorities it now has is based upon inadequate resources. If this be true, a request for extension of its authority over a completely new field of marketing might better be prefaced by efforts to obtain adequate staff and financing to discharge its present responsibilities.)

The proposed amendments would extend coverage of the act to all agricultural or forest commodities, presumably on the theory that futures trading in commodities not now subject to the act requires regulation fully as much as those which are. Since we are not involved in marketing commodities which would be brought under the act by this amendment, we defer to those who are. But we observe that another provision of the bill would transfer to the Secretary of Agriculture authorities he now holds jointly with the Secretary of Commerce and the Attorney General. We then note that the rationale for extending coverage to other agricultural commodities would also support its extension to non-agricultural commodities (such as metals). If this be intended either now or later, we suggest it is neither wise nor opportune to vest this authority and responsibility solely in the Secretary of Agriculture. In that case, indeed, it might be argued that the Commodity Exchange Authority should be taken out of the Department of Agriculture and established as a separate, autonomous agency.

Second, the proposed bill makes certain provisions concerning financial responsibility.

Certain proposed amendments would empower the Secretary of Agriculture to prescribe minimum financial requirements for futures commission merchants.

We support the principle that futures commission merchants be of sufficient financial substance to assure their ability to meet obligations to their customers and the clearinghouse. However, because we do not know what level of minimum financial substance the Secretary may deem adequate, we are concerned that his rules might exclude responsible smaller firms. The vigor of competition on futures markets owes much to the fact that these small and responsible firms participate with larger ones.

We also point out that commodity markets are justifiably proud of the historical sanctity of their contracts. The record of performance on futures contracts must be unequalled in any other branch of commerce. In the light of this record, unrealistic financial requirements would be an unjustifiable burden on smaller businesses.

We discuss margin requirements below, under separate heading, but we note here that their purpose is to guarantee performance on the contract. That being the case, margins are the chief instrument of financial responsibility in futures trading. However, because the bill treats margin requirements as having a different and altogether alien purpose, we must discuss them elsewhere instead of under the proper heading.

Third, the bill provides for more severe penalties.

Under the bill certain offenses which are now misdemeanors would be made felonies and elsewhere in the bill heavier fines or penalties are proposed. In principle, we endorse heavier penalties as a deterrent to violations, insofar as (a) violations are described in clear and meaningful terms; (b) enforcement procedures are consistent with price uncertainty inherent in futures trading; and (c) respondents are accorded a fair hearing. The act, however, as the Secretary proposes it be amended, does not meet these tests.

In a number of instances the bill would permit the Secretary to act against traders involved in practices described only in vague terms. For example, the Secretary could prosecute a trader for any activity which in his judgment has or may have the effect of "restraining trade." Thus the bill incorporates basic prohibitions of the Sherman Act and the Federal Trade Commission Act without incorporating the "rule of reason" tests the courts have read into those acts and without providing a correlative grant of immunity from those statutes. We know of no precedent for such a comprehensive grant of power to a single administrative official.

Under other proposed sections the Secretary need not delay such action but may issue a cease and desist order or seek an injunction, without bond protecting the respondent, upon belief that such activity is contemplated, thereby depriving respondent of evidence not then available which could subsequently exonerate him.

Finally, the bill proposes a revision in the powers of a reviewing court which would require it to uphold a ruling of the Secretary if the ruling is supported "by substantial evidence on the record considered as a whole," even though the "weight of the evidence" supports the respondent. (This new evidence test being proposed has been criticized by the courts and by such respected commentators as the Hoover Commission on Organization of the Executive Branch of the Government as being unduly narrow.)

There would be less concern about changing the rules for appeal if it were certain that respondents receive a fair and unbiased hearing by the Secretary in cases involving charges under the Commodity Exchange Act. The facts are that no respondent so charged ever has been exonerated when the matter went to final determination by the Secretary's judicial officer. Yet, under present "weight of the evidence" test, a number of these orders have been reversed by appeals courts.

Under these circumstances—and until determinations are made on definitions of manipulation and other violations, on the nature of remedies available to the Secretary, and on limitations to be imposed upon reviewing courts—we are reluctant to support provisions for heavier penalties.

Fourth, cease and desist orders; injunctions.

The bill confers upon the Secretary the power to issue cease and desist orders or to seek injunctions from the Attorney General in various circumstances. We have no objection to such legal procedure so long as they are applied to identifiable and clearly defined present violations. We oppose this authority with respect to violations which cannot be judged until after the fact. We treat this category at greater length under the heading "Margin requirements, manipulation, and excessive speculation."

Fifth, authority to prescribe rules.

The bill would give the Secretary of Agriculture authority to prescribe contract market rules governing conditions of sale when he finds this necessary to effectuate the provisions of the act. At present, these rules are determined by directors of contract markets, often on recommendations of watchdog committees supervising specific aspects of trade. Rules are under constant testing and review and require frequent revisions to adapt them to changing trade circumstances. Because members of these governing boards are active participants in the market, it would seem fair that they have equal incentive and greater competence than the Secretary to promulgate rules which stimulate and protect trade.

Under present law, no exchange can have rules in conflict with the Commodity Exchange Act; hence, the expressed contingency "when this is found necessary to effectuate the provisions of the act" appears to us superfluous and contrived. The act is, in itself, a set of rules and regulations. If additional rules and regulations are required to effectuate its provisions, they should be advanced in these hearings. If found acceptable to the Congress, then they should be incorporated into the act.

Under the present act, the Secretary is furnished copies of all bylaws, rules, regulations, and resolutions made and issued by each contract market and its

governing board or any committee, and all changes and proposed changes, and he exercises effective veto power over such changes. Moreover, section 8a(5) of the present act authorizes the Secretary to make general rules and regulations applicable to all contract markets he deems "reasonably necessary" to effectuate any of the provisions or to accomplish any of the purposes of the act.

In absence of a showing that his present authority is inadequate or that contract markets have rejected reasonable requests from the Secretary for rules he deems necessary, we see neither advantage nor necessity in giving him authority to initiate rules for individual markets.

Sixth, margin requirements, manipulation and excessive speculation.

The bill would grant the Secretary authority to prescribe minimum margin requirements whenever he "has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations, or unwarranted changes in the price of any commodity, or excessive speculation in any commodity, or any other activity reasonably expected to restrain trade."

There are several misconceptions embodied in this and related provisions, which if enacted would seriously impair the proper functioning of the markets. The major misconceptions are:

(a) That adjustments in margin requirements would effectively prevent manipulation or other undesirable trading activity;

(b) That the Secretary has the ability to foresee unreasonable or unwarranted changes in the price of any commodity; and

(c) That excessive speculation in commodities is a chronic or persistent problem and that the Secretary can define or even identify "excessive speculation."

Each of these needs full exposure, because together they reflect a new and alien interpretation of futures trading. We have expressed our conviction that futures markets stand to benefit from improved regulation; we must now voice our conviction that futures markets would suffer untold harm, and would have their functioning greatly impaired if amendments reflecting the misunderstandings were adopted.

The first misconception:

Margin requirements have had as their purpose the guaranteeing of performance on the contract. Margin levels are not established with any view toward preventing manipulation, controlling price change, or discouraging speculation. If the Secretary senses the danger of manipulation or restraint of trade, granting for the sake of argument that he can detect these incipiently, it is questionable on several grounds whether increased margins should be required. This would penalize everybody for the suspected transgressions of one or a few. This is not only inequitable but also would deprive the market of its opportunity for self-correction. The proven antidote for overspeculation, manipulation, or other attempted trading evils is the price defense thrown up by others in the marketplace who detect and act to defeat such efforts. Manipulation is accomplished by monopoly; the best remedy for monopoly is competition. Yet the bill proposes to restrict market entry at the very time that the Secretary deems competition threatened by monopoly. If the Secretary needs additional remedies, they should be specific and curative, not measures which would lower the resistance of the entire system to the incipient malady.

The basic difference between futures trading and the earlier forms from which it evolved is that it is more open and competitive. Distinguishing characteristics which make it so are (1) the clearinghouse established to assure performance of contracts and ease of offset; (2) margin requirements set at levels high enough to protect the clearinghouse and low enough to encourage trade; and (3) the requirements that all trading be done by open outcry at one place.

The futures margins are downpayments on credit transactions and should be set at levels comparable to those on stock purchases. In fact, a futures contract is not a credit transaction but a contractual right to make or receive delivery of a commodity at a fixed price. Whenever title to the commodity is transferred through a futures market, full cash settlement by certified check is required within 24 hours.

It has been suggested that the Secretary seeks standby authority to specify margin requirements to control prices in the event of a national emergency. This raises questions concerning both the nature of such an emergency and the effectiveness of margin controls for this purpose.

In the event of a national emergency there is ample precedent for direct price controls. But it has not been the prerogative of the Secretary of Agriculture to declare such a state of emergency. If it is the desire of the Secretary to

create standby price control, this should be clearly stated and discussed here on its merits.

We must question the effectiveness of margin requirements to control price. Margin requirements have never been used for such a purpose, hence there is no direct evidence of their effectiveness. However, there are several reasons to believe that they would be quite ineffective.

First, prospective buyers and sellers are more influenced by prospects of price change than by the margin requirements. If they believed in the Secretary's forecasting ability, his action in changing margin requirements might well induce rather than discourage trading.

Second, even if trading were discouraged by higher margins, price change would not necessarily be inhibited. Wide price fluctuations often occur where there is only limited trade.

Third, if future purchases are discouraged by increased margin requirements, buyers will increase their forward purchases in the cash market. The price control objective would thus be frustrated. The futures market would simply be deprived of its capacity to anticipate the ultimate real value of cash grain.

The danger in using margin requirements for regulatory purposes is this: To the extent they curtail trading, the distinction between futures markets and less competitive markets is diminished.

APPROPRIATE MARGIN STANDARDS

Appropriate margin levels serve a useful purpose in guaranteeing performance on futures contracts.

Because clearing members of the exchanges own stock in the clearing house and are subject to other financial requirements, margin levels can safely be lower for them than for persons who are not members of the clearinghouse.

Because hedgers do not run the risk of price change but only the lesser risk of changes in the relationship between cash and futures prices, margin requirements can safely be much lower for hedging accounts. Hedging margins should be as low as safe practice allows because: (1) the financing of commodity inventories is reduced in cost thereby and (2) the practice of hedging requires two transactions instead of one and hence entails extra costs. The saving in financing cost, which is influenced by margin levels, must more than offset the extra transaction cost for hedging to be economical.

It is likewise important that speculative margins remain low, because active speculative participation tends to create a broad, fluid market and encourages competition.

We are happy to note that previous witnesses have put into proper context, although in a negative sense, the "genesis" of H.R. 11788 first—that the recent, widely publicized fraud perpetrated by Allied Crude Vegetable Oil Refining Corp. was facilitated by low margin levels or would have been prevented by higher margin levels. In fact, however, the fraud involved was accomplished off the futures markets. Higher margin levels would not have prevented the machinations that did encompass the futures markets. The commodity trade wants to prevent a recurrence of the Allied case; but at the same time opposes measures which, if adopted through misconception, would not prevent such a disaster but would impair legitimate functions of futures markets, and secondly;

In summary: (1) Margin requirements have been adequate in the sense that they have fulfilled their purpose of guaranteeing performance; (2) they have not been used, nor should they be, to prevent manipulation or other abuses, nor to control prices in a national emergency, for this would jeopardize their true purpose while failing to accomplish the new and alien purpose; and (3) futures contracts are not credit instruments nor are margins "downpayments" on credit transactions, so margin levels should not be geared to such considerations.

Finally, we believe that margins, at appropriate levels and serving their true purpose, should be adequately policed. We see no objection, for example, to the CEA audit of margin accounts at levels established by the contract markets. We also believe that some guidance to contract markets might be found in a study of margin levels for various commodities, which would relate margins to the statistical record of price change. Margin levels should be high enough at all times to guarantee contract performance and they should be established with no other purpose in view.

The second misconception:

The proposed amendment clearly assumes that the Secretary has the ability to foresee "unwarranted or unreasonable price change." (We probably would

not agree with the amendment's framers on what constitutes unwarranted or unreasonable price change because, elsewhere in the bill, they define artificial prices in such a manner as to include any substantial price change—see our discussion of manipulation below.) Even if we were agreed upon a definition, we could not agree that the Secretary is able to foresee unwarranted or unreasonable price change. Price change is warranted by uncertainty and uncertainty always exists, even in the Department of Agriculture. It is possible, through intensive study of the facts, to say in retrospect whether price change was warranted. It is not possible to say this in advance. Indeed this is why we have futures markets, where differing opinions of prospective price changes can be reconciled. Even in retrospect, most futures price changes are seen to have been warranted by the emergence of new information. Because new information emerges randomly, however, it is impossible to say in advance what price change is reasonable or warranted.

The Secretary of Agriculture has at his disposal the information and resources which enable him to learn whether a price change which has occurred seems to have been warranted by the facts as they unfolded. He can also endeavor to ascertain whether any unwarranted changes seem to have resulted from honest mistakes in judgment or from deliberate manipulation. This is his proper role in the interest of fair and efficient marketing. To go further in influencing price change would be to control prices. Already, in existing price support and related legislation, the Secretary is empowered to control certain prices within certain limits; but it has never been the intention of Congress in regulating commodity futures markets that he be given additional authority to control prices through margin requirements.

It is common knowledge, and no criticism of the Secretary, that his price forecasts have been inaccurate on occasion. In the circumstances surrounding the defeat of the wheat referendum in 1963, he predicted wheat prices much lower than those which occurred, and much lower than those predicted on the futures markets. The Secretary's opinion of "warranted price change" differed from market opinion, and the Secretary was proved to be wrong. Given the authority to act upon such beliefs, the Secretary could prevent warranted price change, thus compounding the error.

If the Secretary had the ability to anticipate unwarranted or unreasonable price change he would, by the same token, know what price changes were warranted and reasonable. Under these circumstances, there would be no need for markets. The Secretary simply would be empowered to set prices at appropriate levels.

The third misconception:

The same considerations apply to excessive speculation as to the prospect of warranted price change. In addition, we question the CEA definition of excessive speculation. Actually, many futures markets have inadequate speculation. Yet, by CEA standards, speculation always is adequate and commonly excessive. The CEA has on occasion assessed the "adequacy of speculation to carry the hedging load," implying a definition of adequacy which limits speculative positions to the size of the net hedging position, and has referred to "excesses" above that level.

This very restrictive definition of speculative adequacy altogether ignores the price determining role of futures trading and limits the role of futures markets to that of accommodating hedging. The most important function of future markets is price determination, which facilitates and is facilitated by hedging.

To be sure, excessive speculation can cause unwarranted price change on occasion, but if it is impossible to anticipate unwarranted price change, it is likewise impossible to anticipate excessive speculation. Inadequate speculation, the more common condition, has price effects also; prices are poorly defended on markets with inadequate speculation, but these are not recognized in the bill.

Referring to our earlier discussion of cease and desist orders and injunctions, we believe that these three misconceptions have a direct bearing upon those issues, too. We think that it is impossible for the Secretary to detect possible manipulation or restraint of trade or excessive speculation or unwarranted price change at an incipient stage. Therefore, penalties for such violations must always be invoked after the fact. We believe penalties should be severe enough to serve as a real deterrent, but that markets must be given every opportunity and encouragement to perform properly, which would be denied if this amendment were adopted.

Seventh, manipulation: The proposed amendment concerning manipulation says the word "manipulate" shall be construed to mean "the exacting, causing,

or maintaining of an abnormal or artificial price by any action or course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to a level different than that which would otherwise prevail. Any such exacting, causing, or maintaining of an abnormal or artificial price shall constitute manipulation irrespective of any acts or omissions by the holders of futures contracts adversely affected thereby."

We first make some observations regarding the setting in which this definition has emerged. The CEA apparently feels that the requirements for a finding of manipulation set forth by the courts, particularly by the fifth circuit court in *Volkart Bros., Inc., v. Freeman* (1962) are too difficult to prove. Thus, the proposed amendment is worded in such a way as to qualify almost any large transaction as manipulative. We judge this from the CEA's current complaint against one of our members, Cargill, Inc. A measure of CEA's differences with producers and the trade on what constitutes manipulation is seen in the fact that the Chicago Board of Trade, the Association of Commodity Exchange Firms, Inc., and the Great Plains Wheat, Inc. (a wheat producers organization), all have requested and have been granted permission to intervene in this case in support of Cargill's position.

First, the CEA apparently would define as artificial or abnormal any price different from what would have prevailed without certain actions or transactions. Thus, it would include almost any substantial hedging transaction, particularly in a relatively thin market.

Second, the CEA would look only to the results of actions, without regard to intent. Thus, an innocent buyer or seller whose transaction was prompted by honest but mistaken analysis, could be cited for manipulating if his action had a price effect.

Third, the CEA would ignore the obligation of shorts in the marketplace—either to offset their contracts or to obtain and deliver supplies. The CEA concept of deliverable supplies, much narrower than the usual trade concept, seems designed to excuse the shorts from delivery obligations. Thus, we interpret the last sentence in the above amendment as saying that the long cannot defend himself against a manipulation charge by showing that shorts failed to fulfill their contractual obligations.

We believe that manipulation and attempts to manipulate are serious offenses against the marketplace which should be severely punished. We believe, however, that the proposed amendment defines manipulation so loosely and arbitrarily as to enhance the prospect that ethical participants in the markets would be falsely accused and convicted, without in any measure enhancing the prospect of proving real guilt. The proper direction in which to carry a definition of manipulation is toward greater refinement and precision. Instead, this proposed definition is much broader and looser than the one currently established in case law. It is a blunderbuss approach by which the accuser cannot wholly miss, but by which he really does not improve the odds that the real offender will be hit.

We believe that if the CEA cannot cite specific practices which shall constitute manipulation, the courts must be left to define manipulation in case law. Admittedly, it is costly and cumbersome to proceed in this manner, but until the courts are given statutory guidance which is precise and discriminating, it is the only fair way.

We are aware, as we fear the CEA is not, that congested markets commonly result from Government programs which limit free supplies. Abrupt, substantial price changes can occur in congested markets as overdue liquidation or covering takes place, particularly during the delivery period. We favor orderly acquisition and liquidation of futures contracts, yet we feel that the delivery obligation in the contract must be respected, even at the expense of occasional abrupt price changes.

In conclusion we do not question the desire of the Commodity Exchange Authority to improve performance of futures markets in the public interest.

However, it seems clear that this bill would contribute little to that end. We urge this committee to reject the bill in its entirety. Although some of its provisions may bring improvement, on balance, the bill so completely misconceives the CEA's regulatory responsibilities, we believe it should be returned to the Department for complete overhaul.

We also urge the committee to consider steps needed to improve the performance of the Commodity Exchange Authority. Specifically, we suggest that the Congress impose high standards for the CEA's professional staff, in-

sist on the assembly and the interpretation of evidence needed to provide a more reliable guide to its enforcement activities, and finally, provide sufficient funds to permit it to perform all its functions fully and efficiently. We believe that implementation of these proposals would solve many of the enforcement problems which underlie the CEA's request for broader permit to regulate futures markets.

Mr. MATSUNAGA. The time of the gentleman has expired.

Are there any questions?

We will allow 1 minute.

Mrs. MAY. No questions.

Mr. DOLE. I will not take time for any questions now. Let me say the witness has done an excellent job. I understand that your entire statement will be made a part of the record. There has been a very weak case made for H.R. 11788 and a strong case made in opposition to it. While not a member of this subcommittee, I am interested in the legislation.

I certainly commend you for a very fine statement.

Mr. PARROTT. Thank you, sir.

Mr. BURTON. I will not take time for questions, but I would like to congratulate you on your statement.

Mr. PARROTT. Thank you, sir.

Mr. MATSUNAGA. Thank you. Certainly, your entire statement will be made a part of the record.

Our next witness is Mr. William F. Brooks of the National Grain Trade Council, who is accompanied by Mr. Robert L. Searles, chairman, the National Grain Trade Council.

We will be glad to hear from you now.

STATEMENT OF WILLIAM F. BROOKS, NATIONAL GRAIN TRADE COUNCIL

Mr. BROOKS. Mr. Chairman and members of the committee, my name is William F. Brooks. Mr. Searles is the chairman of the board of the National Grain Trade Council, and he will testify. With him is Mr. Robert Deibel, president, St. Louis Merchants Exchange, and Carl Farrington, chairman, Grain Terminal Merchants Association. The St. Louis Merchants Exchange is one of the largest grain markets in the country. He is also president of a small feed manufacturing concern, and in this capacity uses these futures markets. These are people that use these markets. And you have had presented to you a letter which has been written which we request be incorporated in the record along with Mr. Searles' statement.

Mr. MATSUNAGA. Without objection, the letter will be made a part of the record at this point.

(The letter referred to follows:)

THE TERMINAL ELEVATOR GRAIN MERCHANTS ASSOCIATION,
Kansas City, Mo., April 5, 1966.

HON. SPARK M. MATSUNAGA,

Chairman, Special Subcommittee on Domestic Marketing and Consumer Relations, Committee on Agriculture, House of Representatives, Washington, D.C.

DEAR MR. MATSUNAGA: My name is Carl C. Farrington. I am president of the Terminal Elevator Grain Merchants Association. Members of this association operate grain elevators having a storage capacity of more than 1 billion bushels at ports and in terminal markets throughout the United States.

As merchandisers of large quantities of grain, we make extensive use of the hedging opportunities available to use through futures trading in contract markets. We have a vital interest in H.R. 11788 now being considered by your subcommittee. However, in the interest of avoiding repetition and conserving the time of the subcommittee, we are not submitting a separate statement, but I am appearing with and concur in the statement being presented by Robert L. Searles, chairman of the National Grain Trade Council, of which the terminal association is a member.

Sincerely yours,

CARL C. FARRINGTON,
President.

Mr. MATSUNAGA. You may proceed, Mr. Searles.

STATEMENT OF ROBERT L. SEARLES, CHAIRMAN, NATIONAL GRAIN TRADE COUNCIL; ACCOMPANIED BY ROBERT DEIBEL, PRESIDENT, ST. LOUIS MERCHANTS EXCHANGE; AND CARL FARRINGTON, CHAIRMAN, GRAIN TERMINAL MERCHANTS ASSOCIATION

Mr. SEARLES. Mr. Chairman and members of the committee, I will observe your request to be as economical with your time as possible. I have spent 13 years in exchange management, 12 years as president of the Futures Association in Minneapolis, and I have been a futures trader myself since 1948. I appear here, though, as chairman of the National Grain Trade Council, and the council appreciates the opportunity to be heard on the Commodities Exchange Act amendments as proposed by H.R. 11788.

The many markets and trade associations that make up the council have a vital interest in reasonable and effective futures market regulation and we feel that the proposals before you deserve very close scrutiny by everyone concerned with free competitive markets.

The organized grain marketing industry is anxious to cooperate with Government to maintain useful grain markets, properly serving all segments of the agricultural economy. Before this effective distribution system is materially changed by amendment to existing law, we respectively suggest that members of this committee visit operating exchanges and see for themselves how they work.

I am going to, if I may, refer you to page 2, to look at some of the particular items and to call attention to a few which we feel are more important than others.

H.R. 11788 would empower the Secretary to set margins. This function is performed now by men who have had long experience in judging commodity values. They set margins at levels sufficient to guarantee contract performance by both buyer and seller while also recognizing that margins must be kept at levels that encourage maximum use of the market. The history of commodity exchanges shows that this margin setting has been done successfully over the years.

What is the Secretary going to do that is not done now? Will he bring more knowledge or competence to a field where experts now operate? That's doubtful. Will margin powers be used to try to alter market price trends? Possibly. Use of margin control by the Secretary for price control purposes would be ineffective, simply accentuating price moves by narrowing trade. Margin is the "earnest money" to guarantee contract performance. That's its sole function. Price control is a separate matter and should be dealt with directly

in price control legislation, assuming that Congress wishes to grant commodity price control powers to the Secretary.

I would like to move forward, although I do want to call attention to some of the words in this part of the bill. Many of the words in this margin control matter are subjective in nature, and they apply subjective standards of judgment. I will cite some of them: reasons, belief, danger, sudden, unwarranted, excessive. All of these words have vague and differing meanings, depending on who says them. What reasons, whose beliefs, what degree of danger? Who can define these words objectively, clearly, giving legal basis to their use?

I can't. I doubt that anyone can.

We wonder what the margin controls might have been recently imposed by the Secretary in connection with the Department's recent unanticipated and unannounced large corn sales. These Government corn sales were handled by the grain marketing industry only because of the availability of a fluid corn futures market to which the users of that market had ready access for hedging purposes.

If I may ask you to move forward to page 5 of my statement, please, this amendment empowers the Secretary to write exchange rules. With this power the Secretary can dictate exchange rules and set margins as he wants them. This amendment really covers everything else. It does not matter what else goes in this bill if this one is accepted, for with this power the Secretary can dictate exchange rules that set margins as he wants them, require disciplinary action based on whatever evidence he says is sufficient. You name it. He's got it. Power unlimited for the Secretary of Agriculture. Naturally, we oppose replacing the combined judgment of every exchange board of directors with the judgment of one man, the Secretary of Agriculture.

As it stands now, exchange rules are subject to USDA disapproval if the Secretary finds they are improper or contrary to law. The few times such disapproval has occurred, the infrequency of complaints and the effective manner in which exchange business-conduct committees, aided by existing CEA regulation, control trade practices, indicates a reasonably successful market management picture.

If I may ask you to go forward again to page 9.

Once again this is brought up in the matter in requiring markets to adopt rules prescribed by the Secretary of Agriculture. And we would like to comment again, since it is referred to twice in these proposed amendments.

With such a power the Secretary can do all the things to control markets cited in other sections. It is an all-encompassing power, setting the Secretary over each and every exchange board of directors. His word would be law, the directors would direct only housekeeping matters, and the competitive commodity marketing system would become an arm of government. If this is a USDA aim or goal, this rulemaking power over exchanges would do more to accomplish it than any other act short of nationalization of the whole commodity marketing system itself.

We oppose the granting of this power to the Secretary of Agriculture.

On page 10, we have the definition of "manipulation" and standard of proof sections. We would like to call attention to this matter.

"Manipulation" is defined here as the —

exactng, causing, maintaining of an abnormal or artificial price by any action or course of action which raises, depresses, fixes, pegs or stabilizes the price at or to a level different than that which would otherwise prevail.

This definition effectively describes every trade which is made in a futures market, for each trade has a market effect. Without a particular trade the market would have necessarily been different. Therefore, every trader, by the simple act of making a trade is guilty of manipulation. Every trade made becomes the grounds for a charge of manipulation.

A series of judicial decisions have defined manipulation for the purposes of the Commodity Exchange Act.

These decisions include the element of intent as a basic ingredient of manipulation. We disagree with the proposed removal of intent in the bill before you.

The proposed definition of "manipulation" provides that certain acts shall constitute manipulation irrespective of what adversely affected holders of futures contracts may do.

