

AMEND THE COMMODITY EXCHANGE ACT

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HEARINGS
BEFORE THE
COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES
NINETIETH CONGRESS

FIRST SESSION

ON

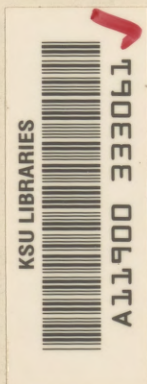
H.R. 11930 and H.R. 12317

AUGUST 15, 1967, AND SEPTEMBER 11, 1967

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Printed for the use of the Committee on Agriculture



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1967

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AMEND THE COMMODITY EXCHANGE ACT

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HEARINGS

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AMEND THE COMMODITY EXCHANGE ACT

TUESDAY, AUGUST 15, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The committee met, pursuant to notice, at 11:10 a.m., in room 1301, Longworth House Office Building, Washington, D.C., the Honorable W. R. Poage, chairman, presiding.

Present: Representatives Poage, Gathings, Abernethy, Jones of Missouri, Stubblefield, O'Neal, Vigorito, Dow, Montgomery, Belcher, Teague of California, Mrs. May, Dole, Goodling, Wampler, Miller, Burke, Mathias, Mayne, Zwach, Kleppe, Price, and Myers.

Also present: Christine S. Gallagher, clerk; Hyde H. Murray, assistant counsel; Francis LeMay, consultant.

The CHAIRMAN. The committee will come to order.

We have for consideration this morning H.R. 11930 and H.R. 12317. This is with reference to amending the Commodity Exchange Act. This will be made a part of the record at this point.

(H.R. 11930 by Mr. Poage and H.R. 12317 are similar bills. The text of H.R. 11930 follows:)

[H.R. 11930, 90th Cong., first 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 a comma after the word "soybeans" in the third sentence of the section and deleting the phrase "and soybean meal" in such sentence and substituting therefor the phrase "soybean meal, coffee, sugar, livestock, and livestock products";

(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."; and

(c) By substituting a comma for the period at the end of the last sentence of the section and adding thereafter the following: "or an official or employee of each of the executive departments concerned, designated by the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General, respectively; and the Secretary of Agriculture or his designee shall serve as Chairman."

SEC. 2. 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 commission 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 commission finds are necessary to diminish, eliminate, or prevent such burden. In determining whether any person has exceeded such

limits, the positions held and trading done by any persons directly or indirectly controlled by such person shall be included with the positions held and trading done by such person; and further, such limits upon positions and trading shall apply to positions held by, and trading done by, two or more persons acting pursuant to an expressed or implied agreement or understanding, the same as if the positions were held by, or the trading were done by, a single person. Nothing in this section shall be construed to prohibit the commission 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 2 (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. 3. 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 commission 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. 4. 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 transactions or positions. For the purposes of determining the bona fide hedging transactions or positions of any person under this paragraph (3), they shall mean sales of, or short positions in, any commodity for future delivery on or subject to the rules of any contract market made or held by such person to the extent that such sales or short positions are offset in quantity by the ownership or purchase of the same cash commodity by the same person or, conversely, purchases of, or long positions in, any commodity for future delivery on or subject to the rules of any contract market made or held by such person to the extent that such purchases or long positions are offset by sales of the same cash commodity by the same person."

SEC. 5. Section 4b of the Commodity Exchange Act, as amended (7 U.S.C. 6b), is amended as follows:

(a) By deleting the portion of said section which begins with the phrase "It shall be unlawful" and extends through the phrase "for or on behalf of any person" and by substituting for the deleted portion, the following: "It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any other person, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, on or subject to the rules of any contract market, for or on behalf of any other person"; and

(b) By inserting the word "other" before the word "person" where the latter word appears in subparagraph (A), and the first time it appears in subparagraphs (B) and (C).

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

(a) By deleting the second proviso from the last sentence of the section and substituting therefor the following: "*Provided further*, That such money may be invested in obligations of the United States, in general obligations of any State or of any political subdivision thereof, and in obligations fully guaranteed as to principal and interest by the United States, such investments to be made in accordance with such rules and regulations and subject to such conditions as the Secretary of Agriculture may prescribe."; and

(b) By adding at the end of the section 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 futures commission merchant."