This would have the effect of relieving holders of futures contracts from carrying out their obligations either to take delivery or to make delivery. This would render meaningless an essential feature of futures contracts. If it is approved by the Congress and if, as a result, persons who make futures contracts are permitted to avoid their contractual responsibilities, those contracts under some State laws, would be regarded as unenforceable contracts.

We respectfully direct your attention to the case of *Volkart Brothers et al. v. Freeman* (311 Fed. 2d 52).

In summary, the proposed definitions of trade practices that would be in violation of the law are so broad and so all inclusive that they include the just and the unjust. The conditions under which margin control might be invoked by the Secretary are so vague that he could use this power at any time, depending on his belief or his understanding of the words "unwarranted," "unreasonable," and others. The degree of evidence needed to prove a person guilty under the proposed amendments is much less than that which would be permitted were the same person to be tried in a regular court.

None of these measures, in and of themselves, goes directly to the problems involved in regulating commodity markets. We would rather see the Congress make a study of grain marketing to determine what, if any, changes in the law are necessary, keeping in mind that the purpose of markets is to bring buyers and sellers together to trade commodities in volume, fairly and competitively. Regulations of markets should never mean political price control or suppression of trade through regulation. Just as falsifying the reading of a thermometer can deceive the user of the thermometer, just so can the falsifying of market values deceive the Nation's producers, marketers, processors and consumers.

It just is not in the national interest to try to control markets through CEA legislation in a manner that defeats the useful purpose of those markets.

This is not to say that the Nation should not protect itself from oversupply or undersupply of a particular commodity through some appropriate national program. This merely says that Commodity

Exchange regulation should be so framed that it makes the markets more effective distribution points, accurately recording true values competitively arrived at. Any regulation that unreasonably penalizes users of markets, reduces trade volume, or otherwise inhibits true market utility can only restrain trade and work a hardship on the economy of the country.

For these reasons we oppose the enactment of the proposals before you. We again recommend that the Congress initiate a study, with the cooperation of markets themselves, of the proper supervision of commodity markets by the CEA.

(The prepared statement submitted by Mr. Searles reads in full as follows:)

STATEMENT OF ROBERT L. SEARLES, CHAIRMAN, NATIONAL GRAIN TRADE COUNCIL

The National Grain Trade Council appreciates the opportunity to be heard on the Commodity Exchange Act amendments proposed in H.R. 11788. The many markets and trade associations that make up the council have a vital interest in reasonable and effective futures market regulation and we feel that the proposals before you deserve very close scrutiny by everyone concerned with free competitive markets.

The organized grain marketing industry is anxious to cooperate with Government to maintain useful grain markets, properly serving all segments of the agricultural economy. Before this effective distribution system is materially changed by amendment to existing law, we respectfully suggest that members of this committee visit operating exchanges to see for themselves how they work.

In his letter of transmittal, the Secretary of Agriculture calls attention to the 1963 *De Angelis* case as a principal reason for recommending this legislation.

We understand the Department, before this committee, has admitted that the powers requested here would not have prevented the November 1963 debacle.

None of the proposals in H.R. 11788 does anything about the failures inherent in that case.

The proposals before you in H.R. 11788 are largely market control powers which have broad price control implications. The bill doesn't close the door on warehousing fraud. The bill doesn't protect securities customers' funds from misuse. The bill doesn't promise more effective inspection of collateral posted with lending institutions.

In other words, even if this proposed legislation became law, it would still not prevent a repetition of the *De Angelis* affair.

Now let's look at what the bill would do, following the items as listed in the committee print, dated October 28, 1965.

Empower the Secretary to set margins

This function is performed now by men who have had long experience in judging commodity values. They set margins at levels sufficient to guarantee contract performance by both buyer and seller while also recognizing that margins must be kept at levels that encourage maximum use of the market. The history of commodity exchanges shows that this margin setting has been done successfully over the years.

What is the Secretary going to do that is not done now? Will he bring more knowledge or competence to a field where experts now operate? That's doubtful. Will margin powers be used to try to alter market price trends? Possibly. Use of margin control by the Secretary for price control purposes would be ineffective, simply accentuating price moves by narrowing trade. Margin is the "earnest money" to guarantee contract performance. That's its sole function. Price control is a separate matter and should be dealt with directly in price control legislation, assuming that Congress wishes to grant commodity price control powers to the Secretary.

The language in section 13 (adding sec. 4j to the act) says margin control can be exercised "Whenever the Secretary of Agriculture has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations, or unwarranted changes in the price of any commodity, or, excessive speculation in any commodity, or any other activity reasonably expected to restrain trade

* * * "

Many of the words are subjective in nature, defying objective standards of judgment. "Reason," "belief," "danger," "sudden," "unwarranted," "excessive," all these words have vague and differing meanings, depending on who says them. What "reasons," whose "beliefs," what degree of "danger"? Who can define these words objectively, clearly, giving legal basis to their use? I can't. I doubt that anyone can.

We wonder what margin controls might have been recently imposed by the Secretary in connection with the Department's recent unanticipated and unannounced large corn sales. These Government corn sales were handled by the grain marketing industry only because of the availability of a fluid corn futures market to which the users of that market had ready access for hedging purposes.

Proposed CEA control of commodity futures margins has been compared to SEC control of security margins. It would be more accurate to make the comparison between stock margin requirements and capital invested in ownership of cash grain. Both represent actual ownership, one of corporation assets, the other of actual grain.

A futures contract, to a merchant or processor, is a form of contractual price protection and doesn't represent actual inventory, although a long contract may be ultimately used to acquire needed supplies.

Take the case of an elevator owning 100,000 bushels of corn at \$1.20 a bushel. The elevator has \$120,000 of its own and bank's money tied up, 100 percent of the value of the corn. The hedge contract, a sale of 100 July corn, for example, ties up an additional 6 cents per bushel, or \$6,000. This commitment of additional capital is an acceptable cost of obtaining price insurance.

Suppose that the margin requirements were suddenly raised to 70 percent, to match Federal Reserve margin requirements. The capital needs for carrying 100,000 bushels of corn would amount to \$204,000, instead of \$126,000. It's easy to see the restraint of trade that such a move would cause.

Marketing costs would rise. Many would cease using futures markets, making them less fluid and effective. The additional cost of carrying price risks, without futures protection, or the cost of additional borrowing to carry an over-margined hedge, would lower prices to farmers and raise prices to consumers.

In other words, minimum margin requirements for hedging trades have a firm economic reason.

Minimum requirements for speculative futures trades are always larger than for hedge purposes. Still, the sole requirement here is to guarantee contract performance. If speculative margins were unduly manipulated by the CEA, the net result would be to reduce trading volume, accentuate price fluctuations, and produce a restraint of trade by eroding the fluidity of the market.

No matter how this CEA margin control prospect is viewed it leads to the conclusion that such control could be reasonably expected to restrain trade and raise marketing costs.

We oppose this margin control proposal.

Empower the Secretary to designate additional commodities subject to the act

So long as the act has as its purpose the enforcement of fair competitive trade practices in marketplaces, the addition of other commodities is not harmful. If the purpose of the act is market price control or suppression of competitive trade through punitive market control, then we would oppose this provision. Much depends on the action by Congress on other parts of this bill. We would prefer, when additional commodities should come within the provisions of this act, that this be done by action of Congress.

Empower the Secretary to write exchange rules

This amendment really covers everything else. It does not matter what else goes in this bill if this one is accepted, for with this power the Secretary can dictate exchange rules that set margins as he wants them, require disciplinary action based on whatever evidence he says is sufficient. You name it. He's got it. Power unlimited for the Secretary of Agriculture. Naturally we oppose replacing the combined judgment of every exchange board of directors with the judgment of one man, the Secretary of Agriculture.

As it stands now, exchange rules are subject to USDA disapproval if the Secretary finds they are improper or contrary to law. The few times such disapproval has occurred, the infrequency of complaints and the effective manner in which exchange business conduct committees aided by existing CEA regulation, control trade practices, indicates a reasonably successful market management picture.

Empower the Secretary to exercise the authority presently vested in the Commodity Exchange Commission

We think that the present Commodity Exchange Commission would be preferable to one-man rule. The same principle cited above would apply here.

If a broader futures market regulatory law is in order, it may be time to consider establishment of a separate commission, similar to the SEC, to supervise all futures markets, whether dealing in agricultural, mining, or other products.

Empower the Secretary to issue cease and desist orders against individuals

This power presupposes that a person's intentions are definable and known to the Secretary and, based on this knowledge, the Secretary can stop what he thinks is intended. This enters a legal field for which there is little precedent in this country. Stopping a man from doing something, based on assumed intentions, cannot also be based on any objective criteria. How could any Secretary use this power without violating existing legal rights extended to all citizens?

We oppose this proposal.

Empower the Secretary to establish minimum financial requirements for futures commission merchants

This appears to be a trade function, not a Government function as far as it relates to members of organized exchanges. We recommend this remain a function of exchanges.

Power to refuse registration

The provisions of this proposed amendment under section 25, paragraphs (A) or (B) appear to be reasonable and proper. Paragraph (C) repeats the financial requirements authority, in this case granting power to the CEA to enforce these requirements by refusal to register futures commission merchants.

Traditionally, in the United States personal reputation as well as amount of invested capital have governed bank decisions extending businessmen lines of credit. The same "character judgment" principle is often applied by trade associations or exchanges in approving registration of member firms. To place registration on a financial test alone denies the new, the young, the less affluent, a chance to compete. This is not fair to those climbing the business ladder. It loads the dice in favor of the rich and against the struggling newcomer. Local boards of directors can make such judgments. The Secretary of Agriculture would never have the information to do the same. As it stands, we would oppose this latter proposal.

Provide authority for injunctions to restrain or prevent violations

This is not unlike the cease and desist order provision. It presupposes that the Secretary has insight into intentions of allegedly incipient violators.

We oppose this grant of authority.

Apply to all persons the provisions of the act, instead of just members of contract markets and their agents

There appears to be no reason not to enact such an extension of the scope of this act.

Prohibit depository of segregated customer funds from treating such funds as belonging to the commission merchant

Since the depository or clearinghouse deals solely with the clearing member, not the customer of the member, there is some question about making such a depository responsible for ultimate use of funds in segregated accounts. The aim of this section is not in question. The mechanics of the section are:

Expand recordkeeping requirements to include spot or cash transactions and inventories

This intrusion into spot or cash records places a burden on the grain trade and raises a serious question about how great a police function should be granted the CEA. Is there a limit, in a free society, to the degree of governmental inspection and control imposed on citizens? Does this go beyond the reasonable needs for this type of regulatory regulation? We think so and oppose such an expansion of reporting requirements.

In addition, under section 24(b) of the bill, the Secretary would be given the authority to furnish information to other departments or agencies of the

Government. We object to the disclosures of information submitted on a confidential basis solely for the purpose of this act.

Apply penalties of the act to persons against whom an order had been issued, should such a person attempt to exercise trading privileges during the life of such an order

This is a reasonable extension of CEA powers, assuming that the orders concerned are not based on arbitrary or capricious decisions, particularly relating to the "manipulation" definition.

Require markets to adopt rules prescribed by the Secretary of Agriculture

With such a power the Secretary can do all the things to control markets cited in other sections. It is an all-encompassing power, setting the Secretary over each and every exchange board of directors. His word would be law, the directors would direct only housekeeping matters, and the competitive commodity marketing system would become an arm of Government. If this is a USDA aim or goal, this rulemaking power over exchanges would do more to accomplish it than any other act short of nationalization of the whole commodity marketing system itself.

We oppose the granting of this power to the Secretary of Agriculture.

Apply penalties of the act to any person who aids, abets, or acts in concert with any other person in violation of the act

This is reasonable so long as the determination of a violation is based on conclusive evidence, not on "belief" or alleged "manipulation" as defined in these amendments and so long as the violation was intentional.

Certain violations to be made felonies instead of misdemeanors

We must assume that criminal actions, alleging violation of the Commodity Exchange Act, must be proved beyond a reasonable doubt and not on the basis of either the weight of the evidence or on substantial evidence on the record.

No matter how labeled, we condemn every illegal and improper act even remotely connected with the operations of futures markets. We believe that violators of the act should be appropriately punished whenever a violation is found.

Definition of manipulation and standard of proof

"Manipulation" is defined here as the "exacting, causing, or maintaining of an abnormal or artificial price by any action or course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to a level different than that which would otherwise prevail."

This definition effectively describes every trade which is made in a futures market, for each trade has a market effect. Without a particular trade the market would have necessarily been different. Therefore, every trader, by the simple act of making a trade is guilty of manipulation. Every trade made becomes the ground for a charge of manipulation.

A parallel example might be a traffic law that says that "unlawful operation of a motor vehicle is the moving forward, or backward or parking of a car on Main Street." There are two results to this. Either everyone with a car on Main Street runs the risk of capricious police action, or everyone stays off Main Street.

In the commodity markets of the United States, the manipulation definition proposed would either have to be ignored by the CEA or, if used, the definition would drive everyone out of the market for fear of unwarranted prosecution.

Is either of these alternatives the intent of this legislation? We would assume the answer to be no.

A series of judicial decisions have defined manipulation for the purposes of the Commodity Exchange Act. These decisions include the element of intent as a basic ingredient of manipulation. We disagree with the proposed removal of intent in the bill before you.

The proposed definition of "manipulation" provides that certain acts shall constitute manipulation irrespective of what adversely affected holders of futures contracts may do.

This would have the effect of relieving holders of futures contracts from carrying out their obligations either to take delivery or to make delivery. This would render meaningless an essential feature of futures contracts. If it is approved by the Congress and if, as a result, persons who make futures contracts are permitted to avoid their contractual responsibilities, those contracts under some State laws, would be regarded as unenforceable contracts.

We respectfully direct your attention to the case of *Volkart Brothers, et al. v. Freeman*, 311 Fed. (2d) 52.

The "weight of evidence" principle is to be replaced by the phrase, "substantial evidence on the record considered as a whole." This latter phrase has been used in regulatory matters, for example, in determining the proper level of rates to be charged by a public utility or the methods employed by public utilities in their bookkeeping and depreciation operations.

Proceedings under the CEA are disciplinary in nature. It would appear that the defendant should have the same protection under CEA justice as he would have in court, especially in view of the penalties involved.

While we have found it necessary to oppose most of the pending amendments, we appreciate the value of the Commodity Exchange Act and the functions of the Commodity Exchange Authority. There are areas in which the CEA can be more effective than the trade can in the regulation of markets. For example, the setting and supervising of speculative position limits involves knowledge that active members of the trade do not want to have. Commodity marketing is competitive. Knowledge of another's position in the market can constitute an unfair trade advantage. Therefore, boards of trade traditionally are hesitant to arm their directors with knowledge of competitors' positions. The CEA can perform this function without violating confidential information.

In summary, the proposed definitions of trade practices that would be in violation of the law are so broad and so all-inclusive that they include the just and the unjust. The conditions under which margin control might be invoked by the Secretary are so vague that he could use this power at any time, depending on his belief or his understanding of the words "unwarranted," "unreasonable," and others. The degree of evidence needed to prove a person guilty under the proposed amendments is much less than that which would be permitted were the same person to be tried in a regular court.

None of these measures, in and of themselves, goes directly to the problems involved in regulating commodity markets. We would rather see the Congress make a study of grain marketing to determine what, if any, changes in the law are necessary, keeping in mind that the purpose of markets is to bring buyers and sellers together to trade commodities in volume, fairly, and competitively. Regulation of markets should never mean political price control or suppression of trade through regulation. Just as falsifying the reading of a thermometer can deceive the user of the thermometer, just so can the falsifying of market values deceive the Nation's producers, marketers, processors, and consumers.

It just is not in the national interest to try to control markets through CEA legislation in a manner that defeats the useful purpose of those markets.

This is not to say that the Nation should not protect itself from oversupply or undersupply of a particular commodity through some appropriate national program. This merely says that commodity exchange regulation should be so framed that it makes the markets more effective distribution points, accurately recording true values competitively arrived at. Any regulation that unreasonably penalizes users of markets, reduces trade volume, or otherwise inhibits true market utility can only restrain trade and work a hardship on the economy of the country.

For these reasons we oppose the enactment of the proposals before you. We again recommend that the Congress initiate a study, with the cooperation of markets themselves, of the proper supervision of commodity markets by the CEA.

Mr. MATSUNAGA. The time of the gentleman has expired; I allowed you an extra minute to summarize.

Mr. SEARLES. Thank you, sir.

Mr. MATSUNAGA. I am sorry that we have to rush this way, but there are too many witnesses, and there is limited time at our disposal.

Your entire statement is made a part of the record.

Are there any questions?

Mr. DOLE. The witness has made a very outstanding statement. This bill talks about the word "manipulation". From your observation, are there many of these so-called "manipulations"?

Mr. SEARLES. I would be hard pressed to define any particular time when I have seen "manipulation" in the many grain exchanges. I cannot think of a time that I could cite when I witnessed it.

Mr. DOLE. That is, under the present definition?

Mr. SEARLES. Well, under the present law, yes, sir.

Mr. DOLE. Under the present law, yes.

Mr. SEARLES. Yes, sir.

Mr. DOLE. Thank you.

Mr. MATSUNAGA. If there are no further questions, we will call our next witness, who is Mr. Ralph C. Bagley, on behalf of the Minneapolis Grain Exchange.

We will be glade to hear you now, Mr. Bagley.

STATEMENT OF RALPH C. BAGLEY, ON BEHALF OF THE MINNEAPOLIS GRAIN EXCHANGE

Mr. BAGLEY. Thank you, Mr. Chairman and Congressmen, for having given me this time in which to comment on H.R. 11788.

My name is Ralph C. Bagley. I live in the village of Orono, Minn., and I am here to represent the Minneapolis Grain Exchange as its president. I am also president of the Bagley Grain Co., which has country grain elevators at about 20 locations in the Dakotas and Montana.

The members of the Minneapolis Grain Exchange and those who use its facilities are naturally very much interested in any legislation which might impair the usefulness of this market.

We are bound to have grave concern over any important extension of the Government's involvement in the management of free markets. We are afraid that too much authority to tamper with the historical functions of commodity markets will destroy their effectiveness.

It is not my intention to detail the features of H.R. 11788 which are particularly objectionable in their present form as compared to some that are not. You have already listened to a host of qualified people from the grain trade who have testified to this. It might be better for me simply to emphasize that we are in no way opposed to reform. Changing times require new approaches to problems and in recognition of this the Minneapolis Grain Exchange has an enviable record of rules revision to meet every challenge that has developed through the years. There is no blemish on its long record of contract performances and cooperation with State and Federal authorities. This exchange just does not need further controls by the U.S. Department of Agriculture. If it needs anything more in order to serve the people better, it might be the opportunity to demonstrate how efficiently and at what low cost it could market the grain stocks which are under the control of the Commodity Credit Corporation.

I do want to stress something about margin requirements because there's an aspect of it which is apt to escape the notice of many who have not used futures contracts for hedging purposes.

By way of background, we suspect that one of the important reasons the Secretary of Agriculture has in mind for wanting authority to increase margins on commodity trading is that by taking such action he could kill off a substantial volume of any trading which would tend to move the cost of grain in a direction contrary to the Department's

current purpose. The question naturally arises as to whether that authority always would be wisely used.

We know that officials in Commodity Exchange Authority in private conversations have suggested that margins might properly be in a range above 25 percent of the value of a commodity. Those who argue in support of margin control by CEA point to "similar" controls—regulation T of the Federal Reserve Board—governing financial transactions in securities markets. They reason that what has functioned satisfactorily there could be expected to produce the same result as applied to commodity markets. That this is just not true needs to be given broader recognition because if margin requirements are set too high then trading in commodities becomes a luxury available to the limited few who can afford it. As a result, those of us who need to insure our transactions by the use of futures contracts and find it impossible to do so are faced with having to speculate in a business which is notorious for the magnitude of its risks.

For example, as it applies to the New York Stock Exchange, the seller owns an investment security which he offers to the prospective buyer for cash. One hundred percent payment is required to complete the transaction and regulation T merely limits the part of the payment which can be borrowed from a bank or a broker.

In the commodity markets, both the buyer and the seller enter into an agreement to deliver goods during some month in the future. To guarantee performance on this contract both the buyer and the seller deposit money with the central agency called the clearinghouse which holds these margins in escrow. The only purpose of the margin is to guarantee performance on the contracts. The margins are not a downpayment on anything and therein lies the significant difference, and also a lurking danger which I intend to bring to your attention in the best way I know how; that is, by reference to what I and many other grain traders do every day.

I am the fourth generation in a family of grain merchants whose incorporated business has been in existence since 1889. Perhaps one reason we have survived through many years of economic ups and downs is that we have been able to avoid speculation in large measure by making use of futures contracts to hedge our grain inventories. At certain times these inventories are quite large.

Right now, for example, it is very difficult to get enough boxcars for the loading of grain to keep pace with our purchases in the country. As a consequence, two situations have developed, both of them perfectly normal to this type of business. We have to increase our sales contracts or hedges and we have to borrow more money from the banks to finance these inventories until the grain can be brought to market and sold. The availability of a fluid futures contract market removes much of the risk of doing business and thus enables us to operate on very small margins, all of which is bound to be of benefit to the producer and to the consumer.

At this time, our elevators are paying an average price of about \$1.50 per bushel for good wheat in the country, and we put up in addition a margin of 6 cents per bushel to hedge or insure it against a market decline. Thus our total investment is about \$1.56 per bushel. Now, if the Secretary of Agriculture under the authority given him in H.R. 11788 should want to increase contract margins to \$1 per

bushel, for example, we will have invested \$2.50 in every bushel of wheat we own—far more than its market value. As a consequence, we will use up our line of bank credit that much faster and ultimately only those who are very well heeled will continue to be buyers of grain. Surely, this is not what the Congress would have intended but it is a very real danger if you regard commodity margins as you do security margins and make it too costly for some to trade in them.

The various segments of industry which comprise the membership of the Minneapolis Grain Exchange would support most if not actually all of the objections which have been raised here to H.R. 11788. We feel that if there are problems having to do with public interest, these are minor in their application and can rather easily be resolved by conference between Government and grain representatives rather than by broad legislation.

Thank you again for hearing our message.

Mr. MATSUNAGA. Thank you very much, Mr. Bagley. You did it in 8 minutes; you have still 2 minutes remaining.

Mr. Hagen?

Mr. HAGEN of California. Mr. Bagley, as I understand it, most of the members, perhaps all of the exchanges, including the Minneapolis Grain Exchange, actually trade in grains outside of the futures markets; is that correct?

Mr. BAGLEY. Yes; I would say that most of them were.

Mr. HAGEN of California. Do any of the ultimate consumers, like Pillsbury and these other flour mills, have seats on the exchange?

Mr. BAGLEY. Of course; yes, they do. They use the market to a great extent. It is only that the individuals who operate in the grain exchanges do not all individually use the futures markets, but almost all of their firms do use them—other departments.

Mr. HAGEN of California. Would the majority of the members of the exchange be representative of ultimate consumers as manufacturers?

Mr. BAGLEY. I do not think that I quite understand that question.

Mr. HAGEN of California. Would a majority of the members of the exchange be agents of the ultimate users, say, such as Pillsbury?

Mr. BAGLEY. Yes; they would be at some place along the line, in the handling of the produce in the exchange.

Mr. HAGEN of California. As I understand it, there is no profit to be made from these contracts themselves, in terms of brokerage fees, or anything like that; is that correct?

Mr. BAGLEY. That is correct.

Mr. HAGEN of California. What is the reason why an outfit like Pillsbury might want to have a member representing its organization on your exchange?

Mr. BAGLEY. To have the advantage of seeing all of the grain that would come into the market, to be able to choose from that which it wanted for its use.

Mr. HAGEN of California. As I understand it, there are two main participants in that trade: No. 1, the hedger, who does not want any profit or loss but only a guarantee against future losses. You might make a profit or you might suffer a small loss; is that correct, by a hedging operation, but the loss is always within acceptable limits.

Mr. BAGLEY. That is right.

Mr. HAGEN of California. And then there are the speculators.

Mr. BAGLEY. There are the speculators.

Mr. HAGEN of California. I understand it is your contention, and the contention of other witnesses, that these speculators are equally necessary to hedging; is that correct?

Mr. BAGLEY. Yes, they are, because they are assuming risks that take up the slack in the trading market. And I, as a hedger, for example, would be very happy to give up an eighth or a quarter of a cent in order to get this insurance. This speculator is there. I need him to take that risk.

Mr. HAGEN of California. Of course, he is in the market to make a profit?

Mr. BAGLEY. Yes, sir. I always hope that he does, sir; so he will stay there.

Mr. HAGEN of California. Since the Government more or less fixes the price, at least the minimum price of some of these commodities, has not the justification for a futures market almost been eliminated? You have minimum prices on wheat and on cotton, and so forth. Has not the justification for this eliminated the need for future trading?

Mr. BAGLEY. To some extent that is, of course, true. The supplies of grain are limited to those which are not in the hands of the Commodity Credit Corporation, but, on the other hand, the Commodity Credit Corporation markets these in great quantities at times, and this does have an important market effect, even though as far as the raiser of the grain is concerned, he has a definite price for his product.

Mr. HAGEN of California. These swings in prices are less than they would be in the absence of Government support programs, would they not?

Mr. BAGLEY. That is correct.

Mr. HAGEN of California. Were there more abuses evident before the institution of the Government price support programs? Was there more manipulation of prices in the futures market before the Government price support programs were instituted?

Mr. BAGLEY. Well, sir, I have seen no evidence of that in the market. True, if you do not have some form of a ceiling or a floor price, you expose the market to an opportunity to make a long swing, either up or down, but with a lot of speculators in the market to take up the cushion of the trade, this is not apt to happen. I have been in the grain since 1929, and there have been very few occasions when I have seen a wide violent swing, unless it had been for a reason, such as a war or some similar national calamity.

Mr. HAGEN of California. There is a statement in your statement that I wish you would expand on. On page 2, you state:

By way of background, we suspect that one of the important reasons the Secretary of Agriculture has in mind for wanting authority to increase margins on commodity trading is that by taking such action he could kill off a substantial volume of any trading which would tend to move the cost of grain in a direction contrary to the Department's current purpose.

Would you expand on that; would you elaborate on that statement?

Mr. BAGLEY. I simply feel that he has in mind having this authority to accomplish that result. However, I did not really believe that this would be the consequence of having that authority. I think there might be other damage that could be done through artificiality, but if you stop the trade entirely, you stop the movement of the commodity.

The only thing I am afraid of is that you make the prices jump a cent or 2 cents, which, in my view, is a lot, but which, probably, in the national program would not be a great deal.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Thank you very much, Mr. Bagley.

Let me assure you that we have no intentions of cutting out your fifth generation from your present business.

Mr. BAGLEY. I am gratified, Mr. Chairman.

Mr. MATSUNAGA. Our next witness is Mr. James W. Hogan, representing the American Feed Manufacturers Association, as well as being vice president of the Ralston Purina Co., who is accompanied by Mr. Oakley M. Ray, who is vice president of the association.

STATEMENT OF JAMES W. HOGAN, VICE PRESIDENT, PURCHASING DIVISION, RALSTON PURINA CO., REPRESENTING THE AMERICAN FEED MANUFACTURERS ASSOCIATION; ACCOMPANIED BY OAKLEY M. RAY, VICE PRESIDENT, AMERICAN FEED MANUFACTURERS ASSOCIATION

Mr. HOGAN. Mr. Chairman and members of the committee, my name is James W. Hogan. I am employed by Ralston Purina Co. in St. Louis, as vice president of the purchasing division in charge of grain operations. I am here today representing the American Feed Manufacturers Association, the national trade association of commercial feed manufacturers. I have with me Oakley M. Ray, vice president of the association.

Feed manufacturers are users of the futures markets and thus are interested in this proposed legislation. We use these markets to minimize risk. One example is the hedging of stocks of feed ingredients, to avoid having to take the risk of sharp changes in the prices of ingredients between the date of purchase and the date of their sale as finished feeds. Our operations would be more costly if there were no futures markets and we had to take the increased risks. Since feed makes up an average of about two-thirds of the cost of producing meat, milk and eggs at the farm level, the elimination of the futures markets would result in either higher consumer prices for meat, milk, and eggs; lower prices to farmers; or perhaps some of each.

The proposed bill, H.R. 1178, is a very comprehensive proposal which, in our opinion, would burden futures trading and run the serious risk of eliminating the opportunity we now have to obtain price insurance at a reasonable cost. Futures markets require a substantial volume of trading to work satisfactorily. Any action which would reduce the trading volume of a market would endanger the functioning of the market.

The futures markets which our industry has been using have been working well. If there were manipulation which created artificial prices and/or excessive price fluctuations, we certainly would not be able to use these markets to minimize price risk. The fact that an industry such as ours has been able to use these markets for many years for hedging purposes is a practical indication of the efficient functioning of the markets.

Thus we did not see the need for making sweeping changes in the futures markets' regulations. We have studied the U.S. Department of Agriculture statement describing the changes that are being proposed and do not see that any well-established reasons or justifications have been advanced for such major action.

It seems to us that at the best only limited improvements are possible, and that it is not wise to take the risk of impairing the market operations which is currently performing an economic function.

One of the provisions of H.R. 11788 which concerns us is the granting to one person the authority to establish margin requirements. We doubt that any individual should be given this much power. This would not serve as an effective preventative of manipulation in our opinion. It could very easily make it economically impractical for feed manufacturers and other hedgers to use the market. Industries like ours which use the market for price insurance should not be required to pay more than is necessary to assure contract performance.

We favor the continuation of supervision of regulated futures markets by the CEA. If some changes in regulations appear to be desirable, each should be carefully studied in advance by CEA in cooperation with the exchanges and in cooperation with those who make use of the markets. The American Feed Manufacturers Association would be pleased to cooperate with such a study. In the meantime, we urge this committee not to make any drastic changes in the present law. The powers under existing law are broad. We do not know of any problem which cannot be reached within the existing regulatory authority. To enact the proposed bill would give rise to much uncertainty and run the risk of seriously damaging futures markets which have been working efficiently and are performing an economic function.

Thank you for the opportunity to present this statement.

Mr. MATSUNAGA. Thank you very much, Mr. Hogan, for a brief yet comprehensive statement.

You have certainly made your point in a very few words, and we appreciate it.

Mr. HAGEN of California. Does Ralston Purina control any seats on any of these exchanges?

Mr. HOGAN. Yes, sir. We are members of practically, if not all, major markets.

Mr. HAGEN of California. In the case of the cotton exchange, as I understand it, their activities have diminished to the point where they have closed some of the exchanges and others are in danger of being closed, because of the price support programs.

Mr. HOGAN. Yes, sir.

Mr. HAGEN of California. Why hasn't the same situation occurred in the case of the wheat markets?

Mr. HOGAN. The reason is that the cotton program price was so restrictive and limited that there was a limited potential move in price, so that there was no function that the market could perform; it had to dry up and wither. However, in grain, there has been more opportunity for price support to fluctuate, and, therefore, a need to have this protection against risks.

Mr. HAGEN of California. Is that because there are more specialized types of grains and that cotton is a more fungible uniform commodity?

Mr. HOGAN. No. The reason, in my judgment, is that the price of cotton—and I am not an expert in this particular area by any stretch of the imagination—was pegged at such a high price level that practically all of it went into the hands of Government control, and there was no possibility for private movement or trade in cotton. Conversely, in grains they were allowed more flexibility of movement because of the more realistic base price level.

Mr. HAGEN of California. Thank you.

Mr. MATSUNAGA. Are there any further questions?

If not, we certainly appreciate your appearance here before this committee this morning.

Our next witness is Mr. Charles W. Pence, from the Great Plains Wheat, Inc., who is special assistant to the president of that organization.

We will be glad to hear from you now, Mr. Pence.

**STATEMENT OF CHARLES W. PENCE, SPECIAL ASSISTANT TO THE
PRESIDENT, GREAT PLAINS WHEAT, INC.**

Mr. PENCE. Mr. Chairman and members of the committee.

Allow me to introduce myself. I am Charles W. Pence, special assistant to the president, Great Plains Wheat, Inc., a regional market development association.

I might also say that I am interested in this bill as a wheat producer in the State of Kansas.

The organization is supported by wheat producers in Colorado, Kansas, North Dakota, Oklahoma, and South Dakota through their State wheat commission or related organization.

At this time, I would like to express the appreciation of Great Plains Wheat and myself for the opportunity to testify before the committee. We are here today to consider amendments to the Commodity Exchange Act as outlined in H.R. 11788.

It is our belief that producers benefit substantially from a recognized market where contracts for the future delivery of wheats are executed. Any action, public or private, which makes trading more difficult and cumbersome would tend to reduce the quality of market services, increase their cost, or both.

Futures trading in grains, as now conducted, is highly efficient. We are unaware of any market procedure for farm commodities which enables risk transfer and price insurance at such a low cost per dollar of trading.

The futures market enables a merchandiser or processor to insure himself of a price sometime in the future. Thus, millers can quote flour prices well in advance of delivery and be highly certain what wheat costs will be. Also, exporters can quote wheat prices in advance of delivery with the certainty that price will be protected. Obviously, this is of great importance to the producer even though he does not directly participate in futures trading as listed above. The futures market also guarantees the producer the privilege of selling his wheat anytime he so desires when the price is right. There is always a buyer on this market.

We have analyzed the proposed amendments to the Commodity Exchange Act as outlined in H.R. 11788 and have found several provi-

sions of this bill which reflect inadequate appreciation of the economic purposes and operations of futures markets, some of which would impair their proper functioning.

An underlying philosophy which is alien to the purpose and concept of futures trading is expressed in section 4j. In this section, the Secretary of Agriculture is credited with the ability, not only to discern, but to anticipate unwarranted or unreasonable price change. Changes in price is warranted by uncertainty, and uncertainty will always exist. Many economic factors such as weather, environment, supply and demand, government policies, both here and abroad, affects the price of wheat from day to day. It is possible, through intensive study of the facts, to say in retrospect whether a price change was warranted. But since it is not possible to say this in advance, we have futures markets where differing opinions concerning prospective price changes can be reconciled.

The Secretary of Agriculture has at his disposal the information and resources which enable him to learn whether a price change was warranted by the facts as they become known. He can also endeavor to ascertain whether this unwarranted change resulted from honest mistakes or from deliberate manipulation. This is his proper role in the interest of fair and efficient marketing.

The same section refers to the prospect of excessive speculation to which many of the same considerations apply as to the prospect of unwarranted price change. The Commodity Exchange Act has, on occasion, assessed the adequacy of speculation to carry the "hedging load," implying a definition of adequacy which limits the speculative position to the size of the net hedging position and has indeed referred to "excess" above that level. This is a very restrictive definition of speculative adequacy which tends to ignore the price determining role of futures trading and limits the role of the futures market to that of accommodating hedging. The most important function of the futures market is price determination which, in itself, facilitates, and is facilitated by, hedging. Inadequate speculation, the more common condition, has its price effect also, a fact which is not recognized in the bill. Prices are poorly defended on markets with inadequate speculation where the cost of trading tends to be high.

Both of the above considerations reflect inadequate appreciation of the purposes and operations of the futures market, and occur in section 4j. This section also proposes to vest control of margin requirements in the Secretary of Agriculture. If the Secretary senses the danger of manipulation or restraint of trade, it is questionable on several grounds whether increased margins should be required. This penalizes everybody for the suspected transgressions of one or a few, which is not only inequitable, but also deprives the market of the opportunity for self-correction.

The proven remedy for overspeculation, manipulation, or other attempted trading evils is the price defense thrown up by others in the marketplace who detect and, therefore, counteract such efforts. The best antidote for monopoly is competition. Yet the remedy proposed in the bill is to restrict market entry at a time when the Secretary deems competition to be threatened.

There are two reasons why it is important to the futures market that hedging margins be as low as safe practices allow. First, the

financing of commodity inventories is thereby reduced in cost. And, second, the practice of hedging requires two transactions instead of one and hence entails extra transaction cost. It is likewise important that speculative margins remain low because participation reduces transaction cost to hedgers and enhances competition.

H.R. 11788 also proposes to define the word "manipulate." The statutes have never before contained such a definition. The word is inherently difficult to define. It has been left to the courts, therefore, to look at all the evidence in individual cases in order to make a final determination. The courts have tended to emphasize two factors in determining manipulation. First, evidence of abnormality or artificiality of price. Second, evidence of intent to create such abnormality or artificiality.

The bill proposes a much broader definition which is frightening for legitimate traders to contemplate. The bill says:

The word manipulation shall be construed to mean the exacting, causing, or maintaining of an abnormal or artificial price by any course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to be a level different than that which would otherwise prevail.

It is true that futures markets have extraordinary absorptive capacity. It is quite normal for large purchases or sales to affect the price. Reference to prices which "would otherwise prevail," taken apart from reference to abnormality or artificiality, is too vague a criteria of "manipulation."

A serious defect in the proposed definition of "manipulation" is the complete omission of any reference to intent. Users of futures markets make innocent mistakes. If a number of traders, acting independently and without collusion, should purchase and hold a large quantity of futures contracts in the light of some reasonable expectation that failed to materialize, they could, by this definition, be proved guilty of "manipulation." It is imperative that "intent" be an element of a definition of "manipulation."

We believe that many of the proposed amendments to the Commodity Exchange Act as outlined in H.R. 11788 will throttle the low-cost services that futures trading renders today. Were it not for the price risk insurance supplied by the efficient hedging operations of the futures market today, this price risk would be shifted to the producer and the consumer. This could result in lower prices to the producer and higher prices to the consumer. Thus, we are opposed to H.R. 11788.

Mr. MATSUNAGA. Thank you. The time of the gentleman has expired. You used exactly 10 minutes. Congratulations. Unless there are questions from the members, we will proceed to the next witness.

Mr. DOLE. I want to the record to show that Mr. Pence does represent producers in the Midwest, in my State, and in Congressman Redlin's State. Therefore, his testimony is very interesting to us. He again points out the fact the Department has made a very weak case in presenting H.R. 11788. I thank you for a very fine statement.

Mr. PENCE. Thank you, sir.

Mr. MATSUNAGA. Does Mr. Redlin want to make a comment?

Mr. REDLIN. No; but I join in the statement.

Mr. MATSUNAGA. Our next witness will be introduced by Congressman Findley, from Illinois.

Mr. FINDLEY. Thank you, Mr. Chairman.

It is my pleasure to introduce Prof. T. A. Hieronymus of the University of Illinois, who is one of our most eminent farm economists and a specialist in the futures market. I have read much of his material. I am very gratified that he would take the time to appear before this subcommittee.

Thank you, Mr. Chairman.

Mr. MATSUNAGA. Thank you, Mr. Findley.

You may now proceed, Professor Hieronymus, professor of agriculture economics, University of Illinois.

STATEMENT OF T. A. HIERONYMUS, PROFESSOR OF AGRICULTURAL ECONOMICS, UNIVERSITY OF ILLINOIS

Mr. HIERONYMUS. Mr. Chairman, and members of the committee, and Mr. Findley. I have prepared and filed a statement, and I will now read this, or endeavor to read this, in the time allotted. My paper consists of three parts: (1) the philosophy of the proposals; (2) the ancestry, and (3) the specific proposals.

The specific proposals to which I most object are: (1) control of margins; (2) the power of cease and desist and injunction, and (3) the abolishment of the Commodity Exchange Commission, and (4) the definition of "manipulation."

In the section on ancestry, I have pointed out that some of these proposals have had a long history and have been sponsored under a variety of justifications. The most recent is the infamous Tino de Angelis affair. I followed the De Angelis affair for several years before his bankruptcy on November 19, 1963. I included a long letter that I wrote in 1964, reviewing the whole affair.

The De Angelis matter, rather than justify a new legislation makes it absolutely clear that futures markets are now adequately governed and regulated. Never has a worse justification been advanced. An understanding at the bill requires a look at the philosophic concepts involved.

The proposals are concerned with the same two major aspects of futures trading with which all of the legislation since 1921 has been concerned: (a) manipulation and excessive speculation, and (b) protection of the public from malpractice and fraud. I have no quarrel with the latter of these and will not speak to the parts of the bill that pertain to commission futures merchants, financial responsibility, and so forth.

The USDA has long been preoccupied with price excesses in futures markets and thus with manipulation and excessive speculation. The underlying concept seems to be that futures markets exist for hedging and that speculation is a necessary evil; that hedging is good and speculation is bad; that speculation should only be tolerated to the degree necessary to absorb the risks shifted by hedgers.

A good example of this attitude is found in some comments of the joint committee on the economic report in December 1947. Mr. Mehl, who was then Administrator of the Commodity Exchange Authority, said:

I believe that if we are to maintain the present system of marketing * * * we will have to tolerate some degree of speculative trading in order to take up the slack between the merchant and processor who wants to buy for hedging purposes, and the one who wants to sell for hedging purposes.

In immediate response, Representative Rich said:

I am not interested in trying in any way to stop legitimate business; I want that to proceed. But I thought if there was anything that you could suggest to our committee whereby we might, from your experience, stop speculation pure and simple, and let legitimate trade go on, I wish you would make that recommendation.

Hedging serves useful economic purposes that have long been understood and appreciated. The legislative record is replete with testimonials, the textbooks describe and extoll the merits of hedging, and the Commodity Exchange Act has been changed from time to time in the direction of more considerate treatment of hedgers.

In fact, however, hedging is the lesser beauty of futures markets. These markets are competitive pricing institutions operating in a highly uncertain and thus speculative context. The futures prices established in these markets are speculative prices established by the trading activities of speculators. In addition to absorbing the risks shifted by hedgers, speculators serve the necessary and useful purpose of establishing prices that regulate the flow of stored commodities onto the market and that guide future production.

Thus the two major functions of futures markets are risk shifting and pricing. In my judgment the speculative pricing functions is of the greater importance and it is performed better as the level of speculative activity is greater.

Commodity prices have certain jobs to do. Most important among these are the guiding of production and the regulation of the rate of consumption. The prices that will result in an equilibrium between demand and supply forces are uncertain and thus speculative. The market is continually searching for that single price that will just equate supply and use. If the market were all knowing and all wise, there would be no price variation. As the balance of judgments in the market is that the price should go up, it is quickly bid higher. The converse is, of course, true. All things foreseen are quickly discounted into current prices so that, at any given time, the judgment of the market is that prices will not change.

These speculative functions must be performed whether in futures or in cash markets. There are futures markets for only a few of the many commodities that move in commerce. The question is whether the speculative job is accomplished better in the futures markets than in the cash markets.

Careful examination of futures markets suggests a stabilizing influence of speculation. Most certainly the actively speculated markets do not have any consistent pattern of price variation. Variations in prices are random.

For every long there is a short and thus, for every dollar gained, there is a dollar lost. Speculation then, is a zero sum game in which speculators vie with each other for profits that they, in the aggregate, cannot achieve. Competition in the major futures markets is so highly developed that the theoretical model of perfect competition is closely approached. Speculators compete with each other and each competes against the market. When a speculator takes a market position, he is saying: "I am right and the market is wrong." The thing that he thinks he is right about is that price will equate supply and use.

The speculators who are accurate in their forecasts make money and those who are wrong lose. In his quest for profit the speculator is guided to making the best price forecast of which he is capable. He then hazards his money in support of his judgment. Thus speculation is what futures markets are truly about. And speculators are very skilled. First, tremendous efforts go into price forecasting. The most advanced technicians are employed. The network of information is tremendously extensive. For example, the recent rain in South Africa was quickly registered in Chicago corn futures prices.

A second indication that futures markets are good is the difficulty that price forecasters have in being right. Over the years, I have achieved some stature and reputation as a forecaster of soybean and soybean product prices. I do not want to do anything to destroy this concept but I have looked back and must recognize that, at best, I have batted only slightly better than 500.

This mediocre record does not indicate that I am incompetent, but rather it is mediocre because I have been batting against major league pitching. The market is a tough competitor.

The USDA does a lot of price forecasting. The several situation reports, such as fats and oils, feed, wheat, et cetera, are competently prepared and very useful. However, their record is no better than mine. When power is granted to the Secretary of Agriculture to control excessive speculation that is judged at a given time to have put prices too high or too low, someone has to decide when the existing price is too high or too low. Price excesses can be judged by hindsight, but I do not know of anyone who is qualified to make such a judgment with sufficient accuracy to dictate the market price. If there is such a person in Government, he should be moved to price outlook work. I doubt that there is such a person. Government salaries are not that high.

The point that I wish to emphasize is that the wisdom of the market is great. If this were not so it would be possible for every reasonably competent technician to make a fortune. This obviously does not happen.

The burden of what I have said is that the philosophic concept, that hedging is good and speculation is a necessary evil, is wrong. Competitive speculation in major futures markets is a thing of economic beauty. Legislation with regard to futures trading must recognize this.

Thank you very much.

(The prepared statement submitted by Mr. Hieronymus reads in full as follows:)

STATEMENT OF T. A. HIERONYMUS, PROFESSOR OF AGRICULTURAL
ECONOMICS, UNIVERSITY OF ILLINOIS

My name is T. A. Hieronymus. I am a professor of agricultural economics at the University of Illinois. I have been employed there since 1946. My principal area of concentration over the years has been ingrained and soybean marketing, pricing, and use. This work has included extensive study of futures trading for the past 20 years. My writings on the subject are fairly voluminous.

A proposal for the extensive amendment of the Commodity Exchange Act has been placed before both Houses of Congress by the U.S. Department of Agriculture. If enacted into law these changes may have major effects on the operation of existing futures markets. More importantly, they will have major effects on the development of futures markets for additional commodities that,

as a result of the nature of the commodities, need to take on quite different characteristics than the older markets. Some of the provisions of the proposed legislation are salutary and should receive support. Others contain possibilities of causing severe damage and should be rejected.

Philosophy of the proposals.—An understanding of the proposals first requires a look at the philosophic concepts involved. First, the bill is massive and comprehensive. For many years the Commodity Exchange Act has been amended in a piecemeal fashion and the Congress has considered small suggestions for change in such a way that the law as it now stands has gradually evolved. The proposal for massive change implies that this procedure has been inadequate. It casts critical reflection on the legislative history of the existing law. However, the economic effectiveness of existing futures markets supports the historic process and casts doubt on the need for great changes.

Second, the proposals would invest sweeping powers in the hands of the Secretary of Agriculture. He would have great discretion in control of businesses and individuals and, indeed, over the market mechanisms. As a philosophic concept, I suggest that economic affairs should be regulated by markets and by law. They should not be regulated by administrative fiat.

Third, the proposals are concerned with the same two major aspects of futures trading with which all of the legislation since 1921 has been concerned: (a) Manipulation and excessive speculation, and (b) protection of the public from malpractice and fraud. I have no quarrel with the latter of these and will not speak of the parts of the bill that pertain to commission futures merchants, financial responsibility, etc.

The USDA has long been preoccupied with price excesses in futures markets and thus with manipulation and excessive speculation. The underlying concept seems to be that futures markets exist for hedging and that speculation is a necessary evil, that hedging is good and speculation is bad, that speculation should only be tolerated to the degree necessary to absorb the risks shifted by hedgers.

A good example of this attitude is found in some comments of the joint committee of the economic report in December 1947. Mr. Mehl, who was then administrator of the Commodity Exchange Authority, said, "I believe that if we are to maintain the present system of marketing, with the incident of hedging which enables processors and dealers to transfer the price risk from their shoulders to speculators who are willing to assume these risks, we will have to tolerate some degree of speculative trading in order to take up the slack between the merchant and processor who wants to buy for hedging purposes, and the one who wants to sell for hedging purposes." In immediate response, Representative Rich said, "I am not interested in trying, in any way, to stop legitimate business; I want that to proceed. But I thought if there was anything that you could suggest to our committee whereby we might, from your experience, stop speculation pure and simple, and let legitimate trade go on, I wish you would make that recommendation."

Hedging serves useful economic purposes that have long been understood and appreciated. The legislative record is replete with testimonials, the textbooks describe and extoll the merits of hedging, and the Commodity Exchange Act has been changed from time to time in the direction of more considerate treatment of hedgers.

In fact, however, hedging is the lesser beauty of futures markets. These markets are competitive pricing institutions operating in a highly uncertain and thus speculative context. The futures prices established in these markets are speculative prices established by the trading activities of speculators. In addition to absorbing the risks shifted by hedgers, speculators serve the necessary and useful purpose of establishing prices that regulate the flow of stored commodities onto the market and that guide future production.

Thus the two major functions of futures markets are risk shifting and pricing. In my judgment the speculative pricing function is of the greater importance and it is performed better as the level of speculative activity is greater.

Commodity prices have certain jobs to do. Most important among these are the guiding of production and the regulation of the rate of consumption. The prices that will result in an equilibrium between demand and supply forces are uncertain and thus speculative. Equilibrium prices continually change as the underlying factors affecting supplies and requirements change. The market is continually searching for that single price that will just equate supply and use. If the market were all knowing and all wise, there would be no price variation.

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As the balance of judgments in the market is that the price should go up it is quickly bid higher. The converse is, of course, true. All things foreseen are quickly discounted into current prices so that, at any given time, the judgment of the market is that prices will not change.

These speculative functions must be performed whether in futures or in cash markets. There are futures markets for only a few of the many commodities that move in commerce. The question is whether the speculative job is accomplished better in futures markets than in cash markets. A perfect job would be no price variation. This is not possible because some things are unforeseeable such as, for example, drought, floods, etc.

Careful examination of futures markets—comparisons of the price variation in actively speculated markets and the less actively speculated markets, and comparisons with price variation of commodities in which there are no futures markets—suggests a stabilizing influence of speculation. Most certainly the actively speculated markets do not have any consistent pattern of price variation. Variations in prices are random.

For every long there is a short and thus, for every dollar gained, there is a dollar lost. Speculation then, is a zero sum game in which speculators vie with each other for profits that they, in the aggregate, cannot achieve. Competition in the major futures markets is so highly developed that the theoretical model of perfect competition is closely approached. Speculators compete with each other and each competes against the market. When a speculator takes a market position, he is saying: "I am right and the market is wrong." The thing that he thinks he is right about is that price which will just equate supply and use. And this is also what the market thinks it is right about.

The speculators who are accurate in their forecasts make money and those who are wrong lose. In his quest for profit the speculator is guided to making the best price forecast of which he is capable. He then hazards his money in support of his judgment. Thus speculation is what futures markets are truly about. And speculators are very skilled. First, tremendous efforts go into price forecasting. The cost advanced techniques are employed. The network of information is extensive. For example, the recent rain in South Africa was quickly registered in Chicago corn futures prices.

A second indication that futures markets are good is the difficulty that price forecasters have in being right. Over the years, I have achieved some stature and reputation as a forecaster of soybean and soybean product prices. I do not want to do anything to destroy this concept but I have looked back and must recognize that, at best, I have batted only slightly better than 500. This mediocre record does not indicate that I am incompetent, but rather it is mediocre because I have been batting against major league pitching. The market is a tough competitor.

The USDA does a lot of price forecasting. The several situation reports such as fats and oils, feed, wheat, etc., are competently prepared and very useful. However, their record is no better than mine. When power is granted to the Secretary of Agriculture to control excessive speculation that is judged at a given time to have put prices too high or too low, someone has to decide when the existing price is to high or to low. Price excesses can be judged by hindsight, but I do not know of anyone who is qualified to make such a judgment with sufficient accuracy to dictate the market price. If there is such a person in Government, he should be moved to price outlook work. I doubt that there is such a person; Government salaries are not that high.

The point that I wish to emphasize is that the wisdom of the market is great. If this were not so it would be possible for every reasonably competent technician to make a fortune. This obviously does not happen.

The burden of what I have said is that the philosophic concept, that hedging is good and speculation is a necessary evil, is wrong. Competitive speculation in major futures markets is a thing of beauty and a joy forever. Legislation with regard to futures trading must recognize this.

Ancestry.—I should next like to speak to the ancestry of the bill. Some of the current proposals are orphans who have been looking for a father for a long time. The request for authority to control margin requirements was associated with the efforts to prevent inflation and reduce the high price of grain in December 1947. In 1948 the case for control of margin requirements was related to the severe decline in grain prices in February 1948. In 1950 the request for control over margins was attached to the Defense Production Act of 1950. None of these fathers claimed the orphan.

The alleged father of the current set of changes is Mr. Tino De Angelis of Allied Crude Vegetable Oil and sundry other companies. It is fitting that the amendments should be on a massive scale because certainly the De Angelis affair was massive. But never has a less likely parent been chosen. The single most important argument against the current bill is the tremendously successful performance of futures markets under the impact of the De Angelis assault. In early 1964, Mr. Warren Collins, of the American Farm Bureau Federation, asked me for my opinion about the proposed changes in the Commodity Exchange Act and, in the same letter, "how the soybean oil scandal developed and how it might have been prevented." I replied under date of June 3, 1964. It is a long letter and for this I apologize, but it tells a story about futures markets that badly needs telling. I quote, "Dear Warren: I have not yet seen S. 2859. I have asked for a copy, but if you have one available perhaps you should send it to me.

"There is not any brief way to describe the vegetable oil scandal, nor are all of the facts known. About 1954, the United States started exporting substantial amounts of soybean oil to Spain under Public Law 480. A substantial share of the business was handled by Allied Crude Vegetable Oil Refining Co. As exports of various fats and oils expanded, this company became a very important market factor. They seemed to be able to undersell the competition and to get the bulk of the business. From the mid-1950's until last fall, conversations about the probable price trends were dominated by speculation about the position and actions of Tino De Angelis of Allied. He was known to have built up a very large cash position in expectation of export business. In the spring of 1961, the price of oil increased rapidly and for no apparent reason except that Allied was buying heavily. I was quite surprised by the price increase at the time. As exports failed to materialize, the price declined sharply into the fall of the year. About that time the U.S. Department of Agriculture purchased some 500 million pounds of oil for charitable donation. It is my impression that Allied was the principal supplier.