SEC. 7. 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) Notwithstanding any other provisions of this Act, no person desiring to register as futures commission merchant shall be so registered unless he meets 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 each person so registered shall at all times continue to meet such prescribed minimum financial requirements: *Provided*, That such minimum financial requirements will be considered met if the applicant for registration or registrant is a member of a contract market and conforms to minimum financial standards and related reporting requirements set by such contract market in its bylaws, rules, regulations, or resolutions and approved by the Secretary of Agriculture as adequate to effectuate the purposes of this paragraph (2)."

SEC. 8. 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 and positions of such person, and the transactions and positions of the customers thereof, in commodities for future delivery on any board of trade in the United States or elsewhere; shall keep books and records pertaining to such transactions and positions 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. 9. Section 4i of the Commodity Exchange Act, as amended (7 U.S.C. 6i) is amended by deleting the last sentence and adding the following at the end of the section. "Such person shall keep books and records of all futures transactions and positions coming within the provisions of (1) and (2) hereof, and shall keep books and records of such cash or spot transactions in such commodity entered into, and inventories and purchase and sale commitments of such commodity held, in any month in which such person is required to make any report under the provisions of (1) or (2), as the Secretary of Agriculture may require. Such books and records shall show complete details concerning all such transactions, positions, inventories, and commitments, including the names and addresses of all persons having any interest therein, and shall be open at all times to inspection by any representative of the United States Department of Agriculture or the United States Department of Justice. For the purposes of this section, the futures and cash or spot transactions and positions of any person shall include such transactions and positions of any persons directly or indirectly controlled by such person."

SEC. 10. 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. 11. 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, and the orders issued pursuant to the provisions of section 5a of this Act, and for compliance in all other respects with the requirements applicable to such board of trade under this Act."

SEC. 12. Section 5a of the Commodity Exchange Act, as amended (7 U.S.C. 7a), is amended as follows:

(a) By deleting paragraph (2) thereof and substituting therefor the following:

"(2) keep all books, records, minutes, and journals of proceedings of such contract market, and its governing board, committees, subsidiaries, and affiliates in a manner that will clearly describe all matters discussed by such

contract market, governing board, committees, subsidiaries and affiliates and reveal any action taken in such matters, and allow inspection at all times by any authorized representative of the United States Department of Agriculture or United States Department of Justice of all such books, records, minutes, and journals of proceedings. Such books, records, minutes, and journals of proceedings shall be kept for a period of three years from the date thereof, or for a longer period if the Secretary of Agriculture shall so direct;"

(b) 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

(c) By adding after paragraph (7) the following paragraphs:

"(8) enforce all bylaws, rules, regulations, and resolutions, made or issued by it or by the governing board thereof or any committee, which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relate to other trading requirements, and which have not been disapproved by the Secretary of Agriculture pursuant to paragraph (7) of section 8a of this Act; and revoke and not enforce any such bylaw, rule, regulation, or resolution, made, issued, or proposed by it or by the governing board thereof or any committee, which has been so disapproved; and

"(9) enforce all bylaws, rules, regulations, and resolutions made or issued by it or by the governing board thereof or by any committee, which provide minimum financial standards and related reporting requirements for futures commission merchants who are members of such contract market, and which have been approved by the Secretary of Agriculture."

SEC. 13. Section 5b of the Commodity Exchange Act, as amended (7 U.S.C. 7b), is amended as follows:

(a) By deleting the phrase "rules and regulations" and substituting the phrase "rules, regulations, or orders"; and

(b) By adding immediately after the phrase "Secretary of Agriculture" the phrase "or the commission".

SEC. 14. 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 commission, with the right to appeal an adverse decision after such hearing to the court of appeals as provided for in other cases in paragraph (a) of this section."

SEC. 15. Section 6(a) of the Commodity Exchange Act, as amended (7 U.S.C. 8), is amended to read as follows:

"(a) The commission 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 or the commission 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 commission 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 commission 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 notify the other members of the commission and 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 commission, duly filed as aforesaid as a part of the record, shall be considered by the court of appeals 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 commission or may direct it to modify its order. No such order of the commission 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 commission."