"The price of oil was rather low and draggy from the fall of 1961 until the fall of 1963. It was apparent that Allied was carrying huge inventories, paying large storage charges and high rates of interest, and was doing a lot of export business at prices that appeared to be below cost.

"As the Russian wheat business developed, stories of prospective oil exports circulated and the price increased sharply into November.

"Quite suddenly, Allied declared bankruptcy. It was not surprising that the high costs of carrying oil and transactions at losses should finally catch up and cause a failure, but it was surprising that it should occur on a rising market. It was also surprising that one firm could stand such costs and losses for so long. How they did it was subsequently to become clear.

"Following the bankruptcy, the people who presented warehouse receipts found that there was practically no oil. These were American Express warehouse receipts. It now appears that there were warehouse receipts out for about 800 million pounds, an amount nearly equal to the whole U.S. supply, and a far greater amount than could possibly have been at the New Jersey tank farm. It is clear that the costs and losses were paid out of fraudulently acquired funds involving warehouse receipts. Corruption, counterfeiting, bribery, etc., were obviously rampant. This is the core of the scandal.

"When Allied and De Angelis started trading in cottonseed oil futures and soybean oil futures is not readily apparent. Their market actions were apparent to the trade for some years, especially from 1961 on. Their market position seemed to be basically long. Their actions appeared to be the opposite of hedges; they appeared to go long futures to lend strength to a large long cash position.

"By last November, Allied had accumulated a huge long position in cottonseed oil futures on the New York Produce Exchange and in soybean oil futures on the Chicago Board of Trade. Even though it did not have access to the position records, the Chicago Board of Trade raised margin requirements. De Angelis could not come up with the money and so went into bankruptcy. Ira Haupt had extended De Angelis credit for margin as a hedger and consequently went bankrupt as cottonseed oil futures prices declined. The forced liquidation at Chicago was picked up by other traders and the price quickly stabilized and recovered. The large ownership was diffused quickly and the price did not change greatly. No funds of futures market customers were endangered and all losses of the longs were paid.

"Three things seem reasonably clear: (1) a large cash position was built up to the point of dominating the market and could be construed as manipulative. This is quite legal and I know of no way to prevent someone from engrossing a cash market if he wants to and has enough money. It has proved to be stupid in the past because a price that is put above market value will finally come back down at the expense of the person engrossing the market. The history of these is a pretty good preventive. De Angelis blames the Government for his troubles. This blame is misplaced. However, I doubt that the whole thing could have happened in the absence of surplus disposal programs of the USDA. Also, the history of speculation about what De Angelis was doing often suggested something less than purely competitive actions by officials of governments who receive Public Law 480 allocations.

"(2) There was extensive fraud, corruption, bribery, etc., in warehousing. Possibly some closer warehouse supervision is desirable. American Express Warehousing Co. performed very badly. It did not have enough money to guarantee the quantities of product that it attempted to guarantee. The parent company, American Express, has only limited liability. Warehouses take on a public utility aspect. It is important that receipts be valid. In this connection it is worth noting that none of the missing soybean oil was in warehouses regular for delivery on the Chicago Board of Trade. For years, the exchange supervision of warehouses regular for delivery that duplicates supervision by the Federal Government has looked a little silly. It looks less so now.

"(3) De Angelis and Allied Crude turned to futures market operations to bolster cash operations. This was finally their undoing. The Chicago Board of Trade got worried about how good the financing behind soybean oil contracts was and took action to make it good. This action unstuck the house of cards and it fell. They took this action soon enough that the contracts were financially sound. No customer lost money because of invalid contracts or financial insolvency of any other customer or any agent through whom he traded. No exchange lost money or had to assume customer losses. De Angelis and his assortment of companies was in trouble with the courts, the Federal Government, and the trade generally for years and no one seemed able to do much about it. But when his actions threatened the validity of futures contracts, the commodity exchanges clobbered him. He successfully dominated the cash vegetable oil markets for years but when he tangled with the future markets he lost.

"A lot of people lost a lot of money out of this affair. One must certainly sympathize with those who held American Express warehouse receipts that proved to be worthless and wonder if better warehouse supervision is needed.

"Past this point I have limited sympathy for the losers. Ira Haupt Co., for example, lost heavily. They extended huge amounts of credit to Allied on the basis that it was hedging which it obviously was not. One can only explain such impudent behavior on the basis of greed for commissions. There is an interesting sidelight in the Haupt facet of the scandal. It is my understanding that the company used securities that it held for customers to finance the Allied trades with the Produce Exchange. It was this loss that the New York Securities Exchange made up. The Produce Exchange (the futures market) already had its money and didn't lose because it had been quite hardnosed about margins. Also, Haupt did not use futures customers' funds because these must be held in segregated accounts.

"It seems reasonably clear that other firms that lost money were fairly active participants with De Angelis to the extent of collecting big storage and interest charges, both directly and indirectly, and trading commissions. One must ascribe a substantial share of their losses to greed and be only moderately sympathetic.

"When De Angelis went down, many things came up stinking. There are two notable exceptions. One is the USDA. In view of the heavy involvement of the USDA in oil surplus disposal programs since 1954, it is a substantial tribute to the integrity of USDA personnel that they are out of this clean.

"Second, the institution of futures trading was clearly financially responsible and not corrupted. On November 21, 1963, 2 days after the collapse, I wrote to Bob Liebenow, 'One should expect some sharp repercussions, both immediate and over a prolonged period, as a result of the soybean oil fiasco and the accompanying soybean break.'

"The situation dates back several years. The essence of it was a concentrated cash position with strong manipulative overtones that was, at least in

part, a byproduct of governmental surplus disposal programs. In my judgment, the futures markets in soybean oil and soybeans diffused and reduced the impacts of this manipulation and were instrumental in breaking it up. As importantly, these markets are currently important and useful in diffusing the concentrated holdings of the now defunct combine over a large ownership so that they can be carried and disposed of in a more orderly fashion.

"Instead of being criticized, the futures markets should have an award for superior performance. I would not defend, but would attack. There is a real story to be told and I would not be bashful in telling it."

"What I said then had been fully borne out by subsequent disclosures. There is no rational basis for making futures markets a whipping boy in the De Angelis scandal. Rather, the whole affair is a clear indication that futures markets are adequately governed and regulated by themselves and the Commodity Exchange Authority at the present time.

"I hope that this long letter is not too confused but, as I said at the outset, the affair defies simple description. Sincerely, T. A. Hieronymus."

Four objections.—Finally, I would like to comment on four specific provisions of the bill. First, the abolition of the Commodity Exchange Commission. The most important function of the CEC is the establishment of speculative position limits. In 1936 the Congress reserved authority to limit positions to the Commission composed of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General. This put a desirable brake on precipitous action. I cite an example. In 1953 the USDA proposed speculative limits of 50 contracts per person on soybean oil, cottonseed oil, and lard. These were amounts of about 2 percent of the open interest then existing. It was argued in opposition that such small amounts would inhibit the growth of the young soybean oil market and impair its use. The CEC adapted the amount but suspended the implementation indefinitely. The limits are in existence today but remain suspended. On March 17, 1966, the open interest in soybean oil futures at Chicago was 17,023 contracts. The 2-percent standard applied to this amount would be 340 contracts. I think that had the 50-contract limit been put into effect, the market would not have grown and developed into the very useful hedging and pricing mechanism that it now is. An unwise action was prevented by the CEC; it should not be abolished.

Second, cease-and-desist orders, and injunctions. These two things would permit the Secretary of Agriculture, directly or through the Attorney General, to compel traders to comply with his notions of what price behavior should be. It presupposes that the Secretary can recognize incipient cases of price distortion. A basic criticism of these provisions goes back to the difficulty of anticipating price changes. Seemingly erroneous courses of prices often, if not usually, turn out to be quite correct when we gain the advantage of hindsight. Speculative actions that seem most misguided usually turn out to be correct and profitable.

Were such power placed in the hands of the Secretary, there would be a great temptation for him to act frequently and closely control markets. His slogan might well be: "When in doubt, prevent because we cannot afford to have failed to take action when evidence of illegal action subsequently comes to the fore." It is difficult enough to be a speculator without being subject to precipitous action of the Secretary. The Secretary now has great powers of persuasion because he has power to bring action when violations occur. To grant the power of cease and desist and of injunction is to grant the power to punish. This does not belong to a regulatory agency but rather to the law and the courts.

Third, the definition of manipulation. The bill says that "the word 'manipulate' shall be construed to mean the exacting, causing, or maintaining of an abnormal or artificial price by any course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to be a level different than that which would otherwise prevail." As I read this it says that at anytime that an artificial price is judged to have existed—that is, if a price declines subsequent to a rise or rises subsequent to a decline—everyone who had a part in the move is guilty of manipulation. Everyone who makes a trade, even the smallest job lot trader, has an effect on price and causes it to be something different than otherwise would have prevailed. Thus every trader would be guilty and those selected by the Secretary would be punished. Accusations of manipulation have been brought by the Secretary on numerous occasions during the past 30 years. Some of the accused have been found guilty and some have not. I do not think that the law should be changed to define all of the accused guilty.

The word "manipulate" was not defined in the Commodity Exchange Act of 1936. Definition has been left to the courts. Over the years a fairly clear concept of the nature of manipulation has evolved. This concept contains five considerations: (1) an artificial price, (2) intent, (3) effective control of the cash supply, (4) a dominant position in futures, and (5) causation of and responsibility for the artificial price. Each of these is subject to investigation and judgment. Manipulation cases are not simple. They are not simple because the forces affecting prices and of competitive power in markets are not simple. They cannot be made simple by definition in the law.

Fourth, control of margin requirements. As I have pointed out, this proposal has a long history and the Congress has wisely refused its passage. The alleged purpose of the proposal is control of excessive speculation. To use margins for this purpose requires that the Secretary can identify excessive speculation when it is occurring. We can only tell in retrospect whether a given price change is warranted or not.

An important reason for not granting margin control is that it would not work. Suppose that the longs do get overly exuberant, the price goes up sharply, and this is recognized by the Secretary. He imposes higher margins. The longs will not have any trouble; they already have profits and experience no difficulty. The shorts will have difficulty since they have losses; it is their capital position that is extended. An increase in margin requirements will force them to buy in short positions, lending further upward impetus to prices. Long speculators do not mind a margin call in a rising market; the shorts do. I have long been intrigued by CEA thinking on this matter.

Margin requirements serve the necessary and useful purpose of guaranteeing contracts. The exchanges keep them at levels adequate to accomplish this purpose. The De Angelis affair makes this clear. The validity of contracts is essential to the effective functioning of futures markets. This function of margins should not be endangered by giving some other purposes to margins.

Margins should be kept at minimum levels consistent with contract guarantee. Capital for carrying inventories is furnished to markets by speculators at a very low or negative rate of return. If speculators are impaired from furnishing capital, the cost of obtaining funds from other sources will be greater and the cost of marketing increased. Money to finance inventories that are hedged can be obtained at prime rates. This is true because there is almost no risk of loss. There is no risk of loss to banks because speculators assume the risks of ownership.

Margins should be kept at minimum levels to maximize competition in markets. Margins affect ease of access to markets. The markets' best defense against dominance by a few, monopoly, manipulation or over-exuberant speculation is competition provided by other traders who detect and defeat such efforts and mistakes. This is the stuff that successful speculators are made of. Their ability to enter the market and compete should not be impaired.

Conclusion.—The four provisions that I have singled out are not the only ones to which I object, but they are sufficient to make my basic point—the underlying philosophy of the bill is wrong. It is based on a misunderstanding of the nature of speculative markets. The bill reveals a failure on the part of the USDA to appreciate the function of commodity futures markets in providing risk capital and in the establishment of interim prices.

The bill fails to recognize the high order of competition that exists in futures markets and, in fact, denies the effectiveness of competition in market regulation. Its central thesis is that competition is not a sufficient means of price establishment and that competition is not a sufficient means of controlling market excesses, dominating power, and manipulative efforts. In essence, the bill is a denial of the effectiveness of a competitive economic system.

Legislation with regard to futures trading should have as its basic objective an increase in the competitiveness of the markets. The function of the law in economic matters is to establish a framework of rules within which competition can flourish and be maximized. Past this point we must have faith in the system.

My fundamental plea is for an appreciation of futures markets as being of the highest order of competition and for an expression of faith in the wisdom of the market. In this piece of legislation you are faced with a choice between the wisdom of the Secretary of Agriculture, whoever he may be, and the wisdom of the market. I think it best to choose the wisdom of the market because this wisdom is the essence of our competitive economic system.

Mr. MATSUNAGA. Thank you very much, Mr. Hieronymus. I do hope that the proponents of the bill know the basic philosophy behind the bill, as you have outlined it.

Are there any questions?

Mr. HAGEN of California. I have one. On page 2 of your statement, you say that hedging serves a useful economic purpose, that regulates the flow of commodities into the markets. With these various support programs that we have, how can the futures market guide production?

Mr. HIERONYMUS. Within the limits of the price floors and ceilings, there is quite a wide range of variation in price. For example, at the moment, the price of soybeans is about 50 cents over the support price. And wheat is 20 cents over. There are no such support prices for such commodities as live hogs, live cattle, dressed beef, pork bellies, soybean oil, soybean meal, and so forth. And these shifts in the markets are guidelines for the producer for making production adjustments, and they are particularly meaningful if the producers then go ahead and use them as a forward contracting device for pricing. For example, right now, the price of corn would reflect back a net price to the farmer in the summer of 1967 of about \$1.25 a bushel. That can be his guide to his production. Our level of participation in the feed grain program is not high, and it is rather less this year than it has been. So that there is a very vast bulk of the commodity prices that are outside of the support mechanisms.

Mr. HAGEN of California. Thank you.

Mr. FINDLEY. Am I correct, Professor Hieronymus, that you feel that the more speculation there is in the futures markets the better?

Mr. HIERONYMUS. I would not want to make it an absolutely unqualified statement, but I could say this, that it is very difficult to ever justify a situation of too much speculation for purposes of good competition and good price defense against buyers, and users, and so forth, on the part of the farmers. The more speculation, the better off the farmers are. It is very easy to justify a lot of futures markets now and in the past which are underspeculated, so that there is price distortion. I would cite this as an example—the Minneapolis wheat futures market where the hedging of hard wheat has to be done in Chicago. That is not adequate speculation. So, we have many examples of too little speculation. It is extremely difficult to identify any single distorted point in time too much.

Mr. FINDLEY. Thank you.

Mr. MATSUNAGA. I take it from your statement, Professor Hieronymus, that there is no educated speculator—that there is no educated speculator—like yourself?

Mr. HIERONYMUS. I would put this very definitely. I would say that there is no speculator who has survived very long who is not a very skilled price forecaster. To do this, you have to be educated. There are miscellaneous people in the business, but there is very tough competition.

I have been making forecasts for years, more or less, and I have a horrible time maintaining a respectable record. That is because the speculators are so very good. I have seen good academicians in

the trade, and they are not so good either. It is a tough competitive situation, and it does a beautiful job of pricing. I do not think that any individual can beat it, in or out of Government.

Mr. MATSUNAGA. Thank you very much. You have performed the feat of giving us a 40-minute speech and answering three questions in 10 minutes.

Mr. HIERONYMUS. Thank you.

Mr. TEAGUE of California. According to the list here, we are about to hear from the farm groups. It is my understanding that the American Farm Bureau Federation did not expect to be heard, but I would ask unanimous consent that a letter dated March 18 to Chairman Cooley from John Lynn, legislative director, American Farm Bureau Federation, be inserted in the record at this point.

Mr. MATSUNAGA. Without objection, that is so ordered, and it will be made a part of the record at this point.

Mr. TEAGUE of California. I might briefly summarize the letter to state that it appears to be in general support of the position taken by most of the witnesses we have heard to date. The Farm Bureau is not objecting to some of the sections of the proposed bill, but it does take a position against many of the proposals.

(The letter dated March 18, 1966, from the American Farm Bureau Federation follows:)

AMERICAN FARM BUREAU FEDERATION
Washington, D.C., March 18, 1966.

Hon. HAROLD D. COOLEY,
Chairman, House Committee on Agriculture,
Washington, D.C.

DEAR HAROLD: We appreciate the opportunity to comment on the provisions of H.R. 11788, a bill to amend the Commodity Exchange Act, as amended.

Our policy with respect to this legislation, is based on a resolution adopted at our last annual meeting as follows:

"Future trading has a prominent and rightful place in our competitive market price system.

"Trading in commodity futures reflects the need of the market system for a way to transfer certain types of risk. It serves a useful purpose for a number of commodities. Experience has demonstrated the need for regulatory measures to prevent abuses.

"We favor extension of the Commodity Exchange Act to all agricultural commodities traded on futures markets. We also favor strengthening amendments to this act as may be found necessary in the light of experience. We oppose proposals to shift the responsibilities of the Commodity Exchange Commission to a single individual, the Secretary of Agriculture, and to authorize the Secretary to fix trading margins, set limits on the amount of trading that may be done by any individual or firm, and place the burden of proof on alleged violators of the law through cease and desist orders."

You will note that we favor extension of the Commodity Exchange Act to all agricultural commodities traded on futures markets.

If it is desirable to regulate futures trading in some commodities—and we think that appropriate regulation is desirable—we know of no reason for confining such regulation to specific commodities. Comparable regulatory authority should be available to prevent abuses in any agricultural commodity that is traded on a futures market, or may be traded on such a market in the future.

The fact that futures trading has recently been inaugurated in a number of new commodities including frozen pork bellies, live cattle, dressed beef, and live hogs—which are not subject to regulation under the existing law—illustrates the need to make the Commodity Exchange Act applicable to any agricultural commodity, or product thereof, that is traded on a futures market.

We do not object to such tightening of the Commodity Exchange Act as may be needed; however, some provisions of H.R. 11788 appear to us to be unnecessary and undesirable. Specifically, we—

(1) Support adoption of additional measures to provide more adequate protection of the accounts for which brokerage firms have custodial responsibility.

Understand that futures commission merchants are now required to segregate customers' funds in separate accounts, and that the proposed legislation would prevent such accounts from being treated as the property of any person other than the customers. This appears to be highly desirable.

(2) Oppose the proposal to shift the responsibilities of the Commodity Exchange Commission (consisting of the Secretary of Agriculture, Secretary of Commerce, and Attorney General) to the Secretary of Agriculture.

The present provisions of the act vesting certain authority—including the authority to fix limits on the amount of speculative trading—in a commission composed of the Secretary of Agriculture, Attorney General, and Secretary of Commerce should be continued as a safeguard against arbitrary or precipitous action by a single individual.

(3) Oppose the proposal to authorize the Secretary of Agriculture to set commodity trading margins.

There is a very real danger that this type of regulation would so restrict the operations of a futures market as to materially impair its usefulness as a mechanism for transferring risk.

(4) Oppose the proposal to give the Secretary of Agriculture authority to issue cease and desist orders against individuals charged with violations of the act.

This proposal puts the burden of proof on the person who is accused of violating the act. We have no brief for anyone who actually is in violation of the act; however, we believe that questions of guilt or innocence are matters that should be determined by an appropriate court rather than by the Secretary of Agriculture.

Most of the other provisions of the bill appear to be technical matters which are of no special concern to us. We would appreciate it if you would make this letter a part of the record on H.R. 11788.

Sincerely yours,

JOHN C. LYNN, *Legislative Director.*

Mr. MATSUNAGA. Our next witness is from the National Grange, the director of legislative services, Mr. Harry L. Graham.

We will be glad to hear from you now.

STATEMENT OF HARRY L. GRAHAM, LEGISLATIVE REPRESENTATIVE, NATIONAL GRANGE

Mr. GRAHAM. Mr. Chairman and members of the committee. The statement I have is a relatively short one which I would like to have permission to insert into the record, and then to make some comments about it and leave time for questioning, if you so desire.

Mr. MATSUNAGA. You may proceed.

Mr. GRAHAM. I will say, first of all, that the Grange certainly has an appreciation of the function of the market, of the function of futures trading, and of forward pricing in the markets.

In our judgment, this legislation is not directed toward changing the basic concept of the markets.

We would, also, say that we believe that the greater the quantity of the commodity which is traded in the market, the more free it probably is from the possibility of manipulation.

Our concern is not so much with wheat and corn as it is with commodities that are in the futures trading at the present time and which

are being traded in relatively small amounts, where the pricing has wide ramifications on the industry, both from standpoint of the producers and the consumers, and where it appears to be relatively easy to establish a corner or close to a corner on the market.

I would point out, first of all, the case of potatoes. They are traded, basically, in only one market. Basically, potatoes futures trading in potatoes is confined to the production in the State of Maine which, although a major producer, is not by any means a majority producer of potatoes in the United States. The history of that market is that over a period of several years, the shorts controlled the market. The estimation of the potato producers and the potato organizations in Maine is that an unrealistically low price was not justified from the standpoint of demand. This costs the potato producers about \$15 million a year in the State of Maine.

As the previous witness indicated, this situation did right itself. But in overcoming it, you had a situation where a single buyer from a Western State walked into that market and began buying the potatoes. The shorts gave him some little better than 1,900 carloads of potatoes to buy, and he covered them with a purchase of over \$2 million. The potato prices went from under \$1 a hundred to over \$5 a hundred in a matter of a couple of weeks, and the loss that had previously been sustained by the producers than was transferred to the consumer. Somewhere in between the two prices, as they leveled out, was the obvious price that should have been established on the basis of the supply and demand situation.

In this example, a relatively small amount of potatoes traded in one futures market had a disastrous effect on potato prices all across the Nation. This was primarily so, because the situation lent itself more to the kind of manipulation which we believe the strengthening of the Commodity Exchange Act would at least give somebody some authority to handle. If nothing else it would simplify removing futures trading in some of these commodities from the market.

I am convinced that a great deal of the high pricing of bacon at the present time is a result of speculation in pork bellies. I am convinced that this is true. There are not enough of pork bellies being traded to have established a market at the level they now have.

The ability, even in an important commodity like oils, for one organization to establish a position that was so long controlling the market, where one man could run his price-support mechanism almost independently of the Government for a considerable length of time, indicates that in the commodities where there is a relatively small amount being traded, there must be some extremely tight controls, certainly tighter controls than we have had in the past. The present organization of the Commodity Exchange Administration does not lend itself to any kind of action that could be taken at a time when it should be taken. There is just too much delay in that kind of an organization, to expect three Cabinet members to find the time to set down and spend considerable time to consider what is happening in a market. They just do not have that kind of time and they do not have it at the same time.

Therefore, although we are not going to try to justify every word that is in this bill, and, certainly, not every section of the bill, the thrust of the bill, in our judgment, is correct. This committee and the Congress should work its will on this legislation and it should

improve it as best it can, according to the constructive suggestions of the witnesses who have appeared before the committee. But, in general, there should be something done in this whole field of commodity exchange regulation to prevent the kind of manipulation that, first of all, brings a great deal of loss to the producers. A man cannot transfer this loss from the producers to the consumer in high cost without any comparable increase to the producers at that time.

The fact is that during part of the time when potatoes were so low, all of this low price was not even transferred to the consumer. So that the public, in general, is not well served by this kind of a situation. The trade is well served.

It seems to us that the function of the Congress is to speak in terms of the public at large. We certainly want strong trading to carry on the business, but we think that the trade is not justified in expecting the public to think that the commodity exchange is always the one that regulates itself with nicety, and that prevents the public from being used.

Mr. MATSUNAGA. Your entire statement will be made a part of the record at this point.

(The prepared statement of the National Grange submitted by Mr. Graham follows:)

STATEMENT OF HARRY L. GRAHAM, LEGISLATIVE REPRESENTATIVE, NATIONAL GRANGE

Mr. Chairman and members of this distinguished subcommittee, my name is Harry L. Graham, legislative representative of the National Grange.

Almost from the beginning of its history, the National Grange has favored the establishment and maintenance of regulatory agencies designed to protect the public from the results of market frauds, manipulation, cornering, and all other monopolistic activities which tend to impair free competition—a basic requirement of the market system.

The regulation of the speculative markets was found necessary after the wild fluctuations during the last century and the beginning of this century, especially after the market collapse in 1929. The resulting controls and supervision has added to their stability and to the integrity of the invested capital of those who risk their earnings in support of the industrial ventures of the United States.

The commodity markets have been expanding to include a number of items which previously were not being sold on the futures market. As a result of the opportunities for manipulation, situations have been created where there seems to be an unnecessary risk on the part of the public.

We saw an outstanding example of this a year ago during the so-called "salad oil scandal" which rocked the commodity market and caused considerable concern in all quarters. We were particularly concerned because the Commodity Exchange Authority understood the situation and was well aware of the developments in this important market, but they had no authority to take action to prevent what turned out to be a mammoth fraud against the public.

The addition of pork bellies and beef sides to the exchange has created other problems and, in our judgment, has had something to do with the increase in the price of bacon this last year, an increase not consistent with the increase in the price of pork.

We have been particularly concerned in the Grange about the operation of the potatoes futures market and the fact that it was possible for the "shorts" to corner the market for a long time; the opposite end of the market was then able to corner it later. This kind of activity is not good for the market, and, in fact, creates a great deal of damage to commodities and their pricing. Farmers have lost millions of dollars as a result of these manipulations.

We are convinced that the present vesting of authority in the Secretary of Agriculture, the Attorney General, and the Secretary of Commerce, is an unwieldy arrangement. The need for this kind of arrangement is not borne out by any experience we have had in any of the other regulatory agencies. Therefore,

we would support the proposal of this legislation to eliminate the present arrangement and place this organization under the Department of Agriculture with regulatory authority.

The other provisions of the bill in our judgment are necessary to strengthen the authority of the Commodity Exchange Commission and to make it possible for it to render the kind of service to the American public which we have the right to expect from commissions which have been granted the kind of authority this legislation grants to this one.

It is axiomatic that the "free market" cannot exist if it is subject to manipulation and dishonest practices. It is also a proven fact that as long as such markets exist, there will be those who try to manipulate them. We sincerely believe this legislation is necessary, not only to correct the abuses we have seen, but to prohibit similar abuses in the future.

Therefore, the Grange will support this legislation, and we sincerely and respectfully petition the Congress to give it your prompt and vigorous support.

Mr. MATSUNAGA. Mr. Graham, do you disagree with the testimony of others given here that trading in futures has tended to keep the prices to the consumers down?

Mr. GRAHAM. In the case of potatoes, it certainly did not. It did for a while, and then it turned around and shoved it unreasonably high. I think that is true in the case of pork bellies at the present time. Nobody can say that the price of bacon is necessarily low. The price of bacon seems to be out of any kind of relationship with the rest of the hog. When bacon is \$1.25 a pound and hams are 79 cents a pound, it seems to me that we have something that is kind of out of balance. Frankly, I take care of that by having ham or beef with my eggs, instead of bacon, but the price of bacon is, in my judgment, unrealistically priced in relation to the rest of the hog.