SEC. 16. 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 and fourth sentences thereof to read, respectively: "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 contract market, or has willfully made 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 omitted to state in any such application or report any material fact which is required to be stated therein, 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 or the commission 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 prohibiting him from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Secretary of Agriculture, 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. * * * Upon evidence received, the Secretary of Agriculture may prohibit such person from trading on or subject to the rules of any contract market and require all contract market to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant or as floor broker hereunder, may suspend, for a period not to exceed six months, or revoke, the registration of such person."

(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".

SEC. 17. 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 contract market, 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 or the commission 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 nor more than one year, or both, except that if such failure or refusal to obey or comply with such order involved any offense within paragraph (a) or (b) 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) or 9(b). Each day during which such failure or refusal to obey or comply with such order continues shall be deemed a separate offense."

SEC. 18. Section 6b of the Commodity Exchange Act, as amended (7 U.S.C. 13a), is amended to read as follows:

"Sec. 6b. If any contract market 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 contract market, or any director, officer, agent, or employee of any contract market 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 or the commission thereunder, the commission 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 contract market, director

officer, agent, or employee shall cease and desist from such violation, and if such contract market, 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 contract market, 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 such failure or refusal to obey such order continues shall be deemed a separate offense."

SEC. 19. 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"; and

(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 of the United States to which it, or the Secretary of Agriculture, or the United States is a party."

SEC. 20. 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 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 his 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 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. 21. Section 8a(3) of the Commodity Exchange Act, as amended (7 U.S.C. 12a(3)), is amended by inserting the following at the beginning thereof after "(3)": "in accordance with the procedure provided for in paragraph (b) of section 6 of this Act, to suspend or revoke the registration of any person registered under this Act if cause exists under subparagraph (2) (B) or (C) which would warrant a refusal of registration of such person, and".

SEC. 22. 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. 23. Section 8a of the Commodity Exchange Act, as amended (7 U.S.C. 12a), is further amended as follows:

(a) By deleting the word "and" at the end of paragraph (5) and substituting a semicolon for the period at the end of paragraph (6) and adding thereafter the word "and"; and

(b) By adding after paragraph (6) the following new paragraph:

"(7) to disapprove any bylaw, rule, regulation, or resolution made, issued or proposed by a contract market or by the governing board thereof or any

committee which relates to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market or relates to other trading requirements, when he finds that such bylaw, rule, regulation, or resolution violates or will violate any of the provisions of this Act, or any of the rules, regulations, or orders of the Secretary of Agriculture or the commission thereunder."

SEC. 24. 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 for any person, against whom there is outstanding any order of the Secretary of Agriculture prohibiting him from trading on or subject to the rules of any contract market, 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."

SEC. 25. 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 futures commission merchant, or any employee or agent thereof, to embezzle, steal, purloin, or with criminal intent convert to his own use or the use of another, any money, securities or property having a value in excess of \$100, which was received by such commission merchant to margin, guarantee, or secure the trades or contracts of any customer of such commission merchant or accruing to such customer as the result of such trades or contracts. The word 'value' as used in this paragraph means face, par, or market value, or cost price, either wholesale or retail, whichever is greater.

"(b) 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 contract market, or to corner or attempt to corner any such commodity, or knowingly 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.

"(c) Except as provided in paragraphs (a) and (b) of this section, 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 8b, or to fail to evidence any contract mentioned in section 4 of this Act by a record in writing as therein required."

SEC. 26. 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. 9a. Whenever it shall appear to the Secretary of Agriculture that any contract market or other person has engaged, or is engaging, in any act or practice constituting a violation of any provision of this Act, or any rule regulation, or order of the Secretary or the commission 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 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 any 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 or the commission thereunder. 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 occurring, 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. 27. The Commodity Exchange Act, as amended, is further amended by adding thereto a new section 13 to read as follows:

"Sec. 13. (a) Any person who commits, or who willfully aids, or who abets, counsels, commands, induces, or procures the commission of, a 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 may be held responsible in administrative proceedings under this Act for such violation as a principal.