Mr. MATSUNAGA. Can we attribute the high price of bacon today to trading in pork bellies futures?

Mr. GRAHAM. Part of it. I have a friend who has more money than I do who stopped by one of the commodity brokers engaged in selling pork bellies not very many weeks ago and bought two contracts of pork bellies. He sold them the next week for \$6,000 profit. This did not reflect any profit to the producer. It simply reflected a higher price to the consumer. I do not think that there is any question but what bacon is an instance where this has been true.

Certainly, when potatoes went to the price that they did, where one man could corner the market, this does not indicate that this is a good thing.

Mr. MATSUNAGA. Do I understand that you prefer this type of general legislation, rather than specific legislation pertaining to a specific commodity, such as H.R. 6006 which would provide for the elimination of trading in potato futures?

Mr. GRAHAM. Mr. Chairman, I would remind you and the committee that we have been trying to get this potato futures bill passed for 4 years, which does not encourage us very much. If this kind of legislative reform is the answer to the problem, there ought to be some kind of action that could be taken within 4 or 5 years. And the present bill is the basic reason for that.

Mr. MATSUNAGA. Do you feel that because of the lack of legislation in the areas pertaining to specific commodities, that we ought to have general legislation passed as is encompassed in H.R. 11788?

Mr. GRAHAM. I cannot think of a stock market eliminating trading in some items and permitting specifically some items to be traded.

I do not see why we should have a different rule on commodity markets than we do on the stock market.

Mr. MATSUNGA. Thank you.

Mr. Greigg?

Mr. GREIGG. On the first page of your testimony, Mr. Graham, you have made reference to an item that we have heard so much about before, the salad oil scandal. You have included something to the effect that they had no authority to take action to prevent what turned out to be a matter of fraud against the public. I would like your comments on that particular facet of your testimony as to whether or not, in your judgment, you feel that the enactment of H.R. 11788 would prevent a similar occurrence from happening again?

Mr. GRAHAM. I do not know that it would prevent a similar occurrence from happening. We would find it sooner that we did, I think. We were talking about it with the people in the Commodity Exchange at the time this was developed, and anybody who was watching anything at all understood that this was out of line with what seemed to be the basic situation. They simply informed us that they were watching it, but they could not do anything about it in terms of any actions to be taken. We recognize that the Chicago Exchange did take some action and increased the margins, but they acted at the wrong time. At the time they did act, people were bankrupt, institutions were bankrupt. This, in our judgment, was not a good situation and should not have been left to go as far as it did. This is no cause for permitting fraud or permitting what appears to be an unnatural development happening in the market.

I have heard people argue that they had the authority to do something, but, apparently, the legal staff of the Commodity Exchange Authority did not think they had the authority to do it.

Mr. GREIGG. The reason I raise the question is that this question was put to the Secretary when he testified a couple of years ago, and he indicated that even with the enactment of this piece of legislation, we could have a similar occurrence.

Mr. GRAHAM. I think that you could.

Mr. GREIGG. How would enactment of this legislation prevent the very item that you discuss in your testimony?

Mr. GRAHAM. The possibility of requiring them to increase margins could have forestalled its development to the point that it went. I am not sure that this is adequate. If it is not adequate, then we should do some more homework on this thing and carpenter it up to where it is adequate. There is nothing to be gained by any commodity exchange, in my judgment, in permitting this kind of fraud to develop—it is not good for the exchange, and certainly it is not good for the public, and I do not think that it is good for the whole image of our system.

Mr. HAGEN of California (presiding). Mr. Dole?

Mr. DOLE. In view of what Mr. Greigg has stated, it is good to call attention to this, because Mr. Mehren stated, and his testimony is in front of me—in that case we were talking about fraud—that is Mr. Mehren's testimony and not mine. I notice that you made very little mention of the definition of the word "manipulation," which appears on page 2 of the bill and also in other sections of the bill.

If you favor this legislation, you apparently also favor imposing criminal sanctions on a person or persons, even though there is no in-

tent shown to violate the act. That is what the definition indicates could be done. Do you mean to state that you would penalize someone in a criminal action without a showing of intent.

Mr. GRAHAM. I am not prepared to defend every word of this legislation.

Mr. DOLE. That is a very important word.

Mr. GRAHAM. I recognize that. I think that we ought to have a definition of "manipulation," certainly.

Mr. DOLE. Do you not think that it should include "intent"?

Mr. GRAHAM. Yes, yes; I think that this is obvious. That is why I suggested that the committee and the Congress work their will on this bill in the light of the testimony that had been given, the constructive testimony as presented by the witnesses.

Mr. DOLE. We have had some examples cited here. One witness stated they had had 84 years of experience in the exchange, and another one said 90 years. There have been no problems at all during that period of time, and that they have done a very fine job of policing their own exchanges. I am surprised that the National Grange would be supporting this legislation.

Mr. GRAHAM. What I thought I said, if you will remember, is that we support the thrust of this legislation—which was in the earlier part of my testimony. I did not say that we are supporting everything. We are limited to 10 minutes. Obviously, I could not cover all of it.

Mr. DOLE. It might take 10 minutes to determine what the thrust is.

Mr. GRAHAM. You got the thrust of it from the previous witnesses, although I am not quite in agreement with many of their points. But the thrust of it is to have the commodity exchanges working in terms of the public interests as well as in terms of the interest of the trade.

Mr. DOLE. I believe everyone agrees with that objective. I think that one witness this morning suggested that they could do all of these things by sitting down—Mr. Searles made that comment, I believe—that these problems could be worked out by sitting down with the Secretary, without enacting legislation. I do not feel any body representing the trade wants to do anything that would be against the public interest. I have been impressed with the very solid examples given where they have acted in the public interest. But the witness for the Department on Monday had to go back to 1947, in fact to the early 1950's, to even justify the legislation. I have been convinced that there is not much need for it.

Mr. GRAHAM. Again, I am not going into the question that every method that is used is what should be used. I think the committee sitting here in session is listening to the kind of testimony that, as we have many times suggested, this can be accomplished. But by the same token, the statement I made in terms of the Commodity Exchange Authority was the one they gave to me within the last year, at the time this one was developing, and at that time it did not have that authority. If they did have it, that is another matter. One of the reasons that we need to get it out of the present Commission setup is: Suppose the trade did want to sit down and work this out. I am not objecting to this method. But how are you going to sit down with three Cabinet secretaries at the same time? I think that we ought to get it in one shop or the other.

Mr. DOLE. They could work it out, even with the three Cabinet secretaries. They have only met once, I guess.

Mr. GRAHAM. It is so high-handed, this kind of a situation. Obviously, it is meaningless. Let us do it so that somebody does have not only authority but responsibility. And this is partly what this bill does. And then within that kind of a structure, we can accomplish something. I do not think that there is any disposition—certainly, not on our part—I have not seen any great dictatorial disposition on the part of the Secretary of Agriculture to do otherwise.

Mr. DOLE. I believe that in the area of farm prices, he is one of the greatest manipulators of all times.

Mr. GRAHAM. This is a matter of opinion. I have a different opinion of the Secretary, which does not necessarily mean that either opinion is correct or wrong.

Mr. DOLE. I have a high opinion of the Secretary, but I think that some of the actions taken to depress the market prices in effect amounts to manipulation, whether we like to use that word or not.

Mr. GRAHAM. I think that this has a certain amount of validity, but I think this was the purpose of the legislation. I mean, this is almost in the language of the legislation creating this power for the secretary. So, this action is a bit different than what we are talking about at this time, I think. I just think that we need to improve this situation to where we have responsibility and authority in the same place, and to set up the machinery by which this can be handled voluntarily if possible, when necessary.

Mr. DOLE. Thank you.

Mr. HAGEN of California (presiding). Thank you.

The next witness is Mrs. D. W. Brooks, vice president, National Cotton Council.

Mr. MOBLEY. My name is Leonard A. Mobley, of the Washington office. Mr. Brooks is unable to appear. We have copies of his testimony that we would like to have placed in the record, if possible.

Mr. HAGEN of California. If there is no objection, the statement of the National Cotton Council will be made a part of the record at this point.

Does this support the legislation?

Mr. MOBLEY. It does not.

Mr. HAGEN of California. Will you give a copy of this to the reporter?

Mr. MOBLEY. Yes, sir.

(The prepared statement submitted on behalf of D. W. Brooks, vice president, National Cotton Council, follows:)

STATEMENT OF D. W. BROOKS, VICE PRESIDENT, NATIONAL COTTON COUNCIL

My name is D. W. Brooks, of Atlanta, Ga., I am secretary-general manager of the Cotton Producers Association. Today I appear in my capacity as vice president of the National Cotton Council. The council is the overall organization of the raw cotton industry consisting of cotton producers, ginnermen, warehousemen, merchants, spinners, cottonseed crushers, and cotton cooperatives.

The biggest problem which confronts the American cotton industry today is selling more cotton to spinning mills both here and abroad. As cotton no longer has a monopoly in the textile industry, it constantly faces a terrific competitive battle with synthetic fibers here in the United States as well as in foreign countries.

We need to make cotton as attractive as possible to our customers—the spinning mills all over the world. Mills must acquire a year's supply of cotton during

the relatively short harvest season. In order to operate with any degree of stability, they must have price protection for their raw material. The synthetic fiber industry in making their products as attractive to mills as possible affords price protection to their customers against inventory losses.

Based upon present legislation and upon statements from the Department of Agriculture, it is our understanding that the future policy for cotton will be to make it competitive in both domestic and world markets. This will mean that of necessity there will be fluctuations in the price. Under these conditions the only way that mills and other people handling cotton, including producers and merchants, can afford themselves price protection for their production or inventories will be through the use of futures exchanges. For a period of many years now cotton futures exchanges have been used very little due to the fact that the Commodity Credit Corporation has been able to give price protection in the marketplace for cotton through the loan program. At best it is going to be a difficult problem of bringing the exchanges back into active use again so that they can give satisfactory protection to the producers, the handlers and the mills. The market must be greatly broadened as compared to its present use; otherwise, it will not be able to serve this need.

Prior to the protection given to cotton by Commodity Credit Corporation, experience indicated that it took the judgment of a large number of people to create a reasonable market through a futures exchange. For example, if the mills sold goods prior to the time they had actually been able to make a purchase of their raw cotton requirements for the goods covered in the sale, they would immediately have to buy futures to be certain they were protected on the cost of the cotton to be used in making the goods. Likewise, very often farmers needed some protection on their crops because of heavy borrowing for production purposes. Consequently, they needed to sell or hedge enough of their intended production before they actually harvested their crop to assure themselves a price that would make it possible for them to pay their production expenses. The futures market provided them the means of doing this.

In addition to these two groups, very often cotton buyers and cotton merchants would either sell to the mills cotton which they had not yet acquired from the farmers, or would buy from the farmers cotton which they had not yet sold to the mill. Consequently, they had a problem of protecting themselves against changes in the market price of cotton until the other side of these transactions could be completed. Again, the futures exchange provided this protection.

In addition to these groups, in all active commodity markets there have always been a large number of people who were buying and selling purely from the viewpoint of whether they considered the commodity too high or too cheap. Although these people were generally considered as speculators, very often they furnished enough volume in a market to make it possible for the legitimate buying and selling of hedges.

The banks have a problem of financing the production of cotton and the acquiring of cotton by the merchants and the mills. The banks have always been willing to lend a very high percentage of the price of the cotton involved provided it was hedged, whereas if it were not hedged they require a much greater margin.

Therefore, if the cotton market is going to operate effectively under the new policy as developed under recent legislation and under the policies of the Department of Agriculture, as we now understand them to be, then it is highly desirable that the exchanges be operated in a manner that will create a large volume of business. Such a large volume of business is necessary to assure a sound and dependable method of price insurance to all who produce, handle, finance and process cotton.

The object of the testimony of the National Cotton Council, based on resolutions which have been passed by this body, is to urge that an environment be maintained that will permit and encourage the efficient functioning of the cotton futures exchanges. There are two provisions in H.R. 11788 that we wish to call to the attention of the committee because we believe they will greatly restrict the use of the cotton exchanges and thereby seriously impair their usefulness. One of these provisions referred to is in section 1(d) of the bill which defines manipulation. We feel that this definition is far too broad and could prevent legitimate operators needing to use the exchange from doing so. The uncertainty that such a provision would leave in the minds of many people who would like to use the exchange would in our opinion outweigh any possible benefits it might have.

This provision is so indefinite and so broad in its scope that the legitimate users of the exchange might be fearful that the rules could be changed after they had placed their hedges and that therefore they would not have the protection that they expected to have when they used the exchange. In other words, once a contract is made on the exchange according to the rules and regulations which have been drawn up for the exchange then that contract should be permitted to go on through to its maturity, and if there are any practices which would be deemed to be bad and not in the interest of the general public or of the users of the exchange then those practices should be clearly defined and banned prior to the time that contracts are made.

Uncertainty as to what is meant by manipulation could very easily discourage the use of the exchange to the point that the volume of trading would become so low that it could not furnish the protection that it needs to furnish. It will not be easy to get people to again use an exchange after it has been out of operation for such a long period of time and if there are any serious questions concerning the reliability of the contracts once they have been made then this no doubt will greatly hamper the use of the exchange both by the actual handlers of cotton and the speculators as well.

The second provision of the bill that raises serious questions among the people who have had experience in dealing on the exchanges in prior years is the question of margins. Margin requirements are essentially for the protection of the exchange itself and the exchange must keep the margin requirements at such a point that the financial integrity of the exchange or the contract involved can never be questioned.

On the other hand, the exchange itself should be in better position to judge this and assume responsibility for it than anyone from the outside. If the margin requirements are set too high the exchange cannot be used by many legitimate operators in cotton who need the protection of the exchange most. It would tie up so much of their operating capital that it would largely offset or more than offset the savings which they would obtain in borrowing from the banks at a much higher percent of the value of the commodity involved.

While margin levels should be safe, it is important that they not be higher than the need for protection of the exchange and its brokers. It is crucial not to discourage the use of the markets because there is ample evidence in many economic studies which shows that the markets which are used most provide the best estimates of price and provide an extra margin of safety because the greater the number of transactions the greater the opportunity there is to put in legitimate hedges and this tends to minimize the need for excessive margins. Without going into details, use of the commodity futures exchanges represent an entirely different economic problem from the use of the stock markets of this country. One represents only price protection whereas the other represents the actual transfer of ownership of a purchase and the purchase of a stock certificate on margins becomes a credit transaction which is entirely different from the role of a commodity exchange. Consequently, there is a vast difference between the use of a commodity exchange as compared to the use of the stock exchange and this, of course, needs to be recognized in writing rules and regulations for a commodity exchange.

The two provisions outlined above could have a very restrictive effect on the use of the cotton futures exchanges. If these exchanges are to give proper price protection in the years ahead, we feel that they must be widely used. We, therefore, ask that the committee give serious consideration to eliminating or making proper changes in these two provisions of the bill.

Mr. HAGEN of California. The next witness is Mr. Angus McDonald of the National Farmers Union.

Do you wish to read your statement or just to present it?

**STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH,
NATIONAL FARMERS UNION**

Mr. McDONALD. Mr. Chairman and members of the committee, I would like to read a portion of my statement which is very brief.

First, let me say that I am Angus McDonald, director of research of the National Farmers Union. I have been with the organization for about 18 years. I live in Washington.

I would like to say, first, Mr. Chairman and members of the committee, that I would like to associate myself in part, at least, with the statement of Harry L. Graham that you have just heard.

We do not endorse the crossing of every T and the dotting of every I in this legislation. We do support the principle of it.

When I went over the amendments I was attracted to the definition of "manipulation," which I felt was rather broad. I am making this statement now because in composing my statement in great haste I forgot to note that exception to our general support of the bill.

We have been in appropriations hearings the last few days. We are in them this afternoon and, therefore, I have not been able to spend a great deal of time on this amendment. I am substituting here, in fact, for Reuben Johnson, who asked me to come in and help him out.

The burden of my testimony is based on this document here, Mr. Chairman, which is the report of the Comptroller General of the United States, and I assume that all of the members of the committee are familiar with this document, and I would like to read a resolution which was adopted a few days ago in Denver, Colo., by the delegates of the National Farmers Union at the national convention. And the resolution is as follows:

While we recognize there is some considerable advantage of future trading in establishing prices for certain farm commodities, we are also cognizant of continuing abuses, prevalent on the exchanges that cause price movements beneficial only to specific groups.

We, therefore, endorse new legislation to more effectively protect the farmer from artificial price movements produced by specific trading practices. Reference to this recommendation is based on "Report of the Comptroller General" of the investigation of Commodity Exchange Authority No. B-146770.

I would like to make two points here.

In going through this document it seemed quite evident to me that the Department of Agriculture has been very negligent in enforcing the Commodity Exchange Act.

And point No. 2 is that it seems to me that these flagrant abuses have been allowed to go on without the private groups in charge of the exchanges doing much about them, either.

Numerous examples are given here in this document of cheating, conflict of interest, and so on and so forth. It is quite lengthy. There are dozens of interests where these various practices were allowed to go on.

Now I asked the Department of Agriculture officials, one of those in charge of this bill, why this situation obtained, and the answer that he gave was that there was not sufficient funds to carry on these investigations. I was amazed that in one of the references given here it was to the effect that the annual volume of business amounts to \$26 billion, involving three exchanges, that the Department had gone on for years and years and years and never looked into these practices. So I think that is the thing that the committee should give its attention to.

I want to make this final point. It seems that the kind of groups that failed in their function, according to my limited information, it seems that the Department of Agriculture has not been able to enforce the law or has not sufficient power to go into these matters. I would hope that the committee would decide to amplify and expand

the power of the Department of Agriculture and to use your influence to make it possible for them to have the \$270,000 additional, or whatever it is, to police in better fashion these exchanges.

We feel that the Department of Agriculture would be more responsive to the public interest and private groups. We feel that as people in the Farmers Union and in the other farm groups—our State president in Illinois, for example, Mr. Ray Watson, is very much concerned about this—people like that would be able to bring pressure on the Department of Agriculture, call their attention or whatever to it, when it was found out that these abuses existed. We are not trying to restrict hedging or anything of the sort.

That completes my statement, Mr. Chairman.

Thank you, sir.

Mr. HAGEN of California. Mr. McDonald, you have submitted a copy of your written statement, have you not?

Mr. McDONALD. Yes.

Mr. HAGEN of California. There being no objection, it will be made a part of the record at this point.

Mr. McDONALD. Thank you, sir.

(The statement referred to follows:)

STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH, NATIONAL FARMERS UNION

Mr. Chairman and members of the committee, we are appearing here in support of H.R. 11788, a bill which would amend the Commodity Exchange Act in regard to authorizing additional powers of the Secretary of Agriculture. Under this legislation the Secretary would be allowed to set margin requirements, in certain situations, designate additional commodities, prescribe contract market rules, issue cease and desist orders against individuals, establish minimum financial requirements for firms handling customers future business, deny registration for cause, apply to U.S. court through the Attorney General for injunctions and bring to task those who aid and abet or act in combination with any other person in violation of the act.

The bill would expand the power of the Secretary in regard to denying registration to those persons who had engaged in practices violative of the act, or to those who had been found guilty of a felony in a State or Federal court. There are also a number of provisions inserted for the purpose of clarification.

Attention is called to the following resolution recently adopted by the delegates of the National Farmers Union convention in Denver, Colo.:

"While we recognize there is some considerable advantage of future trading in establishing prices for certain farm commodities, we also are cognizant of continuing abuses, prevalent on the exchanges that cause price movements beneficial only to specific groups.

"We, therefore, endorse new legislation to more effectively protect the farmer from artificial price movements produced by specific trading practices. Reference to this recommendation is based on 'Report of the Comptroller General' of their investigation of Commodity Exchange Authority No. B 146770."

Although we do not pretend to be experts in regard to the regulation of commodity exchanges, we are convinced by a careful reading of the July 1965 report by the Comptroller General of the United States in regard to "The need to strengthen regulatory practices and study certain trading activities relating to commodity futures markets," that there is a great need for tightening up the act and giving the Secretary of Agriculture more authority to protect those participating in futures markets. There is also, according to the study, a great need for more trade practice investigations.

The Comptroller General points out that in the 21 futures markets, 3 have transactions averaging \$25.6 billion annually and have never been subjected to a trading practice investigation since their establishment in the years 1940, 1950, and 1951, respectively.

Questionable trade practices, the investigation indicated, indicate the need for more drastic regulation. The Comptroller found that fictitious trading, cheating, and defrauding commodity customers was not uncommon. The Comptroller General found that even where sanctions were imposed upon violators that the Commodity Exchange Authority did not follow up to determine whether violations of the act had been corrected. In 28 instances in 1 investigation conflicts of interest existed: the buyer, seller, and broker being one and the same person.

USDA it would appear, according to the report, has been negligent in investigating trade practices. On page 11 it is pointed out that the Comptroller General brought certain instances of questionable trading practices to the attention of the Commodity Exchange Authority of USDA which resulted in an investigation. Thirty-four transactions were cited which related to improper activities. In July 1964 officials named in the complaint admitted to the facts charged. The sanctions imposed by the authority proved, it seems to us, weak and ineffective. The report of the Comptroller General contains several other instances which indicate that improper practices were carried on but that sanctions were inappropriate as penalties for violations under the law.

I quote from the Report of the Comptroller General: "The complaints issued by the Department of Agriculture, which resulted from trade-practice investigations of wheat futures traded in May 1960 and soybeans, wheat and rye futures traded in August, 1960, charged 12 individuals who were floor brokers and/or members of the exchange, with violations of the act or regulations. These violations included abusive practices such as noncompetitive trading, cheating customers, deceiving persons from whom orders were received, and causing false reports to be made. Five of the individuals admitted to the facts contained in the complaints and waived hearings on the charges. Sanctions imposed upon these individuals consisted of denial of trading privileges for periods of 10 to 30 days."

We have noted the objections to the proposed legislation as represented by the statement of the president of the New York Cotton Exchange. It appears that this individual's principle objection is not so much a denial that abuses do exist but that the commodity exchanges should continue to have their present control over futures trading in commodities without any additional authority being given to the Secretary of Agriculture.

We feel that the Secretary of Agriculture can be relied upon to protect the public interest more adequately than a private group. We urge therefore that this committee approve the legislation under consideration.

Mr. HAGEN of California. I would like to ask you this question: One of the witnesses earlier, Mr. Bicknell, presented a statement, for the National Federation of Grain Cooperatives. That is a part of your organization, is it not, sir?

Mr. McDONALD. It is my understanding that the Farmers Union Grain Terminal Association has had testimony presented here, which is in opposition to this legislation. We differ on this bill.

Mr. HAGEN of California. In other words, the parent differs from the child, is that right?

Mr. McDONALD. I believe that is a pretty good analogy. Yes.

Mr. HAGEN of California. How lengthy is that Comptroller General's report?

Mr. McDONALD. It is 30 pages, and then there is a short appendix.

Mr. HAGEN of California. Is there any objection to making this a part of the appendix of the report? If there is no objection, we will do that.

Mr. McDONALD. Do you want my copy, or do you have a copy, Sir?

Mr. HAGEN of California. What year was that report made?

Mr. TEAGUE of California. Let me ask a question.

Mr. McDONALD. It was made in July 1965.

(The Comptroller General's report referred to will be found in the files of the committee.)

Mr. TEAGUE of California. Does Mr. McDonald request that it be introduced into the record or that it be made available only?

Mr. HAGEN of California. I think it is significant. I was not aware that there was such a report until he mentioned it. I am surprised that the Department of Agriculture did not mention it.

Mr. TEAGUE of California. I have no objection to it.

Mr. McDONALD. It is very critical, Mr. Chairman, of the department. Perhaps that is the reason that they did not mention it.

Mr. HAGEN of California. We have a pretty good record here, then. Are there any further questions?

Mr. DOLE. I want to welcome Mr. McDonald to this subcommittee though I am not a member. You have been before our committee in the past. I do not find any fault with your statement, in fact the resolution can be reconciled with the statement made by Mr. Bicknell, which you have probably read. Your primary concern is not perhaps with the specifics of the bill itself. You do not apparently agree with the word "manipulation"—that is the definition of that word. What you are saying is that there should be a more diligent investigatory approach by the department. I understand that is your statement. Is that basically correct, sir?

Mr. McDONALD. Yes, sir. And also we feel that the Secretary should be given more power inasmuch as, apparently, the private groups have failed to fulfill their responsibilities. As I indicated by this report—

Mr. DOLE. Based on that report. But you are not jumping up and down for the legislation, are you?

Mr. McDONALD. We are not jumping up and down; no, sir. We are not.

Mr. DOLE. Thank you.

Mr. HAGEN of California. I would like to ask you a question. Many of these commodities are relatively small in volume and the trading is small in volume, too. I would assume that.

In potatoes, for example, the trading would be much smaller than the volume would be in wheat and corn and cotton. Do most of these abuses occur in these relatively short commodities or in the commodities or in the commodities that are large in supply?

Mr. McDONALD. I am not familiar with the situation enough to answer. I do recall various examples are given here in this study on wheat and soybeans and several other major commodities. Whether they involve small amounts or large amounts, I do not know.

Mr. HAGEN of California. The use of the commodity market, for hedging is a bona fide function which should not be eliminated, whatever objection there is it is to the speculation or price rigging. The witnesses have testified that the speculator, also, is a necessary part of the market, so far as the hedging aspects of the market is concerned. Do you agree with that?

Mr. McDONALD. Well, there again you run into the problem of a definition. I have in mind the kind of speculation that we are talking about here which is the speculation which lessens free competition and changes price that otherwise would not be changed if that action did not take place. It is a matter of semantics. It is a matter of definition. I would go along with Harry L. Graham's discussion,

the examples that he gave, that a speculation which costs the consumers more than it should, or the producers less than it should, is a bad speculation, but in one sense everything is speculation. It is gambling, if you want to call it that—betting that the price will rise when you engage in one activity. You are betting that the price is going to go down in another activity. Of course, the amalgamation of all of these activities tends to stabilize, so that you will have a situation of free competition, if there is not some one of these things that is specified in the law which is done, such as fraud and deception, conflict of interest, failure to fulfill orders, which our man in Illinois has reported. He has bought soybeans for example, soybean futures, and he feels that they did not fulfill his order; that they waited a few hours or almost a day, because they felt that if they waited he would not make so much. You see, it was in their interest. That is the way he feels about it.

Mr. HAGEN of California. That is one that got taken.

Mr. McDONALD. Yes.

Mr. HAGEN of California. Thank you very much.

Mr. McDONALD. Thank you, sir.