"(b) Nothing in this Act shall be construed as requiring the Secretary of Agriculture or the commission to report minor violations of this Act for prosecution or the institution of any proceeding under section 9a of this Act, whenever it appears that the public interest does not require such action."

Sec. 28. 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 provision 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.

The CHAIRMAN. We have with us Congressman Hathaway.

We will be delighted to hear from you now, Mr. Hathaway.

We are glad to have you with us.

STATEMENT OF HON. WILLIAM D. HATHAWAY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MAINE

Mr. HATHAWAY. Mr. Chairman and members of the committee, I am grateful for this opportunity to appear in support of H.R. 11930 designed to strengthen the Commodity Exchange Act.

H.R. 11930 is a modest proposal to revise, in the light of increased activities in the future markets, the Commodity Exchange Act. It attempts to establish rules and regulations which are an integral part of all other exchanges and are recognized as beneficial and necessary. It is surprising that the suggested changes are not already a part of the commodities market.

Sections establishing minimum financial requirements and some requirements on who becomes a future commission merchant or floor broker are certainly necessary when you consider that in commodities the margin is extremely low, as little as 5 percent, compared with 70 percent currently for stocks. Certainly the provisions requiring better bookkeeping methods are also a response to necessity. I believe that these provisions are a desirable protection of the public interest.

My interest, of course, relates largely to future trading in potatoes and the impact of such trading on the Maine producers.

From my own observation of this proposed legislation, and from the views expressed to me by Maine potato growers, it appears that the proposals in this bill are needed to provide the Commodity Exchange Authority with more effective means of preventing disorderly market situations, not only in potatoes but in all of the commodities in which there is futures trading.

Members of the industry in Maine have, from time to time, expressed dissatisfaction with potato futures and particularly the ap-

parent impossibility of dealing with unfavorable trading situations promptly enough to correct abuses then in progress. It would appear that the injunctive procedure is needed to make it possible to cope promptly with existing abuses rather than having to wait months or years and then perform what amounts to an autopsy.

From the point of view of the Maine potato industry it seems clear that the enormous increase in activity in the potato futures market, as well as in the other commodities, points to an urgent need to bring this legislation up to date. With a volume in potatoes alone around \$1½ billion and transactions in 600,000 or 700,000 cars it is not surprising that situations now appear which were not apparent 30 years ago when this law was put into its present form.

I hope that your committee will see fit to facilitate the passage of this legislation which, I feel, may result in greater confidence in the usefulness of the potato futures market by the producers and other members of the industry in my State.

That is all of my statement, Mr. Chairman.

I do have an article from Playboy Magazine which, with your permission, Mr. Chairman, I would like to put into the record.

I will first say that you will have to leave out the pictures and the cartoons in putting it into the record.

It is an article on the Commodity Exchange.

I think it is a very good article. It goes into the exchange mechanism in considerable depth.

The CHAIRMAN. I do not think that the committee desires to insert such into the record but we will put it in the files of the committee.

(The document referred to will be found in the files of the committee.)

The CHAIRMAN. Mr. O'Neal?

Mr. O'NEAL. Could we not have a reference to the date of issue?

The CHAIRMAN. May we have that?

Mr. HATHAWAY. Yes; it is the August, 1967 issue of Playboy.

The CHAIRMAN. Are there any questions of Mr. Hathaway?

Mr. Kleppe?

Mr. KLEPPE. Congressman Hathaway, I am interested in your comment here on the first page of your statement about the commodity margin being as low as 5 percent and that for stocks, of course, a 70-percent minimum, and in some cases it goes up to 100 percent. This is something I did not realize. Are the margins on commodities as low as 5 percent?

Mr. HATHAWAY. That is correct.

Mr. KLEPPE. Is there any proposed change in the bill?

I am sorry that I am not current on the provisions of this bill.

Is there any proposed change to change that?

Mr. HATHAWAY. I do not think that there is a provision to change the margin requirements, but there is a provision for greater control.