Mr. HAGEN of California. We have two more witnesses. I do not know whether they represent themselves individually or are from one organization. One is Mr. Don Brouillette of Fowler, Ind., and the other is Mr. Alvin Fischbach of Fowler, Ind., too. I assume that they may be together.

Is that correct?

Mr. BROUILLETTE. No; we are separate.

Mr. HAGEN of California. You may proceed.

STATEMENT OF DON BROUILLETTE, FOWLER, IND.

Mr. BROUILLETTE. Mr. Chairman and members of the committee, my name is Don Brouillette. I, along with members of my family, own and operate country elevators at Dunn, Ind.; Free, Ind., and Hallock, Ind. The total populations of these three huge metropolises is six so that you can readily see that this is about as country of an elevator as you can get. We buy grain, primarily corn, from our farmer neighbors, store it, dry it, and then ship it to the market that we think is best at the moment. During the past year we paid our farm customers \$3.5 million for their grain.

We have storage capacity that was built to store Government grain in days of huge surplus. Now, due to rapid changes in harvesting methods, we often receive more grain from one farmer in 1 day than we used to receive from all our customers in a day. This has caused some problems.

It is and will continue to be physically impossible to transport all of this grain to market during the short harvest period. So we use the storage that was built to store Government grain to hold this until we can ship it. We have about 1 million bushels of this space.

Since our farmers have the peculiar habit of wanting their money as soon as they finish delivering their grain, we must find a method of financing this inventory until we are able to ship it. Also, we hope that this method will pay the interest, insurance, and some storage charges. Our banker being wise, and having seen my balance sheet, does not want to loan me money on anything approaching 1 million

bushels of any commodity unless he knows that I, and in turn he, will be protected in the event that market goes down. So he tells me I must hedge in the future market (i.e., when I buy 10,000 bushels from my farmer, I sell 10,000 bushels of futures).

Looking at my operating statement for last year very simple arithmetic will show that our normal margin between what we pay for grain and what we sell grain for will not cover the total amount shown at the base of the column titled expenses. So storage income through the use of futures markets enables us to pay farmers more for their grain than we would otherwise be able to do, and it also allows us to store it and speed the marketing over a period of time. This being the only way I can stay in business the rest of this week, I am vitally concerned whenever I hear of anyone thinking of changing the laws governing the futures market. I think you have to work with this futures market to see how well it works for farmers, for country elevators, terminal elevators, processors, consumers, and world trade.

I am afraid that some of the regulatory legislation contained in H.R. 11788 will change our futures market irreparably.

The regulations contained in this bill that I oppose are (1) the authority to set margins. This is the authority, as I see it, to attempt to regulate the price of commodities.

Anyone such as myself that would be hedged in a futures market and suddenly found himself being called upon for additional margin on a large inventory would have no choice but to liquidate at least part or all of his holdings. Speculators called upon for more margins would do likewise, the combined effect would cause utter chaos in the market. This is something I do not think any of us want.

Let me speak of the speculator, this much maligned individual. We must have him in a futures market to add liquidity, to take this risk of ownership, and to prevent wild fluctuations of prices.

Let us just visualize for a moment the corn harvest throughout the Corn Belt. This is when we sell the bulk of our grain. When we sell this we are selling to speculators, because they are the high bidders, without them our large sales at harvest time would go at fire-sale prices, thereby hurting us and our farmer customers.

Can you imagine a speculator taking a position knowing that margins could be raised to any level? These are margins that he cannot borrow money on. I think you would drive virtually every speculator from the marketplace, because it is difficult to play a game if they are going to change the rules after play has started. We must have this individual in a free marketplace.

(2) Manipulation, as I read this bill, it seems that even I could be guilty of manipulation if I sold a contract because every trade affects the market, however little. I do not expect that I would be accused of manipulation or that ordinary speculators would be. But I do not think anyone should have the power to both accuse and judge. And we would all be weakened in our trades by the constant threat of changes. How could anyone use a market when, at the Secretary's discretion, he could be accused of manipulation and be forced to liquidate his position?

(3) Authority to write contract rules. Rules now written have been written to facilitate and encourage trade; therefore, they must be

equitable to all parties. Can something that is equitable to all parties be improved upon by someone that is not party to these contracts?

(4) To abolish the Commodity Exchange Commission. What is wrong with having the powers of the commission governed by three people? This seems to be to be wiser and more consistent with our form of government. I do not believe that any Secretary of Agriculture should ever be allowed to have in his power the ability to completely kill the very free markets that have made our Nation the most envied of all nations.

In conclusion I want to point out that the market as it now operates is very useful to me and my customers and that I do not think that there is any need to put the vast amount of new power that has been requested in the hands of the Secretary of Agriculture.

Thank you.

Mr. HAGEN of California. Mr. Teague wants to give you a compliment.

Mr. TEAGUE of California. This is a very excellent statement. I find myself in complete agreement. I am sure that my friends to my left here, the Republican side, and, I hope, hopefully, that the other members of the committee to the right will agree. It is a very good statement.

Mr. HAGEN of California. He has the parties reversed. [Laughter.] Are there any questions?

I would like to ask you a question. Do you speculate on the market yourself?

Mr. BROUILLETTE. Do I speculate?

Mr. HAGEN of California. Yes.

Mr. BROUILLETTE. I think that I would be a little bit remiss to say that sometime in one's life he has not bought a trade. I think that he would be remiss. However, our banker would not let me speculate so I at the present time do not speculate.

Mr. HAGEN of California. Have you made out in your hedging operation?

Mr. BROUILLETTE. In our hedging operation—on the total thing—I think this is true on all of our country elevators, at least, in the area of the Corn Belt that I am familiar with—this is the only salvation that these elevators have if they are going to stay in business the next few years. So ours has been profitable and it has to be, if it is correctly run.

Mr. HAGEN of California. You either make or lose a little, but not very much?

Mr. BROUILLETTE. Actually, what you say is true in one respect, but we use hedges to make storage income. We can make a greater amount of storage or a lesser amount, but the hedge that we use performs the function of paying us the storage charges for distant delivery.

Mr. HAGEN of California. There are margin requirements?

Mr. BROUILLETTE. Yes. When I make—if I buy corn from a farmer and sell the futures contract, then I have to pay for the corn and then I have to put up the margin for the futures contract.

Mr. HAGEN of California. Does the margin reflect the probable increase or the fall in the price of the commodity?

Mr. BROUILLETTE. I put up an initial margin, and then if the amount moves up to a higher level, yes, then I have to put in additional margin,

so that I always have a margin in there that would cover any possible fluctuation in the market.

Mr. HAGEN of California. Are these almost daily calls upon you?

Mr. BROUILLETTE. No, because the market has not been fluctuating this great. Occasionally, if you have a very big risk moving market, such as, possibly, the bean market has been upon occasions, you do receive these requests for additional margins, maybe, every day or two.

Mr. HAGEN of California. And then your banker supplies that?

Mr. BROUILLETTE. He will not supply the money on the market. He will supply me the money on the commodity you own. So that if the market—that is, if I bought cash beans and I sold the futures, if the futures moved up, I would have to put up additional margin, but by the same token the cash bean had moved up in price, so that the banker would loan me more on the beans, because now it was worth \$2 and \$2.50, where I borrowed initially at \$2. By the same token, it works in reverse. I could pull my margin from the futures market and then I have to pay the market.

Mr. HAGEN of California. And you would pay back the banker?

Mr. BROUILLETTE. Yes.

Mr. HAGEN of California. Thank you very much.

Mr. BROUILLETTE. Thank you.

Mr. HAGEN of California. The other witness is from Fowler, Ind., Mr. Alvin Fischbach.

You are not associated with the other witness?

Mr. FISCHBACH. No, sir.

Mr. HAGEN of California. You may proceed.

STATEMENT OF ALVIN FISCHBACH, FOWLER, IND.

Mr. FISCHBACH. Mr. Chairman and members of the committee, I am Alvin Fischbach, president of the Lochiel Elevator Co., Inc., of Fowler, Ind.

We operate three country elevators in Indiana and have an interest in a fourth. Ninety percent of our business is in grain merchandising, storage, conditioning, and shipping of grain. The remaining 10 percent is in custom feed business and allied services.

We have a combined storage capacity of 1.5 million bushels. We do an annual volume of approximately 3½ million bushels. A total of \$4.5 million was paid to farmers for this grain.

Due to the rapid increase of the use of the picker combine, corn in our area is harvested very rapidly and in a different form than it has been in the past. As late as 5 years ago corn was harvested with the ear corn picker and placed in storage on the farm, on the ear, in cribs for storage and conditioning. In the past 5 years corn comes in from the picker combines shelled and placed in the elevator for either conditioning or storage or both. For the farmer who does not wish to store, but wants to sell, we must take the grain and either ship it to terminal markets or place it in storage for our own account. In placing the grain in storage for our own account, to avoid risk, we hedge our purchases with an offsetting sale in the futures market and let the basis appreciate. As the storage season progresses and the cash gains in relation to the futures, we sell the cash in usual channels and buy back the futures. It is a profitable business.

As the Government has reduced its stocks of grain, large grain warehouses now have unfilled space that may be utilized this way. In the past year we have used our space in more of a hedging operation than we ever dreamed we would; in future years we will use it even more.

In a hedging operation one must have strong financial arrangements as inventories run into amounts of money that are staggering. In our company last year, amounts close to \$1 million were needed. Financial institutions are not willing to lend money to warehousemen without strong warehouse receipts and offsetting hedge sales.

Futures markets and hedging play a large role in our business today and will increase in the coming years.

We have a huge investment in storage facilities and the only way we can make it pay is to store hedged grain. If we do not have access to this source of income we will have to charge farmers wider margins.

We feel that any change in the present marketing system would greatly hamper our operations.

I hope that I have made clear that the futures markets are important to my company and to the farmers we serve. The market works fine now. I do not think that new regulatory legislation is needed and I am afraid that some of the proposed changes would hurt the market and make it less useful to me.

In the market we now have four things that are important to us as country elevator people:

1. Liquidity—I want to get orders filled without having to make price concessions (this we have);

2. Broad and representative prices—the futures price at Chicago must have a constant relationship to cash prices at the markets where I sell because I do not deliver on futures contracts and not all our grain goes to Chicago markets;

3. Low margins—interest on the margins that I post is part of my cost of doing business and to have a change in margins would increase our operational costs and be difficult to explain to our financial suppliers; and

4. High prices—I want to be able to pay farmers as much as possible when they have grain to sell. Our customer's prosperity is important to us and to our community.

In order to have the four items I have described, we need a vigorous participation by the speculator. This gives the market liquidity and I can place orders and get them executed without changing the price.

The market is broad and representative. The price differences are fairly constant and we understand them. Because I have the futures market as an outlet I am not at the mercy of the cash market. My company and our customers would be at the mercy of the cash market buyers if it were not for speculators in the futures market. From my point of view, there is no such thing as excessive speculation.

Over the years I have noticed that futures prices are as apt to be at their season's high at harvest as at any other time of year. The farmers who sell at harvest do not sell on a depressed market. Indirectly they sell to speculators. I do not want to see them thrown on the tender mercies of cash merchants.

The worst provision of the bill is control of margins. Margins are now kept at high enough levels by the exchange. I have never had any trouble getting my money or doubt about its safety. To increase

margins strikes at my pocketbook. Worse, I think it might hurt speculators and destroy the effectiveness of the market.

The new definition of "manipulation" is bad. As I read it, every trader, me included, could be found guilty of manipulation. Every position taken affects the price. This restricted definition of "manipulation" would probably scare some speculators out of the market and hurt it.

The power to establish trading rules is undesirable. I think that people in the grain business can best write the trading rules.

The power to issue cease and desist orders is a bad feature of the bill. For futures markets to be a good hedging system, contracts must be real and valid. People who make contracts must be responsible for them, and the markets must be allowed to trade out. If markets are not allowed to trade out, the futures price will not mean anything. If there is manipulation it can be determined and punished later.

It appears to me that this bill is designed to give the Secretary of Agriculture power to control prices. If the Secretary so chose he could destroy the free market. No one should have that power. In addition, I have watched grain prices for a long time and I do not think that anyone is smart enough to decide what the price should be. It would appear that this bill is designed to give the Secretary of Agriculture the power to pass judgment on what the price should be. However well intentioned he might be, he is apt to find that he is defeating his own purpose. He is apt to find that he set the wrong price. Some people can beat the market but no one is good enough to be right much over 50 percent of the time.

Thank you.

Mr. HAGEN of California. Thank you.

Mr. Teague?

Mr. TEAGUE of California. Just this, Mr. Fischbach. You and Mr. Brouillette are in full agreement on the issues before us?

Mr. FISCHBACH. We are.

Mr. TEAGUE of California. Thank you.

Mr. HAGEN of California. Mr. Greigg?

Mr. GREIGG. How was your attention called to these hearings, as a point of interest?

Mr. FISCHBACH. To the hearings here?

Mr. GREIGG. Yes.

Mr. FISCHBACH. In Washington?

Mr. GREIGG. Yes.

Mr. FISCHBACH. We are members of various organizations. They put out a number of publications alerting you to the fact that the hearings were being held here in Washington. The National Feed Grain Dealers Association, an organization of which you are a member, in their latest bulletin, had information regarding the hearings here today.

Mr. GREIGG. Thank you.

Mr. HAGEN of California. I would like to ask you a question. The bill would have an impact on you as a user of the market, that is, for example, in the regulation of the market. You mentioned "manipulation." Is there any aspect of this bill which would give the Secretary—I will restate the question.

You are not presently a user of the Chicago Board of Trade, for example, subject to any type of regulation, either by their board of governors or by the Secretary of Agriculture, or any other governmental office, are you?

Mr. FISCHBACH. It depends, if your trade got large enough you would be. You have a reporting form to submit.

Mr. HAGEN of California. Who do you submit that to?

Mr. FISCHBACH. To the Department of Agriculture.

Mr. HAGEN of California. You are not a member of any such organization?

Mr. FISCHBACH. No. We are not a member of any exchange—no, so far as the exchange itself is concerned.

Mr. HAGEN of California. You have to report to the Secretary of Agriculture?

Mr. FISCHBACH. Well, when your trade exceeds 200,000 bushels in the futures market.

Mr. HAGEN of California. Then you have to report?

Mr. FISCHBACH. There is a reporting form that we submit.

Mr. HAGEN of California. Well, now, what aspect of this bill, if any, would reach out and impose further regulation on you if you are not a member of any of these trading boards or exchanges?

Mr. FISCHBACH. This bill in itself, in the manipulation clause—if they were going to scrutinize this thing down to what would be construed as “manipulation,” it would very definitely involve a person in our position.

Mr. HAGEN of California. You think that it would?

Mr. FISCHBACH. Yes, because we would be trading in the market, the same as anyone else would trade in the market, whether a member or not a member of the exchange.

Mr. HAGEN of California. Is that the only aspect of the bill that would directly involve you?

Mr. FISCHBACH. No. Also, in the required margins, we would have to post more margins.

Mr. HAGEN of California. I understand that.

Mr. FISCHBACH. That would involve us.

Mr. HAGEN of California. Is there anything else? Are there any requirements with respect to solvency and so forth that would affect you?

Mr. FISCHBACH. You are talking from the standpoint of being solvent to trade in the market, you mean?

Mr. HAGEN of California. In your operations as a user of the market, at some point, would you be covered by that in the regulations?

Mr. FISCHBACH. I would not think so, no.

Mr. HAGEN of California. Thank you very much.

Those are all of the witnesses that we have scheduled here for today. There are no further hearings scheduled. We will take this matter under consideration.

Mr. MATSUNAGA (presiding). Thank you.

The record will be kept open for 10 days. I have several communications which have been received which will be made a part of the record at this point.

(The documents referred to follow :)

STATEMENT OF HON. MARK ANDREWS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Mr. Chairman, there are a number of provisions of H.R. 11788 which I consider to be unnecessary and undesirable. Two of them, however, deserve particular attention, and I should like to take a few minutes of this committee's valuable time to discuss them today.

They are—

(1) The proposed grant of authority to the Secretary of Agriculture to prescribe and enforce minimum margins; and (2) the proposed grant of authority to the Secretary of Agriculture to prescribe and enforce bylaws, rules, regulations and resolutions relating to margin requirements and the form and manner of execution of the purchases and sales of any commodity in interstate commerce or for future delivery.

As a farmer, as an individual vitally interested in agriculture, and as a Member of Congress from a farm State, I believe I am qualified to comment on the erroneous assumption that any problems, real or imaginary, can be solved by granting additional authority to the Secretary of Agriculture.

With regard to the proposal to grant the Secretary authority to prescribe and enforce minimum margins, I believe that margins on futures trading in contract markets have had and should continue to have only one purpose. This is to insure the carrying out of the contracts entered into. For this purpose, the governing boards of the several commodity contract markets have performed reasonably and responsibly. They should, in my opinion, continue to have complete responsibility and jurisdiction.

The other proposal to give authority to the Secretary of Agriculture to prescribe and enforce rules relating to margin requirements and transactions in interstate commerce is plainly unnecessary. Under existing laws, the Secretary can prevent the adoption of any rule relating to futures trading that he finds objectionable. I believe the rulemaking powers of the governing bodies and memberships of the several contract markets are being exercised prudently and that they should retain their present jurisdiction and responsibility in the promulgation of rules.

Mr. Chairman, I can see nothing to be gained by transferring this jurisdiction from governing boards which have proven their responsibility in these matters. I particularly object to vesting these additional responsibilities and powers in one man, especially the Secretary of Agriculture.

STATEMENT OF HON. E. Y. BERRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

The Chairman and members of the committee, my name is E. Y. Berry and I represent the Second Congressional District of South Dakota. The legislation under consideration to amend the Commodity Exchange Act has penetrating and dangerous significance for both the businessmen who deal directly with the grain market and the entire body of producers and consumers in this country.

H.R. 11788 gives the Secretary of Agriculture unprecedented powers of the Nation's future and cash markets. The law is written to encompass all agricultural commodities and would make the Secretary of Agriculture a virtual czar over the commodity markets.

Actually, the exchanges need no further controls by the Department of Agriculture. In fact, if something constructive is to be done, we should be considering legislation to prohibit the Commodity Credit Corporation from dumping its stocks on the market to drive down grain prices.

This bill would authorize the Agriculture Secretary to set margin requirements, or credit terms, to head off threatened market manipulation or unwarranted price swings, and to extend Government jurisdiction to additional commodities to prevent unlawful trading practices.

Authority to increase margins on commodity trading will result in trading by only a few well-heeled traders who can afford it. The Secretary would have the power to set exchange procedures and prescribe the terms of future contracts. Those who need to insure their transactions by the use of futures contracts will find it impossible and will be faced with having to speculate in a business which is notorious for the magnitude of its risks.

In the commodity markets, the only purpose of the margin is to guarantee performance on the contracts. They are not downpayments and this is the big difference between the margins in the commodity market and those in the securities market. This is an important point, because those who are pushing for this legislation are claiming that the Secretary's new power would be similar to the normal stock requirement on margins.

Other provisions in this bill allow the Secretary to crack down on any individual who he "suspects" is preparing to violate a CEA regulation. The bill would place entirely in the Secretary's hands the authority now set up on a check and balance system between the Secretary of Agriculture, the Attorney General, and the Secretary of Commerce to establish speculative trading limits. This bill makes it a one-man show.

It also provides for an expanded recordkeeping requirement.

One of the main ways in which grain traders have been able to avoid speculation is by making use of futures contracts to hedge their grain inventories. If the Secretary under the authority given him in H.R. 11788 would increase the margin per bushel to a new high, the trader would be investing far more than the market value and would be using up the bank credit much faster, resulting in trading only by the most wealthy buyers of grain.

Future trading would all but dry up. Hedging would be next to impossible and the effects would be felt down to the country elevators and farm levels. The availability of a fluid futures contract market removes much of the risk and enables buyers to operate on a very small margin which benefits the producer and the consumer.

In all, the bureaucratic controls, the fact that present, rigid laws now are on the books to deal with fraud and market-rigging, the drastic economic effect upon the market and the harm to every co-op and elevator in the country make it imperative that this legislation be opposed by this committee.

STATEMENT OF HON. ANCHER NELSEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. Chairman, I want to express my appreciation to you and the subcommittee for giving me this opportunity to present my views on the proposed amendments to the Commodity Exchange Act.

I have great confidence in the commodity futures markets as they provide a workable system of organized and supervised open trading. They serve as clearinghouses between buyers and sellers, and they are instrumental in establishing high quality standards of commodities for delivery. They allow the trade to carry large inventories at low costs, to merchandise continuously at stable prices, and to distribute their stocks economically. The futures market system is highly competitive and thus highly successful.

However, even the participants of this system have suggested possible improvements to prevent abuses by individual interests. Also the Comptroller General has suggested the need for more frequent and extensive investigation of the system by the Commodity Exchange Authority. I would agree that certain changes should be made. The act should be extended to cover individuals who might assist in violations of the act. Coverage could perhaps be extended to include certain livestock markets. All terminology of the act should be clearly defined. The Authority should be granted sufficient funds in order to obtain adequate personnel and money to carry out its responsibilities. More severe penalties should be instituted and fairly enforced to serve as strong deterrents to violations.

I do not believe that H.R. 11788 meets these needs. Indeed, it doesn't seem that the bill was even designed to meet these needs. A careful reading of the bill indicates that the true purpose is to shift the source of market decisions from the market itself to the Secretary of Agriculture.

In the first place, H.R. 11788 would transfer the responsibilities of the CEA which are now jointly held by the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General to the Secretary of Agriculture exclusively. Even on the face of it this action does not make sense as extension of the powers of the CEA to other commodities suggests that some nonagricultural commodities would be included.

In addition to this, the Secretary would be granted more powers over the market system than have ever been granted any one man in our history. We

have already seen how the present Secretary manipulates prices in the recent case of the Commodity Credit Corporation sales of corn. Under this bill, the Secretary would be given the authority to prescribe contract market rules governing conditions of sale. These rules are now prescribed by the directors of the contract markets who, as participants in the market, have greater competence than the Secretary in these affairs. The act itself is the set of rules for these markets. If changes are needed, the act should be amended to reflect the changes.

This bill would also give the Secretary the authority to prosecute any trader for any activity which the Secretary deems to have the effect of "restraining trade." Where are the legal protections from these vague terms?

The bill gives the Secretary the power to set minimum margin requirements whenever he "has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, or excessive speculation in any commodity, or any other activity reasonably expected to restrain trade."

It has not been proved that margin requirements have any important effect on possible manipulations in trading activity or that "excessive speculation" is a pressing problem. More important, it is a matter of conjecture as to whether the present or any Secretary or anyone else has the ability to foresee unreasonable or unwarranted changes in the price of any commodity, or that the Secretary can adequately define "excessive speculation."

This bill would give massive price-setting powers to one man. It is said that these powers would only be used in case of a national emergency. As I understand it, we have already established procedures for price controls during national emergencies, and those procedures clearly do not delegate the authority to declare such an emergency to the Secretary of Agriculture. I see no legitimate reason to change now. Thank you again for giving me this opportunity to express my views on this bill.

STATEMENT OF HON. BEN REIFEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH DAKOTA

Mr. Chairman and members of the committee, as a former member of this distinguished committee, I appreciate this opportunity to submit testimony on a measure of some concern to my State in the heart of the grain-producing region of the country.

A number of my constituents have contacted me to protest the scope of the authority granted the Secretary of Agriculture in the bill now before the committee, H.R. 11788, to amend the Commodity Exchange Act.

The sweeping changes embodied in this bill would, if enacted into law, give the Secretary of Agriculture power to set margins, prescribe contract market rules, and otherwise impose virtual one-man rule over our free marketing system in commodities.

It is my understanding, Mr. Chairman, that this proposal arose as a result of criticism from the General Accounting Office for an allegedly inadequate job of policing the commodity markets.

Undoubtedly there are procedures in commodity trading which need strengthening for greater public protection. But to lodge in one man the powers contemplated in this legislation would be going too far. The Secretary would become a virtual czar over the Nation's futures and cash markets. He could crack down even on individuals who have violated no regulation, but whom he suspects might be preparing to violate a CEA order or regulation. To my way of thinking, no man deserves such powers which exceed even those of the courts.

For example, say South Dakota elevators are paying an average price of \$1.50 per bushel for good wheat. The grain dealer puts up an additional margin of 6 cents a bushel to hedge or insure it against a market decline.

Thus, the total investment in that wheat is about \$1.56 a bushel.

But if the Secretary of Agriculture had the force of this legislation behind him, he could and very well might increase contract margins to \$1 per bushel. That would mean an investment of \$2.50 a bushel—far more than its market value. Small dealers would use up their bank credit pretty fast under such conditions. The result would be that only those largest and most wealthy dealers would be in the grain-buying business.

The grain trade is not opposed to reforms as such. I am assured that members of the Minneapolis Grain Exchange, for example, would support most if not

all of the objectives this legislation sets out to achieve, as well as the objections that have been lodged to the means of achieving those ends.

Before we set out to enact sweeping legislation of this nature, it does seem to me it would be preferable to have representatives of Government and of the grain trade sit down at the conference table and work out any problems involving the public interest. Should problems of a real and substantive nature be pinpointed without amicable solution, that would be the time for corrective legislation.

In the meantime, the Department might also take a look at its existing tools for regulation and the way in which they have been administered. The sting of GAO criticism is no justification for a sweeping measure like this which could give an unwise administrator, 5 or 10 or 20 years from now, the power to stifle free market forces, eliminate small grain buyers and generally exert one-man rule over the Nation's futures and cash markets.

STATEMENT OF AMERICAN MEAT INSTITUTE

Members of the American Meat Institute, trade association of the meatpacking industry, have recently given some careful study to H.R. 11788, a bill to amend the Commodity Exchange Act, and wish to take the opportunity, through the institute, to register some views about this proposed legislation.

The act in its present form applies to lard and tallow, products of the meatpacking industry. The proposed legislation would give the Secretary of Agriculture authority to designate as a commodity subject to the act any agricultural commodity or product or byproduct thereof simply by finding that transactions involving sales for future delivery of such commodity, product or byproduct were conducted on a board of trade or subject to the rules of a board of trade, and that designation was necessary to effectuate the purposes of the act. Consequently, the Secretary if this bill were enacted would have the authority to bring under the provisions of the Commodity Exchange Act additional products of the livestock and meat industry that are traded on exchanges. At the present time this would include live cattle, dressed beef, hides, live hogs, pork bellies, and hams. Other products of the industry probably would be added at a later time.

While we do not see any particular objection to having futures trading in meat products regulated in the same manner that other commodity trading has been regulated, we would be most concerned if products of our industry were made subject to the type of control that apparently is contemplated by the proposed legislation.