Mr. KLEPPE. What is your main purpose in citing the extreme difference between the commodity margin and the stock margin?

Mr. HATHAWAY. Well, just to show that this is an act which is going to put into line the commodity exchanges with the stock exchanges. At one time we thought it was necessary to have an extensive revision of the rules and regulations pertaining to the sales of stocks and bonds. And the situation in the commodity exchanges is, really, about the

same as it was then when we needed that revision in the stock exchanges. It is about time that we had a little more stringent rules, and these rules are comparable to many of the rules that now exist on the stock exchanges.

Mr. KLEPPE. Would it be true that your concern over this whole margin question is that it lends to a great deal of speculation in commodities?

Mr. HATHAWAY. Yes.

Mr. KLEPPE. And thereby would have an effect on unstabilizing the market?

Mr. HATHAWAY. That is correct.

Mr. KLEPPE. Thank you.

That is all, Mr. Chairman.

The CHAIRMAN. Are there any other questions by anyone?

Mr. Dow?

Mr. Dow. Mr. Hathaway, it is very good to have you here today.

Mr. HATHAWAY. Thank you, Mr. Dow.

Mr. Dow. The only question that I have is in connection with your suggestion of improving the operations of the futures market. You say that you have not offered any measure to increase the 5 percent margin?

Mr. HATHAWAY. Well, this has been traditionally left up to the board to do; although I did not stress it, in the administration's bill, I would consider what they had in mind is to continue to leave it up to the board, to have more stringent requirements with respect to who is going to handle the various accounts with more stringent requirements with respect to accounting procedures.

Mr. Dow. Is there any provision for the board or an overseeing authority now to raise those margins?

Mr. HATHAWAY. Not that I know of, Mr. Dow.

Mr. Dow. Would there be in your bill?

Mr. HATHAWAY. No.

Mr. Dow. Thank you, Mr. Hathaway.

That is all, Mr. Chairman.

Mr. HATHAWAY. You are welcome, sir.

The CHAIRMAN. Are there any other questions?

If there are no other questions, we very much appreciate your attendance here this morning, Mr. Hathaway, and we will be glad to have you sit with us if you care to.

Mr. HATHAWAY. I would like to. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, again, very much.

Our next witness will be Mr. Angus McDonald, director of research of the National Farmers Union.

We will be glad to hear from you now.

STATEMENT OF ANGUS McDONALD, DIRECTOR OF RESEARCH, NATIONAL FARMERS UNION

Mr. McDONALD. Mr. Chairman and members of the committee, my name is Angus McDonald, and I am director of research for the National Farmers Union.

I am appearing here in support of H.R. 11930, a bill which would amend the Commodity Exchange Act. This legislation, in our view, would expand and extend the authority of the Secretary of Agriculture and would make possible better enforcement of the law. The principal changes involve injunction procedure, adequate financial responsibility penalty for cheating and fraud, safeguards for customers' funds, cease and desist orders and the addition of new commodities.

The members of the committee who were members of the committee during the 89th Congress may recall that this witness appeared on April 6, 1966, and gave unqualified support to H.R. 11788, a bill which would have also amended the Commodities Exchange Act and given the Secretary of Agriculture additional powers. We believe that the principal objections to this previous legislation have been met in the new bill now before the committee.

Although the regulation of commodity exchanges is not one of the high priorities of the Farmers Union, the matter was discussed at length at our recent convention in Oklahoma City in March of this year. As a consultant to our program committee I gave a report on the previous legislation. The result of the deliberations of the convention was unanimous adoption of the following resolution:

REGULATION OF COMMODITY EXCHANGES

While we recognize there are some considerable advantages of futures 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.