One of our principal concerns about the bill is the amount of discretionary authority it would grant to the Secretary of Agriculture. All of the authority and functions heretofore lodged in the Commodity Exchange Commission would be granted to the Secretary of Agriculture, and the right now reserved by Congress to determine what products should be regulated under the act also would be delegated to the Secretary. It is our view that the public interest would be best served by preserving the Commodity Exchange Commission, which consists of the Secretary of Agriculture, the Secretary of Commerce and the Attorney General. Certainly the regulation of commodity exchanges involves considerations that cut across departmental lines, and we consider it undesirable to place all authority in the hands of one person. This is particularly true when one considers the type of authority that would be granted if this bill were to become law. To state it another way, the regulation contemplated by the legislation is unnecessarily severe and could destroy commodity markets as a hedging medium. But to turn all authority over to one man would make him the czar of the Nation's futures and cash markets if the authority were as extensive as set forth in this bill. We think there is considerable merit to continuing the procedure involving congressional review before additional products are placed under regulation. We say this for the reason that the authority to regulate trading in agricultural commodities to a large extent involves the power to control prices. For example, the rules under which trading is conducted may encourage or discourage speculation, and exercise an upward or a downward pressure on the market. Even though it might be thought that some control over speculation is desirable, it is doubtful that complete authority should be placed in the hands of one person. We suggest that Congress not surrender any of its prerogatives in this area without some very good reasons being advanced by the Secretary of Agriculture.

Going to Section 1(d) of the bill, we should like to call attention to the definition of the term "manipulate." "Manipulate" is defined to mean "the exacting, causing, or maintaining of an abnormal or artificial price by any action or course of action which raises, depresses, fixes, pegs, or stabilizes the price at or to a level different than that which would otherwise prevail." The section goes on to state: "Any such exacting, causing, or maintaining of an abnormal or artificial price shall constitute manipulation irrespective of any acts or omissions by the holders of futures contracts adversely affected thereby." Elementary economics teaches that price in the marketplace is established by all the transactions of purchase and sale. Every transaction is presumed to have some effect, slight though it may be, and every transaction might well have the effect of establishing a price that otherwise would not prevail. What under the circumstances would determine whether a price was "abnormal" or "artificial"? It would appear that this would be within the discretionary authority of the Secretary to determine, for sections 13, 20, and 21 describe actions the Secretary might take, if manipulation were taking place or the Secretary had reason to believe that manipulation was taking place or being attempted. Moreover, section 28 of the bill would make it a felony, punishable by a fine of not more than \$10,000 or 5 years imprisonment, or both, to manipulate or attempt to manipulate. We suggest that the offense is not sufficiently well defined in the bill to provide a reasonable standard for determining guilt or innocence and hence the provision may be unconstitutionally vague. Whether or not it might subsequently turn out to be valid, we believe it extremely unwise to enact legislation that would provide persons affected with such an unsatisfactory guide as to the conduct expected of them and would place a Government official in the position of taking drastic action if in his sole judgment there was a violation.

The definition of manipulation assumes considerable importance when it is read in conjunction with the grant of authority that would be provided by section 13 of the bill, which would add a new section 4j to the act. This section would authorize the Secretary to prescribe minimum margins in connection with speculative or hedging positions whenever the Secretary had reason to believe that there was danger of manipulation, sudden or unreasonable fluctuations or unwarranted price changes, or excessive speculation, or any other activity expected to restrain trade. In view of the uncertainty of the language used in this section, together with uncertainty in the definition of manipulation, it would appear that the Secretary would have the power to impose margin requirements at any time he in his sole judgment might determine it was a desirable course of action. Historically, margin requirements of exchanges have been for the purpose of guaranteeing performance of contracts and to provide a measure of protection to members of the exchange. However, in the hands of the Secretary of Agriculture, the authority that would be granted by this bill would be an extremely powerful tool for controlling prices of agricultural commodities. If Congress should determine that price control of such commodities is needed—and it is our opinion that it is not needed—then the issue should be faced up to squarely and Congress should determine how the controlling is to be done. We cannot see the wisdom of placing in the hands of an administrative official the power to control prices under such conditions and to such an extent as he might feel was justified.

Your consideration of these views will be greatly appreciated.

STATEMENT OF P. LORING REED, JR., PRESIDENT OF THE BOSTON WOOL TRADE ASSOCIATION

We are grateful for the opportunity to present our views on H.R. 11788, a bill to amend the Commodity Exchange Act, as amended.

The Boston Wool Trade Association of which I am president, and the National Association of Wool Manufacturers, which strongly supports this statement, represent virtually all persons actively engaged in the wool and wool textile business who make use of the wool and wool top futures market.

This exchange has performed a valuable service for our industry through the years. By facilitating the orderly marketing of wool and wool top and lending a measure of stability to the market, it has in our judgment benefited substantially the wool grower, the wool dealer, and the wool manufacturer.

The exchange has worked to the satisfaction of the industry under existing laws and regulations, and we are unaware of any abuses which have occurred that have not been taken care of under the disciplinary rules of the exchange.

Against this background we shall point out a number of features of the pending legislation which in our opinion would if enacted contribute nothing to the improvement of the operations of the market and which we believe would unnecessarily broaden Government control over the market.

The principal features to which we take exception are the following:

1. The Commodity Exchange Commission, composed of the Secretary of Agriculture, Attorney General, and the Secretary of Commerce, would be eliminated. The Agriculture Secretary would be given the Commission's present authority to (a) establish speculative trading limits, (b) suspend or revoke the designation of a contract market and issue cease and desist orders against such market or its officials, after hearing, for violations of the act, (c) hold hearings to determine whether a board of trade should be denied designation as a contract market, and (d) pass on denial by a contract market of membership privileges to a cooperative.

2. The Secretary of Agriculture would also be given authority:

(a) To set margin requirements whenever he finds there is reason to believe there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in prices, excessive speculation, etc.

(b) To designate additional commodities to be subject to the act whenever he determines it is necessary to do so to prevent acts or practices of the kind prohibited by the act.

(c) To prescribe contract market rules which shall prevail with respect to the conditions of sale on such markets when he finds it necessary to effectuate the provisions of the act.

(d) To issue cease and desist orders against individuals for violations of the act.

(e) To establish minimum financial requirements which must be met by futures commission merchant registrants.

3. The bill would define price manipulation as being the causing or maintenance of an abnormal price by any action or course of action which results in a price different from that which would otherwise prevail.

4. The bill, by changing the applicable rule of evidence, would render it more difficult to obtain reversal by Federal courts of quasi-judicial decisions rendered by officials of the Agriculture Department.

It is our conviction that the foregoing provisions of the bill would, if enacted, have a detrimental effect on the operation of the market. Viewed from the standpoint of wool and wool top futures we see no justification for the enactment of any legislation containing these proposed amendments to the Commodity Exchange Act.

We stand ready, however, to meet and discuss with this committee, the Commodity Exchange Commission, or any of its members, at any time, any matters which in their view are problems requiring correction.

STATEMENT BY C. L. MAST, JR., PRESIDENT, THE MILLERS' NATIONAL FEDERATION

The basic purpose of this bill is to amend and strengthen the Commodity Exchange Act, as amended.

The flour milling industry of the united States processed approximately 575 million bushels of wheat into flour in 1965. The members of the Millers' National Federation operate approximately 85 percent of the milling capacity of this country.

As large processors of wheat, we make extensive use of the hedging opportunities made available through trading in wheat futures on the Chicago, Kansas City, and Minneapolis contract markets. The availability and use of option markets in which to hedge wheat and flour purchases and sales contribute to continued low costs in the marketing and processing of wheat.

We believe in effective regulation of the commodity futures markets and it is entirely proper that the rules and regulations and procedures for their enforcement be reviewed by the Congress. We want to see the commodity contract markets grow and to have their regulation and supervision such as to inspire confidence on the part of all who use them or might use them in the future.

We will not attempt to discuss each of the proposed amendments to the Commodity Exchange Act. This can be done more effectively and appropriately by representatives of the contract markets and grain trade organizations. A number of the proposed amendments appear to us to be desirable or at least not objectionable. We will, however, call attention to certain proposed amendments which, we believe, pose a serious threat to the continued functioning of commodity contract markets and the low-cost hedging arrangements presently available to flour millers through these markets.

We believe the proposed definition of "manipulate" (sec. 2 (a) of the Commodity Exchange Act) is too all-inclusive and poses an unreasonable threat to users of futures markets. Intent to manipulate should in all fairness be incorporated in the definition. Under the proposed definition a flour miller with the best of intentions and carrying out large hedging operations in the normal course of his flour milling operations might be charged with causing abnormal prices and faced with the criminal penalties provided by the act.

We oppose granting to the Secretary of Agriculture the power to establish the minimum margins which should be required of traders in the commodity markets whenever he has reason to believe that there is danger of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity, etc. The sole function of trading margins in the commodity markets has been, and we believe should continue to be, to insure the carrying out of the contracts entered into. They are in the nature of a performance bond or earnest money. They are not a credit instrument or part payment of an asset to which title is being transferred. When transfer of title takes place pursuant to a futures contract, immediate and complete cash payment is required.

We believe it not appropriate to grant the Secretary powers to increase margins or issue cease-and-desist orders on the assumption that he can detect possible manipulation or restraint of trade, or excessive speculation, or unwarranted price change at an incipient stage. The penalties for such violations can appropriately be invoked only after the fact. The markets should be given every opportunity and encouragement to perform properly rather than being subjected to governmental restraints prior to the expiration of an option contract. Open competition and free entry to the market on the part of those having contrary views are the best antidote for manipulation or other attempted or alleged trading evils.

Increasing minimum margins in connection with commodity futures contracts is not an appropriate method of controlling prices or preventing inflation or deflation. The effect may well be just the opposite of that desired and intended. Futures trading can be a useful adjunct to cash trading and commodity processing operations but futures prices do not control cash prices. Futures trading could be throttled by unwise governmental intervention but this would not limit cash market fluctuations or halt processing operations. A sudden increase in futures trading margins on wheat by Government action might well have the effect of increasing costs of marketing and processing wheat and precipitating a sharp advance in the cash price of wheat and wheat products.

Margin requirements established by the governing bodies of the contract markets generally have been adequate to fulfill their purpose of guaranteeing performance without unduly restricting trading. No jurisdictional change in the establishment of minimum margins is called for and attempts to use margin control as a means of preventing inflation manipulation, or other evils are likely to prove futile and tend to jeopardize the performance of their true purpose. Such action would almost certainly reduce speculative trading and as speculative trading declined, the market would become less fluid and lose to a degree its value as a hedging medium. We urge the deletion of section 13 of H.R. 11788.

Section 16(b) of H.R. 11788 would grant to the Secretary power to prescribe and enforce "such bylaws, rules and regulations, and resolutions relating to margin requirements, and the form and manner of execution of purchases and sales of any commodity, in interstate commerce, or for future delivery * * *." This appears to be an almost unlimited grant of authority to regulate both cash and futures trading in agricultural commodities.

Under existing law, the rules of designated contract markets and any proposed changes in these rules must be submitted to the Secretary for his examination and will not become effective if he disapproves.

The rules of the contract markets generally are adopted or changed by the membership of those markets. Under existing procedures rule changes are made generally only when the necessities of trade require change.

We believe the present provisions of law relating to the adoption and revision of trading rules are appropriate and adequate, and we oppose the grant of authority contained in section 16(b) of the pending bill.

STATEMENT OF PERRY E. MOORE, MEMBER OF THE FIRM OF ROBERT MOORE & Co.

My name is Perry E. Moore. I am a member of the firm of Robert Moore & Co., commission merchants of New York City. Having testified before the Committee on Agriculture and Forestry of the U.S. Senate in 1936 and before the Senate Banking and Currency Committee in 1950, on the subject of the Commodity Exchange Act, I list below my reasons for opposing H.R. 11788.

I am opposed to H.R. 11788 because it transfers powers that belong to Congress, to the administrative branch of the Government. It also increases the bureaucratic power of the CEA and gives them the status of prosecutor, judge and jury. The following are exceptionally obnoxious.

Section 2. Congress should decide whether additional commodities should be regulated. Otherwise the CEA could multiply its activity in unnecessary fields, thus increasing its cost to the taxpayers.

Sections 3, 5 and 22. Transfers powers from a commission carefully designated by an earlier Congress to an administrative bureau.

Section 9. Any amendment which would interfere with the present relationship between the clearing member and the clearing association beyond what is already required; i.e., complete segregation of funds that belong to customers and those funds belonging to clearing member, would completely hamper the functions of any clearing association. To legislate otherwise opens the door for a legal maneuver by a customer unknown to the clearing association, who could completely restrict the functioning of the clearing association.

Sections 10 and 25. An exchange is better able to establish minimum financial requirements of its futures commission merchant registrants. The Secretary, to "play safe" and avoid any criticism, could penalize present or potential small commission merchants to the advantage of the large ones.

Section 12. It was the intent of Congress that wrote the Commodity Exchange Act, that cash transactions should not be involved in regulations covering futures trading.

Sections 15 and 16. Give the CEA czar-like control of the functioning of the exchange and dictatorial powers of their trading rules without regard to trade practices.

Section 19(a). This is another prosecutor, judge, and jury power given to the Secretary of Agriculture.

Sections 20, 21, and 28. Fear of CEA definition of "manipulation" and "cornering." Unless carefully spelled out, businessmen are under a threat of felonies in which no one wants to become involved. In the CEA definition of "manipulate" they want to disregard, as they did in the *Volkart* case, the "weight of evidence" and substitute their idea—"substantial evidence." The Circuit Court of Appeals would not accept their idea and now they are trying to get Congress to substantiate their position. Why?

Section 13. Has been opposed by the exchanges ever since the CEA was originally written. I quote where I opposed this legislation:

Before the Senate Banking and Currency Committee I testified on July 27, 1950, regarding S. 3936, as follows:

"If section 411 is enacted as it is now, and the present international situation continues, undoubtedly the Government is likely to raise margins substantially in all commodities. Our experience is that the power in the hands of the Government is likely to be used. If the margin required for futures cotton trading is high enough to drive speculation out of the market, the only ones in the market are likely to be those who wish to hedge, and possibly a few well-financed speculators. If there is any substantial quantity of cotton to be hedged, the speculative interest will probably not be sufficient to absorb it. If this situa-

tion comes to pass, the cotton exchanges will have lost the primary reason for their existence and their usefulness will be nullified—to the detriment of the entire cotton industry, including the cotton farmer. * * * I would like to point out that this proposed section 411 is not new. If you will examine the Barkley bill to regulate the exchanges, which was introduced in Congress in 1948, you will find it almost identical with section 411. The only change is that the power in the Barkley bill would have been given to the Secretary of Agriculture. Now it would be given to the President. The Barkley bill and similar measures have been carefully considered by the Senate Agriculture and House Agriculture Committees, and they have failed to approve these bills. Now, under the guise of war-time emergency, this authority is sought again. In our opinion it reflects the attempt on the part of certain forces to extend Government power over our economic system. It is not needed and will do little to check any inflationary forces that are present in our economy.

"I might remind you that the congressional Joint Committee on the Economic Report considered in 1947 the proposal to extend Government power over the commodity exchanges and failed to recommend the passage of such proposals. In this connection, I would like to read you a paragraph from the 1947 report of the joint committee: 'The committee and two of its subcommittees have heard considerable testimony on speculative trading in commodity futures. Experienced and responsible witnesses, including representatives of the administration, the grain trade, and the milling industries, agree on the importance of maintaining efficiently functioning hedging markets, and on the fact that commodity speculators as a body, perform a useful economic service in this connection.'

"The proposed authority to regulate margins for trading on the exchanges is not needed, would not halt prices, or curb inflation, and easily could result in unwarranted prices increases for agricultural commodities. It represents an unnecessary interference with the functioning of free enterprise. * * *"

Again, before the textile section of the New York Board of Trade, Inc., on May 16, 1951, I made the following statement and quoted from the New York Times' editorial of October 17, 1947: "* * * But an even greater source of concern is that Mr. Truman, instead of facing the realities of the situation, still stressed 'gambling' in the commodity markets as the major factor behind the rise in food prices. It seems to us that it is time for some plain speaking about this issue of 'gambling' * * * it would be infinitely more unfortunate and more costly to perpetuate the error (raising margins) by attempting to keep alive the fiction that speculation is the root of the Nation's food-price troubles. * * *"

"I agree that the time has come for some plain speaking about the efforts to blame speculation for the results of distorted versions of economics. We know that any arbitrary increase in margin requirements is a device which penalizes the innocent along with the guilty, reduces trading volume, and destroys the breadth and liquidity of the exchange markets at the very time when these characteristics are most needed to prevent violent and disastrous fluctuations.

"In this enlightened day of commercial history, it is no longer wise to advocate the abolishing of the commodity markets, so critics take the around-about-way and condemn 'excessive speculation.' Of course, that provides that vagueness so essential to political attack. No one can say when the speculation necessary to a liquid market ends and the so-called 'excess' speculation begins. We do know one thing. The power of the Federal Government to step in and arbitrarily fix margins, perhaps without advance warning to the trade and without economic justification, would keep the markets in a continuous state of suspense. It might even make futures trading impracticable. It has happened.

"Those of use who are concerned with free markets, face a great responsibility. We must not only spread the advantages of these markets so important to our American economy, but we must also point out the fallacy of economic tinkering. There are those who do not realize that they are being made the victims of the oldest shell game in the history of civilization—curing planned inflations."

If Congress gives the CEA the right to control margins, they give this Government agency the right to control prices and destroy the functions of the private enterprise system.

STATEMENT OF DON F. MAGDANZ, EXECUTIVE SECRETARY-TREASURER, AND B. H. JONES, ASSOCIATE SECRETARY-TREASURER, NATIONAL LIVESTOCK FEEDERS ASSOCIATION

The National Livestock Feeders Association is a voluntary, nonprofit nonpolitical trade organization of persons engaged in the business of feeding and finishing livestock for the slaughter market. Membership exists in 23 States, with major concentration in the North-Central States. There are nearly 100 State and local livestock feeders associations affiliated with the National Association.

STATEMENT

The National Livestock Feeders Association favors the amending of the Commodity Exchange Act to extend its coverage to red meat animals and the commodities, products and byproducts derived therefrom; to provide additional protection for custodial funds; to set forth limited authority to seek injunctions; to allow for the issuance of cease and desist orders for minor violations; and other enforcement authority necessary to prevent violations of the act.

However, the association is not in agreement with giving the administrator of the act unlimited authority as set down in H.R. 11788, with respect to the setting of margins, the form and manner of executing purchases and sales, the suspension of entire "contract markets," and the like.

Extending coverage of act to other commodities and products

Under the official policy adopted by the membership, the association has taken the position that necessary legislative changes should be made to extend the coverage of the Commodity Exchange Act to include livestock and meat and the products and byproducts derived therefrom. However, we question the language used in the proposed legislation to accomplish this end and recommend it be changed to merely state that the act shall apply to all agricultural or forest commodities, products, and byproducts traded on a commercial exchange(s). We see no need to give the administrator of the act "exemption" authority—or said another way, the authority to determine which commodities and products are supervised and which are not. In fact, we deem such discretionary authority to be undesirable.

Bill grants broad authority

In general, the language of the proposed legislation would grant far-reaching authority to the Secretary of Agriculture, without establishing proper guidelines and limits of authority which should be prescribed by the Congress. This is true in several highly important areas, such as, the setting of margins, the form and manner of executing purchases and sales, the definition of what constitutes manipulation, and the like.

In making these statements, we do not mean to infer that authority should not be given to proceed against those persons or firms who violate the act. Such authority should very definitely exist in cases where said practices are inflicting, or are likely to inflict, irreparable damages to others or to the price structure. The authority granted by H.R. 11788, in its present form, however, would allow the administrator to assume a very dictatorial position even in operational areas which, we feel, should be left primarily to the professional judgment of the exchanges.

Setting of margin requirements

These proposed provisions would give unprecedented power; and we question that the judgment of an administrative official(s) is more adequate or correct, in this connection, than the judgment of the board of governors of a given exchange.

Furthermore, the language of the bill seems to imply a function of margins which we doubt exists to any real degree in commodity trading; namely, that of being an effective control against "manipulation, sudden or unreasonable fluctuations or unwarranted changes in price." Unfortunately, there is a tendency to confuse the function of margins in the case of commodities with those for security markets. The margin in the commodity markets is for the purpose of guarantee-

ing the performance of the contract; whereas, in the case of securities, the margin is the owner's equity or payment to hold title.

Suspension of boards of trade

The suspension of a major board of trade (an entire market) could bring serious repercussions; therefore, any statutory provisions for same should receive serious scrutiny before being put into effect.

Other avenues of enforcement which can be effected against any "contract market" and its officers, or persons operating thereon, should preclude the need to suspend an entire market.

Form and manner of execution of purchases and sales

We doubt the advisability of giving the administrator of the act unlimited authority in this operational area.

Handling of custodial funds

The association fully supports the provisions of H.R. 11788 (p. 6, lines 8-18), aimed at providing additional protection for accounts for which brokerage firms have custodial responsibilities. Preventing misuse of said funds by not allowing them to be treated as the property of any person other than the customer, as provided, is highly desirable.

Authority to seek injunctions

Experience in the (cash) livestock markets evidences the need for regulatory administrators to be given this type of authority to effectively cope with given situations, particularly those of financial inability. However, in our opinion, such recourse should be limited to cases in which irreparable injury is being, or is likely to be, inflicted on other parties, rather than extending the authority to include all violations of the act.

Issuance of cease-and-desist orders

Experience in the (cash) livestock markets has led us to the conclusion that to issue cease-and-desist orders for serious offenses is comparable to "spanking a boy with an empty paper bag." Such enforcement procedure for serious violations amounts to issuing an open invitation to those being supervised "to violate the act until we catch you; then we'll tell you to stop; and if you violate the stop order, we'll then throw the book at you."

It is our position, therefore, that cease-and-desist orders should be considered adequate punishment only in cases involving offenses which are relatively minor. There is nothing wrong in putting teeth in the enforcement provisions of such orders, since the person against whom it is directed has had the advantage of a hearing and has the right of appeal to the courts: on the other hand, if used for minor violations only, the penalties for failure to obey or comply contained in H.R. 11788 (p. 16) would seem to be more severe than warranted.

Additional comments on association policy

With respect to "contract markets," our membership has resolved: "In the interest of avoiding confusion in connection with contract specifications and trading rules, maintaining liquidity in the market and yet not hampering the healthy competition among markets, the NLFA takes the following positions:

- (1) That no specie or class of livestock or carcass or meat cut be traded on more than one commodity exchange in a given city;
- (2) That trading in more than the few major exchanges in the Nation be discouraged; and
- (3) That contract specifications and trading rules be uniform among all exchanges trading a given commodity."

We are not suggesting that the above "requirements," as set down, should be written into legislation. In fact, in our opinion, to do so would constitute undue and unjustifiable extension of regulatory authority. However, we do feel they warrant serious consideration by commodity exchange officials, commodity brokers, and by legislators in developing legislative history in connection with legislation in this area.

O. A. COOPER Co.,
Humboldt, Nebr., March 26, 1966.

HON. SPARK M. MATSUNAGA,
*Chairman, Marketing Subcommittee of House Committee on Agriculture,
House Office Building, Washington, D.C.*

DEAR CONGRESSMAN: It is my understanding that hearings will be held March 28 through April 1 on H.R. 11788, a proposed statute dealing with the operations of commodity futures markets.

As a businessman in an industry that deals with and depends upon commodity futures markets (particularly the grain markets) I would like to point out the dangers that are inherent in granting such broad discretionary powers to the Secretary of Agriculture.

The commodity markets are well regulated and have developed over a period of many years to meet the needs of many businesses of varied and complex types. If there are any imperfections in the general system, they can be dealt with under existing regulations. To change the entire setup and make the commodity markets subject to the decisions of the Secretary of Agriculture would jeopardize the interests of entire industries and a vast number of individuals dependent upon these industries.

We have had Agriculture Secretaries in the past who have ardently espoused personal convictions that were not in harmony with the interests of industry at large. Our present Secretary of Agriculture is a man of great ability and talent, yet even he seems at times to be endowed with too much confidence in the infallibility of his research and decisions. One example is his ramming the controversial sedimentation test on wheat down the throats of the grain and milling industry, despite their vigorous and well-considered objections. He was proven to be wrong and the requirement that the sedimentation test be used on wheat transactions was canceled after a couple of years of highly unsatisfactory performance.

To make the entire operation of the commodity futures markets subject to any Secretary of Agriculture alone could really wreck havoc with our general economy under certain circumstances—and they could happen!

If I may inject a personal note, Mr. Matsunaga, my wife and I had our first personal acquaintance with your good State a few weeks ago—2 weeks spent in those delightful islands was just enough to whet our appetites for many return visits.

Cordially yours,

CHAS. H. JOHNSON, *Secretary.*

BIRDSEY FLOUR & FEED MILLS.
Macon, Ga., March 28, 1966.

HON. SPARK M. MATSUNAGA,
*House of Representatives,
Washington, D.C.*

DEAR MR. MATSUNAGA: I would like to express on behalf of my company our opposition to H.R. 11788 which would amend the Commodity Exchange Act.

We find the futures markets as they presently exist to be useful, in fact almost indispensable, in the daily operation of our business which consists of both flour and feed manufacturing operations. We use the futures markets as a hedging medium and as a realistic guide to values of basic agricultural commodities.

Speaking generally, we believe that the Department of Agriculture already exerts too great an influence on the prices of basic agricultural commodities through its various acreage and production control programs. (This is in no way to minimize or detract from the great value of the Department's many crop and outlook reports, which provide needed information on prospective supplies). We would greatly prefer to see the Department withdraw from active price influencing activities of basic commodities. We feel that to authorize the Secretary to set margin requirements for futures trading, to designate what commodities would and would not be subject to the Act, to prescribe contract market rules, to issue cease-and-desist orders against individuals, to establish

financial requirements for futures commission merchant registration, and other powers that would be granted, would give too much power to the Secretary.

We hope that you will not see fit to report favorably on H.R. 11788.

Yours very truly,

R. T. BIRDSEY, *President.*

BOONE GRAIN & SEED CO., INC.,
Lebanon, Ind., March 28, 1966.

Re proposed amendment to Commodity Exchange Act.

MR. SPARK M. MATSUNAGA,
Representative of Hawaii, Congress of the United States,
Washington, D.C.

DEAR REPRESENTATIVE MATSUNAGA: Our experience of living with Federal controls and final results have been both plus and minus, but by far, more minus for us and our customers out here on the firing line.

The commodity market, as it is, gives our overall economy the flexibility to keep it healthy, under the safeguards of the regulations of framework under which it works. Regardless of the sincerity of anyone person to always act in the interest of the Nation as a whole, he cannot have the total facts, or know the resultant impact of the results of the edict he may issue. Leadership is most necessary, but it can only be true leadership when the freedom of the people is left freedom to act. Today, we hedge, in the commodity market, our operation or grain—of what value would this hedge be if at anytime the Secretary of Agriculture should freeze the exchange, or have the power of limitations?

Please, for many more reasons than I have mentioned, help us keep what we have left of a free competitive system in our fine Nation, by declining the Agriculture Department's request of the proposed amendment.