I believe that the bill before the committee is not inconsistent with this resolution. The record amply supports our view that the Secretary should be given additional authority. The authority to request an injunction to stop existing violations is necessary as indicated by the following case:

On April 19, 1965, the CEA issues a complaint against Harney, Burns, Inc., and its president, A. James Comenzo. On June 24, 1965, Comenzo caused a new firm, Dunbeath-Hagen Corp. to be registered as a futures commission merchant. On February 7, 1966, Harney, Burns, Inc., Dunbeath-Hagen Corp., and A. James Comenzo were indicted by a Federal grand jury in New York for cheating and defrauding customers. The CEA investigation, as is evident from the charges in the indictments, disclosed that Comenzo had continued his fraudulent activities through the firm of Dunbeath-Hagen Corp., despite the complaint issued against him and Harney, Burns, Inc., in April. It is apparent that had the CEA had injunction authority, it could have sought to enjoin Comenzo from his criminal activities, and his customers would have undoubtedly been saved considerable money.

Another case indicates the need for authority to deny known criminals membership as commission merchants:

An individual known as Harry Kay, from Las Vegas, Nev., who had purchased a membership on the Chicago Board of Trade and who thereafter conducted an extensive business handling customers' commodities funds and transactions, was registered as a futures

commission merchant under the Commodity Exchange Act. About 6 months later, Harry Kay fled the country with some \$60,000 belonging to regulated commodity customers.

A criminal information was filed against Mr. Kay in the State of Nevada. He was charged with cheating and defrauding customers, deceiving customers, bucketing customers' orders, confirming fictitious trades, and failing to properly handle customers' funds. During the CEA investigation leading to the criminal information, it was learned that Harry Kay, who was also known as Aaron D. Schlechter, had a criminal record.

In June 1966, Harry Kay (alias Aaron D. Schlechter) returned to the United States and was apprehended. He pleaded guilty to the charges and was sentenced to 2 years in prison. He is currently serving that sentence. If the Commodity Exchange Authority had had the authority to refuse to register applicants with criminal records, the record of Harry Kay could have been checked before the firm was registered and its registration could have been refused, thus saving innocent victims more than \$60,000.

Enactment of legislation in regard to commodity futures markets is long overdue. We call attention to a report of the Comptroller General of the United States, dated July 1965, entitled "Need to Strengthen Regulatory Practices and Study Certain Trading Activities Relating to Commodity Futures Markets." In this document various abuses were described.

We urge that this committee approve the legislation under consideration.

I have one additional comment, Mr. Chairman, to make in addition to the testimony I have just presented.

It has been called to my attention that there may be some doubt as to whether sugar futures should be regulated and included in this legislation. We have no opinion on this matter, but we would like to have an opportunity later to submit a supplemental statement in regard to whether sugar, which is a worldwide controlled commodity and subject to many and various regulations, should be included in the present bill.

Thank you.

The CHAIRMAN. We will be glad to receive that.

Are there any questions?

Mr. Kleppe?

Mr. KLEPPE. Mr. McDonald, would you make a suggestion as to what you think might be a percentage for margins on commodities that might keep speculation down to a minimum and still permit the market to work its will?

Mr. McDONALD. No, Congressman Kleppe; I am afraid that I can't qualify as an expert in that field. I do know that there was authority in the previous legislation and it was apparently objected to, and I would assume that those drafting the legislation felt that the matter was too controversial to be included in this bill.

Now, as to whether or not it should be included, I just do not know.

Mr. KLEPPE. This is what I am getting at: It seems to me that with only the 5-percent figure in this, we are building a market that is very speculative in nature and that this, in itself, could be detrimental to the commodities market as such. So, what I was trying to

find out, not to get an expert opinion but primarily your thoughts along those lines, if you agreed with them, generally, or if you had any specific thoughts along those lines.

Mr. McDONALD. Well, I would hazard a guess that a requirement to increase the margin would be in the interest of good regulations, but this is only a speculative opinion. I could not say definitely.

Mr. KLEPPE. Thank you. That is fine.

That is all, Mr. Chairman.

The CHAIRMAN. Are there any other questions?

Mr. Jones of Missouri?

Mr. JONES of Missouri. I have just a question, Mr. Chairman.

You referred to this man having a criminal record.

Are there not any qualifications now for a person who registers to see that they are of good moral character, or anything like that?

Mr. McDONALD. According to my informant in the Department of Agriculture—he furnished me with documents. I have them in my briefcase, documenting these examples, the indictments, et cetera. According to my informant, there is no requirement in the present law which would give the Department authority to disqualify a person for membership in an exchange because of a criminal record.