Respectfully,

A. L. DORAN.

NEBRASKA CONSOLIDATED MILLS CO.,
Omaha, Nebr., March 28, 1966.

HON. SPARK M. MATSUNAGA,
House of Representatives, Washington, D.C.

DEAR CONGRESSMAN MATSUNAGA: It is my understanding that public hearings are being held on H.R. 11788 from March 28 through April 1 by the Marketing Subcommittee of the House Committee on Agriculture. Since you are a member of this committee, I want to express to you my personal viewpoint regarding the operations of commodity futures markets.

It is undoubtedly true that under the direction of the Commodity Exchange Authority, there have been some abuses of the public interest in the various commodity futures markets. However, in my opinion, the CEA has always acted promptly to correct these abuses and has done so with speed, dispatch, and efficiency. Furthermore, when one considers the tremendous volume of transactions taking place on these markets, it is noteworthy that there have been very few abuses. One very good reason for this is that the exchanges upon which these transactions take place have themselves protected the public interest very effectively.

Our company engages in hedging transactions on the Chicago Board of Trade, the Kansas City Board of Trade, and the Minneapolis Grain Exchange within the futures markets traded on those exchanges. We have always felt that our interests and the interests of those whom we trade with have been very well protected by the exchanges. In addition, the public interest has been zealously guarded by them. For this reason, we feel that the status quo is a very good modus operandi and should be left just as it is.

We further object to placing responsibility for regulating these commodity exchanges with the Secretary of Agriculture since this individual is also the head of the Commodity Credit Corporation, which is the largest buyer and seller of commodities in the United States. We feel that it is inevitable that a conflict of interest would arise for this individual because of this dual responsibility at some future date.

I am reviewing the progress of this bill with a great deal of interest and hope that you will see fit to let it die in committee. Thank you very much for your attention.

Yours truly,

J. ALLAN MACTIER, *President.*

BISMARCK, N. DAK., *March 31, 1966.*

HON. SPARK M. MATSUNAGA,
House Office Building, Washington, D.C.:

Our State wheat commission believes the proposed amendment to the Commodity Exchange Act is unnecessary and support the statement of Great Plains Wheat, Inc.

PAUL E. R. ABRAHAMSON,
Administrator, North Dakota State Wheat Commission.

NORTH AMERICAN EXPORT GRAIN ASSOCIATION, INC.
New York, N.Y., March 31, 1966

HON. SPARK M. MATSUNAGA,
*Chairman, Special Subcommittee on Domestic Marketing and Consumer Relations,
House Committee on Agriculture, Washington, D.C.*

DEAR CONGRESSMAN MATSUNAGA: The North American Export Grain Association is made up of firms which account for virtually all export sales of grain from U.S. ports on the gulf, east coast, and Great Lakes. Because of the importance futures trading plays in this commerce, we are greatly concerned about proposed amendments to the Commodity Exchange Act (H.R. 11788) now under study by your committee.

The characteristics which distinguish export sales from others are the enormous size of individual transactions and the narrow margins earned by exporters.

The recent pattern of grain sales to India illustrates our point. Recently India has been buying about $\frac{1}{2}$ million tons of wheat (18 million bushels) at a flat price for delivery each month. It is not unusual for a single exporter to sell as much as 150,000 tons of wheat to India in a single night.

Because of the amounts involved and the nature of the trade, it is almost impossible to arrange back-to-back purchases of cash wheat in the domestic market and export sales. For this reason, in these transactions, exporters almost invariably find themselves long cash wheat in anticipation of a sale, short cash wheat after a sale has been made and until they can cover, or both. To reduce price risks involved to levels consistent with the narrow margins exporters earn in these trades, substantial futures transactions are necessary. To accommodate these hedges, a large amount of trade on both the long and short side of the futures market by producers, hedgers, merchandisers and speculators is necessary. As grain exports from this country increase, as they seem certain to in the years ahead, this need will grow.

We are concerned that the proposed amendments to the Commodity Exchange Act will discourage use of futures markets by producers, hedgers, merchandisers and speculators, with a resulting increase in the price risk and, therefore, the cost of export sales. Reference to two provisions of the bill will illustrate the problem:

(1) Under the bill, "manipulation" would be defined as any action "which raises, depresses, fixes, pegs or stabilizes the price at or to a level different than that which would otherwise prevail." Since the large hedging transactions associated with exports, particularly in futures markets with inadequate speculation, almost invariably affect price, under this definition exporters would be continuously exposed to the threat of an action by the Secretary under the act. This would be an unacceptable risk in view of other proposed changes involving the burden of proof on appeal from the Secretary's orders and increased penalties for violations.

(2) The bill proposes to permit the Secretary to establish minimum margin requirements under a number of different circumstances. While we question that the purposes for which this authority is requested could be accomplished through the use of margin controls, we are more concerned that the use of margins for purposes other than assuring performance will discourage trade.

We have already noted that if futures markets are to accommodate the growing volume of export trade, we must have more, not less, futures activities by all segments of the trade. Therefore, the use of margins to control suspected manipulation, price changes the Secretary feels are undesirable, or excessive speculation, would clearly limit the role futures markets must play in this expanding trade. Furthermore, the language of the proposed bill is broad and general, without specific groundrules or guidelines to limit any arbitrary action the Secretary might wish to take at any time.

For the foregoing reasons, we urge your committee to consider these amendments carefully and to reject those which seem certain to do more harm than good. We also request that this letter be included in the record of your hearings.

Sincerely,

H. P. HIGGINS, Jr.,
Executive Vice President.

ARCHER DANIELS MIDLAND CO.,
Minneapolis, Minn., April 4, 1966.

HON. SPARK M. MATSUNAGA,

Chairman, Domestic Marketing and Consumer Relations Subcommittee, Committee on Agriculture, House of Representatives, Washington, D.C.

MY DEAR CONGRESSMAN: It is requested that this statement be considered in connection with hearings on H.R. 11788 and incorporated in the record of the hearings thereon.

Archer Daniels Midland Co. with headquarters in Minneapolis, Minn. operates grain elevators, flour mills, soybean processing plants, and other agricultural enterprises throughout the United States. As grain storers and merchandisers and as flour millers and soybean processors, we make extensive use of the hedging arrangements available through futures trading on the Chicago Board of Trade, the Kansas City Board of Trade, and the Minneapolis Grain Exchange, on which we hold memberships. We are also members of the National Grain Trade Council, the Grain and Feed Dealers National Association, the Millers National Federation, and the National Soybean Processors Association. We support and endorse the statements being submitted to your committee by each of the above named organizations.

We particularly wish to stress our concern with respect to three provisions of H.R. 11788. These are the proposed definition of "manipulate", the proposed grant of authority to the Secretary of Agriculture to prescribe and enforce minimum margins, and the proposed grant of authority to the Secretary of Agriculture to prescribe and enforce by-laws, rules, regulations, and resolutions relating to margin requirements and the form and manner of execution of purchases and sales of any commodity in interstate commerce or for future delivery.

We believe "manipulate" should be defined but the proposed definition is too broad and if enacted in its present form would put every large user of futures markets in jeopardy. We believe the Congress should incorporate in the definition the element of intent and findings of various courts of law dealing with this subject.

We believe that margins on futures trading in contract markets have had, and should continue to have, but one purpose, namely to insure the carrying out of the contracts entered into. For this purpose, the governing boards of the several commodity contract markets have performed reasonably and responsibly. They should continue to have complete responsibility and jurisdiction.

We do not believe that changing minimum margins is an appropriate or an effective tool for controlling prices for commodities or preventing manipulation or excessive speculation in a commodity. Furthermore, we do not believe that the Secretary of Agriculture can at an incipient stage properly foresee and take action against dangers of manipulation, sudden or unreasonable fluctuations or unwarranted changes in the price of any commodity or excessive speculation in any commodity.

We strongly urge the deletion of section 13 of H.R. 11788.

We likewise urge the deletion of section 16(b) of H.R. 11788 which would grant to the Secretary of Agriculture power to prescribe and enforce such by-laws, rules, regulations, and resolutions relating to margin requirements and the form and manner of execution of purchases and sales of any commodity in interstate commerce or for future delivery. Under existing law the Secretary can

prevent the adoption of any rule relating to futures trading that he finds objectionable. We believe the rule-making powers of the governing bodies and memberships of the several contract markets are being exercised prudently, and that they should retain their present jurisdiction and responsibility in the promulgation of rules.

There are other provisions of H.R. 11788 which we consider unnecessary or undesirable but which we will not recount here since attention is called to them in the statements being presented by the above-named organizations.

Sincerely,

ERWIN A. OLSON,
Chairman of the Board.

NEW YORK MERCANTILE EXCHANGE,
New York, N.Y., April 6, 1966.

HON. SPARK M. MATSUNAGA,
Chairman, Special Subcommittee on Domestic Marketing and Consumer Relations, House Committee on Agriculture, Washington, D.C.

DEAR CONGRESSMAN MATSUNAGA: The New York Mercantile Exchange is a business organization chartered nearly 100 years ago in 1872, by the State of New York. For some years the exchange has been designated a contract market and our operations have been supervised by the Commodity Exchange Authority.

A board of governors manages the affairs of the exchange. I am at present the chairman of that board. I request that our view, as set forth in this letter, be incorporated in the hearings and become part of the record of those hearings on H.R. 11788.

We oppose the provisions of this bill because present regulations are perfectly efficient and have proven effective. If the CEA is to continue as an adjunct of the Department of Agriculture, we believe that present regulations, efficiently administered (and our experience is that they are indeed efficiently administered) are amply sufficient to regulate cash and futures markets. A much more importantly needed change is for more funds for the present overworked, undermanned staff of the CEA.

We believe that rather than complicate the workable regulations now in effect with unneeded and somewhat cloudy amendments, the Congress should decide, in the public interest, whether futures trading in all commodities, both agricultural and nonagricultural, should be regulated. The value of futures contract trading and its critical importance to the commerce and industry of the Nation is too great to be handicapped with makeshift and patchwork amendments. Under present regulations the CEA and the various exchanges, are perfectly competent properly to carry on this important function.

What is most emphatically and critically needed is that the Commodity Exchange Authority be given independent status similar to that of the SEC.

Practical and viable trading rules and regulations could be worked out by consultations between all exchanges and an independent and an enlarged CEA.

We respectfully submit that public confidence as well as interested industry confidence in commodity futures will be greatly enhanced and we urge that prompt steps be taken to implement these suggestions.

We sincerely thank this committee for the opportunity to make our views known.

Respectfully,

LLEWELLYN WATTS, JR.,
Chairman of the Board.

WASHINGTON, D.C., April 6, 1966.

Re H. R. 11788, a bill to amend the Commodity Exchange Act.

HON. SPARK M. MATSUNAGA,
Chairman, Subcommittee on Domestic Marketing and Consumer Relations, House of Representatives, Washington, D.C.

DEAR MR. MATSUNAGA: Although I retired as Administrator of the Commodity Exchange Authority over 10 years ago, because of my more than 30 years experience with that organization—going back to when it was the old Grain Futures Administration—and my abiding interest in futures trading, I would like to present to the committee my views on some of the more important provisions

of the bill to amend the Commodity Exchange Act, H.R. 11788. I am sorry that a temporary physical disability does not permit me to appear in person.

Perhaps the most important provision of H.R. 11788 is the one which would give the Secretary authority with respect to margins. During the almost 15 years I served as Administrator of CEA, I saw a number of occasions when feverish speculative activity should have been curbed, but we lacked authority to take any action that would do so. We could only go to the exchanges and ask them to raise margins. We had very little success. From these experiences I concluded that it is essential that the Secretary be granted this authority over margins, so that he can protect the integrity of futures prices and provide brakes which can be applied to runaway markets or to potential market "busts" occasioned by overspeculation.

Besides the margin provisions, H.R. 11788 contains a number of other features which I feel would strengthen materially the regulations of the commodity futures markets in the public interest—provisions which I wish I had had in the act I was enforcing for so many years. Some of the more significant of these are:

- (1) Authority over exchange trading rules;
- (2) Authority to designate additional commodities to be subject to the act;
- (3) Authority to establish minimum financial requirements of futures commission merchants; and
- (4) The authority for injunctions to restrain or prevent violations.

I know that many of my friends in the exchanges are opposed to a number of these proposals, but I also know that their long-run interest will best be served by effective regulation of the futures markets in the interest of all the people.

Effective regulation of the commodity markets can be obtained only through strengthening the Commodity Exchange Act. It is too much to expect of the exchanges that they regulate themselves in the public interest. Exchange members are only human and, as we all do, first look to their personal interests. This was well put by Mr. Clarence Rowland, chairman of the Chicago Board of Trade, at the annual meeting of that exchange on January 25, 1960, when he said:

"The Chicago Board of Trade is composed of such interests as farmers, brokers, speculators, processors, elevator operators, commission houses, and exporters. Each of these various segments must of necessity have divergent views. As a matter of fact, divergent views form the real heart of a speculative market since for every individual who wishes to buy there must be an individual who is willing to sell.

"With all of these varied interests and differences of opinion, it naturally follows that our members as well as other users of the market will have differing, even contradictory opinions about deliveries, margins, and commissions. *One would have to be something less than naive, however, not to recognize that many of these ideas are motivated by selfish interests.*" [Italics supplied.]

As a private citizen, with some understanding of the importance of futures trading to consumers as well as producers, I urge that your committee take favorable action on H.R. 11788.

Sincerely yours,

J. M. MEHL.

NATIONAL GRAIN TRADE COUNCIL,
Washington, D.C., April 7, 1966.

HON. SPARK M. MATSUNAGA,
Chairman, Special Subcommittee on Domestic Marketing and Consumer Relations,
House Committee on Agriculture, Washington, D.C.

DEAR MATSUNAGA: On the first day of hearings on H.R. 11788, the Commodity Exchange Authority was requested to supply for the record of those hearings information on the margin activities at grain futures markets during 1947. Because the Authority's records in this respect may be incomplete, we wish to submit for the record of hearings on the bill information available in our files.

After price control administered by OPA had expired, the true value of grains, particularly corn and wheat, were again reflected in both cash and futures transactions. The natural results of supply-demand factors brought about higher prices, and there were suggestions, from time to time, that the exchanges at Minneapolis, Chicago, and Kansas City should increase margin requirements.

The question of margins was under continuous study in that period by the boards of directors at these exchanges.

Early in 1947 it became obvious that the U.S. Government would respond to the food grain demands of countries whose economies had been impaired during World War II. At President Truman's request, former President Hoover had surveyed these demands. In this survey Dr. D. E. Fitzgerald had participated and thereafter became the executive officer of the International Emergency Food Committee. This committee was responsible for allocating supplies of wheat, corn, and other grains to recipient countries.

The Commodity Credit Corporation acted as a purchasing agent at that time for these programs. Dr. Fitzgerald's office would announced allocations for a forward period of 30, 60, or 90 days. Commodity Credit Corporation would then enter or stay out of the market on a day-to-day basis, to obtain these supplies.

In other words, during calendar 1947 and continuing as Greek-Turkish aid and the Marshall plan followed chronologically the activities of the International Emergency Food Committee, there was a substantial, but varying, demand for U.S. grains. As noted above, on the lifting of price controls, the true value of grains were being reflected once again in grain markets.

On March 14 the then Administrator of the Commodity Exchange Authority requested the Minneapolis, Kansas City, and Chicago Exchanges to increase their initial margins to at least 25 percent of the market price. The Minneapolis and Kansas City Exchanges adopted a 25 percent margin on wheat; the Chicago Board of Trade responded to this request by increasing initial margins there.

In May the Chicago Board of Trade lowered its margins and the other two exchanges thereafter followed suit.

During the summer of 1947 President Truman named a fact-finding commission, headed by the then Secretary of Commerce, W. Averill Harriman, to review the import requirements of recipient nations and the export potential for wheat of the United States.

On Monday, September 15, the Administrator of the Commodity Exchange Authority requested the grain exchanges to increase their initial margins to 33½ percent. The question of the purpose of margins became one of at least limited public debate. The directors of the grain futures markets at Minneapolis, Chicago, and Kansas City were studying this request when late on Saturday, September 27, the Harriman Commission's report was released. This was an interim report indicating that during that crop year, 1947-48, the United States could clearly export 500 million bushels of wheat. This amount was in excess of wheat. This amount was in excess of prior estimates.

This report was issued too late for publication in midwestern papers. The report, however, was published in Washington and New York papers.

On Sunday, September 28, this office communicated by telephone with officials of the three grain futures markets, advised them of the Harriman Commission's interim report, and recommended that prior to the opening of the grain markets on Monday, September 29, the board of directors of each grain futures market consider the margin requirements in view of the increased export outlook.

On Monday, September 29, before the opening of the markets that day, the directors of each of the three grain futures markets met and took concerted action to increase margins. This increase was on a sliding scale basis requiring 5 cents additional margin for each 10 cents increase in the price of wheat and corn over the closing price as of Saturday, September 27.

This action, to a large degree, responded to the September 15 request of the Administrator of the Commodity Exchange Authority.

President Truman, on the evening of October 5, in a radio address, stated that he was instructing the Commodity Exchange Commission to demand of the grain exchanges that they increase their margin requirements to at least 33½ percent. Mr. Truman further stated that if the grain exchanges did not comply, the Commission might find it necessary to limit the amount of permissible futures traded in grain.

The boards of directors of the three major exchanges immediately complied with this directive.

Some of the above information is set forth in the report of hearings before the Joint Committee on the Economic Report held as a result of President Truman's anti-inflation message of November 17, 1947. Such information as is not found there can be found in the bound volume of the Kansas City Market Review for 1947. This is a daily publication still published by the Board of Trade of Kansas City.

Respectfully,

WILLIAM F. BROOKS, *President.*

PEAVEY CO.

Minneapolis, Minn., April 11, 1966.

HON. S. M. MATSUNAGA,

Chairman, Domestic Marketing and Consumer Relations Subcommittee, House Committee on Agriculture, Washington, D.C.

MR. MATSUNAGA: We thoroughly appreciate the opportunity to add to your excellent hearing record on H.R. 11788 and to support the testimony of the Grain & Feed Dealers National Association, the National Grain Trade Council, and the Millers National Federation in opposition to that bill.

Open, public, competitive markets have one special characteristic that makes them especially valuable to the Nation.

They tell the truth about values—even when traders, or growers, or consumers, or governments may not especially want to hear it.

Firms such as ours—Peavey Co., grain merchants and flour millers—are able to serve the Nation as we do, in the efficient marketing of crops, because of these markets.

This is particularly so because of the grain futures markets. We and others couldn't begin to do the job we do for America at the very, very low cost that prevails, if it were not for liquid, freely fluctuating commodity futures. This point was well covered in the testimony of Dr. Roger Gray.

These are regulated markets. Both Federal and State Governments have played an important part in keeping the markets competitive and in providing the tools—such as good grain warehouse laws, grain standards and inspection—which marketers use.

When and if evidence indicates the need for changes in laws to further insure the open competitiveness of markets, trade interests are likely to applaud such changes. The role of Government in preserving our competitive system is well recognized.

But such proposals in H.R. 11788 as permitting the Government to write the contract rules, to set the amount of earnest money (margin) and to attempt in various ways to influence or control the prices to be disclosed in the market—these in our view would work against the public interest.

Proposals of this type of market power and others currently before Congress, represent a sharp departure from tradition. We believe there is no more reason for them to be considered now than in all the times past when the U.S. Government has been kept out of price control and market manipulation.

No government is wise enough to do the job as well or as smoothly as the combined decisions of millions of buyers and sellers can do.

The times when firms such as ours have an especially difficult time using the futures markets to help us do a low-cost job is when the markets are too thin. That is, when there is not enough trading—not enough volume.

Speculators ("risk takers") both large and small help provide a liquid market. Sometimes we hear an attempted distinction between "small" and "large" speculators, but one is just as important as the other.

This is not a situation in which someone is creating a risk—the risk is inherent in the ownership of the commodity. Somebody has to carry it and we are far better off in this country with a system in which people do this voluntarily, in open competitive contract markets.

We respectfully urge that H.R. 11788 be rejected and we certainly will co-operate in any efforts the Government wishes to make in exploring other courses of action to improve performance of futures markets in the public interest.

Sincerely,

FREDERIC N. CORRIGAN.

AMERICAN TEXTILE MANUFACTURERS INSTITUTE, INC.,

Washington, D.C., April 11, 1966.

Hon. HAROLD D. COOLEY,

*Chairman, Committee on Agriculture,**U.S. House of Representatives,**Washington, D.C.*

DEAR CHAIRMAN COOLEY: The American Textile Manufacturers Institute as the principle consumer of the domestic output of cotton quite understandably is interested in any legislation affecting the cotton economy of the Nation.

At the present time your committee has under consideration H.R. 11788, a bill designed to amend the Commodity Exchange Act. This legislation was considered by the board of directors and membership of the ATMI at its recently

held 17th annual meeting. The board of directors and general membership approved the following resolution on Saturday, March 26, 1966:

"The Domestic Marketing and Consumer Relations Subcommittee on Agriculture has scheduled hearings on H.R. 11788 on April 4, 5, and 6. This bill proposes several drastic changes in the present Commodity Exchange Act. It would abolish the Commodity Exchange Commission, composed of the Secretary of Agriculture, Attorney General, and Secretary of Commerce, and vest all the present power and authority of the Commission in the Secretary of Agriculture.

In addition, the Secretary of Agriculture would be given authority—

- (a) To set margins on all commodity future markets.
- (b) To designate additional commodities to be subject to the act.
- (c) To prescribe contract market rules to govern conditions of sale on such markets.
- (d) To issue cease-and-desist orders against individuals.
- (e) To establish minimum financial requirements which must be met by future commission merchant registrants.

In addition, the proposed bill defines "manipulation" in a manner completely unacceptable to the cotton trade and changes the "rule of evidence" presently in the act in a manner to make it more difficult for a Federal court to overturn a decision of Judicial Officer of the U.S. Department of Agriculture.

"American Textile Manufacturers Institute opposes the passage of H.R. 11788, in its present form, since it would be detrimental to the movement of U.S.-grown cotton through normal trade channels, from the producers to the consumers."

We urge the Committee on Agriculture not to approve H.R. 11788 in its present form.

Respectfully,

ROBERT C. JACKSON,
Executive Vice President.

NATIONAL COTTONSEED PRODUCTS ASSOCIATION, INC.,
Memphis, Tenn., April 12, 1966.

HON. HAROLD COOLEY,
Chairman, House Agricultural Committee,
Washington, D.C.

DEAR CONGRESSMAN COOLEY: Our members have approved the following resolution:

"Whereas the Secretary of Agriculture has asked for a broad extension of power to control commodities futures exchanges; and

"Whereas existing statutes provide adequate authority to control the operation of these exchanges: Therefore, be it

"Resolved, That we, the members of the National Cottonseed Products Association, Inc., express our opposition to any legislation which would further restrict the free and flexible operation of the futures markets, and we urge that the proposed legislation not be adopted."

Adopted May 26, 1964.

We would appreciate it if you will place this in the record of your committee hearings.

Very truly yours,

FRED H. HUSBANDS,
Executive Vice President.

HOUSE OF REPRESENTATIVES,
Washington, D.C., April 18, 1966.

HON. SPARK M. MATSUNAGA,
Subcommittee on Domestic Marketing and Consumer Relations,
Committee on Agriculture,
Washington, D.C.

DEAR MR. CHAIRMAN: I have followed with great interest the hearings of your Domestic Marketing and Consumer Relations Subcommittee on the Administration's bill, H.R. 11788, to further regulate commodity exchanges. I believe futures markets perform a necessary economic function in the United States and the international economy and I would encourage any effort to strengthen them and insure that they function properly with assurance that those who use these markets are adequately protected from those who would abuse them.

I will not discuss the specific amendments contained in H.R. 11788, which have been discussed at length by the many witnesses that have appeared before

your subcommittee. I would rather limit my comment on the bill itself to the observation that, in deciding the best type of administration for U.S. commodity exchanges, the subcommittee might consider the feasibility of delegating regulatory authority to the Securities and Exchange Commission, as an independent agency responsible to Congress. In this way the perhaps cumbersome administration of the current Commodity Exchange Commission, composed of the Secretaries of Agriculture and Commerce and the Attorney General, might be corrected, and the public responsibility to provide for impartial and adequate regulation of commodity exchanges might be better assured.

My deepest concern is not with H.R. 11788 itself, however, but with the development of markets for commodity futures traded both domestically and internationally, and the potential contribution of the Domestic Marketing and Consumer Relations Subcommittee to fuller use of these markets.

For some time I have urged that the Joint Economic Committee undertake a study of a representative commodity so that it would be possible for us to understand the complex working of the domestic and international markets for an important commodity. It is my theory that futures markets could be used much more effectively to provide adequate price stability with proper flexibility to promote increased productivity and economic growth. Properly constructed markets operating within legal guidelines are the proper substitute for cumbersome and uneconomic commodity agreements which amount to merely Government-sponsored cartels. I would like to see this theory tested by a thorough examination of the supply side of a commodity market—the producers and the means of storage, sale, and shipment—as well as the demand side—the buyers and their marketing and distributive systems. To my knowledge no such study in depth has ever been undertaken. If undertaken, we could understand the problem of developing countries with their sales of commodities important to their development and we would know far better how to deal with them.

Thus my appeal to the Subcommittee on Domestic Marketing and Consumer Relations is that the subcommittee undertake, sponsor or commission a full study of an important commodity—perhaps sugar, or coffee, or copra—which would serve as a model and/or a guide to informed legislative action, and proper oversight of the activities of the agencies administering U.S. foreign economic policy as related to world commodity problems. The study of an agriculture commodity would be applicable to other raw commodities, such as tin or copper or vice versa. Actually “future markets” exist in various forms of development for most important commodities.

Sincerely,

THOMAS B. CURTIS.

Mr. MATSUNAGA. Permission will be granted to our colleagues, E. Y. Berry and Ancher Nelsen, to file statements in the record, as well as Mr. Andrews and Ben Reifel. All of these gentlemen, together with others who may wish to file statements, will be granted permission to do so.

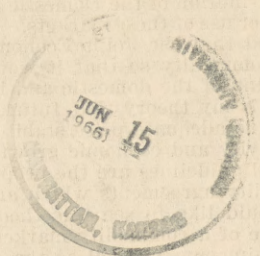
With that, we thank you.

The hearing stands adjourned.

(Whereupon, at 12 o'clock meridian, the subcommittee was adjourned.)



The following is a summary of the report of the Committee on the subject of the proposed amendment to the Constitution of the United States, which provides for the election of the President and Vice President by the electors of the several States.



The Committee has the honor to acknowledge the receipt of the report of the subcommittee on the subject of the proposed amendment to the Constitution of the United States, which provides for the election of the President and Vice President by the electors of the several States.

The report of the subcommittee is hereby recommended to the Committee for its consideration and report thereon to the House of Representatives.

Very respectfully,
The Secretary of the Committee.