Mr. JONES of Missouri. What does it cost to become a member?

Mr. McDONALD. I do not know.

Mr. JONES of Missouri. Thank you.

That is all, Mr. Chairman.

The CHAIRMAN. Are there any other questions?

If not, we are very much obliged to you, Mr. McDonald.

Mr. McDONALD. Thank you.

The CHAIRMAN. Our next witness is Mr. John E. Hean.

We will be glad to hear from you now.

STATEMENT OF JOHN E. HEAN, ARLINGTON, VA.

Mr. HEAN. Mr. Chairman and members of the committee. I am glad to be afforded this opportunity to appear here as a private citizen, one who has been a small commodity trader, in support of H.R. 11930.

The oral statement that I am about to give is a condensation of a statement made by me to the Commodity Exchange Authority on March 4, 1965, regarding an unpleasant experience I had with a commodity exchange firm, Harney, Burns, Inc., of New York City.

A copy of the written statement that I made to the Commodity Exchange Authority has been presented to the committee for the record.

In the fall of 1964, I saw an ad by Harney, Burns, Inc., in the Wall Street Journal, offering to send a weekly commodity report at no charge. I sent to this company, asking to be mailed their free commodity letter. After about a month, a Mr. Frank Engelman contacted me by phone. He asked me "Are you interested in doing any trading? We would very much like for you to open an account with us."

I told Mr. Engelman that I did not have any funds at that time to invest.

He said that he hoped that in the future I might have some funds with which to open an account.

After his first phone conversation, I was contacted a total of about four or five times by phone at about 3- to 4-week intervals.

Mr. Engelman said:

Things have been going great with us here. We are making great progress for our customers, particularly in soybeans. We have been having excellent results in soybeans, and it looks like lots of money could be made with them. Are you now in a position to hop aboard and open an account with us?

I said:

No, my financial position is still the same.

He again emphasized the excellent profit record of his company, Harney, Burns, Inc.

In the third telephone conversation, Mr. Engelman told me about the profits his company was making, the wonderful record that they had for their accounts and that it was certainly a shame that I could not see my way clear to open an account with them.

I explained that my financial position was still unchanged. I told him the only way at that time that I felt that I could possibly open an account was that I had a brother who might possibly loan me \$1,000. When I mentioned this to Mr. Engelman he brought out the point that it was the policy of his company, that the record of their trading was so good that normally within several weeks they were usually able to operate on profits.

He said:

If you open an account with \$1,000, \$5,000, or \$10,000, for example, it is the practice of our company, after we make sufficient profits, to return the original investment to our client. In that way, you have your original investment back, and we are operating strictly on profits that were made.

I said:

Perhaps, under those circumstances I could borrow the money from my brother.

Accordingly, I did borrow \$1,000 from my brother and posted it to open this account.

On February 3, 1965, my account was opened and trading commenced on the same day. By Friday, February 12, my balance was down to \$305. I began to wonder what kind of an outfit this was. I wondered about the large volume of transactions that this company had made for my account.

On Monday morning, February 15, 1965, I called Mr. Engelman on the phone, I told him that I could not understand being in so many contracts with such a limited amount of capital, but what really had me concerned was that I noticed that my balance was down to \$305, based on transaction slips received up to this point. I said:

I implore you—

and I used the words "I implore you"—

Whatever you do, you know this money that I opened the account with was borrowed money, and I am advising you and I am telling you that under no circumstances can I answer a margin call for additional funds beyond the \$1,000 that I put up.

He said that the worst that could happen to me was that I would lose the \$1,000. And he was not going to let that happen. He said that my balance at that time was around \$600 which cheered me up somewhat. When he said that my balance was around \$600, I figured that he had already made some of the money back, on February 15, 1965.

The next thing I heard from Harney, Burns, Inc. was on February 18, 1965. To my shock and dismay there were additional losses of \$685.50. This adds up to making, even after considering my previous balance, my account having a deficit then of \$380.50. I had not only lost the \$1,000, I now owed them \$380.50. I was so alarmed at this point—this was about 5:30 in the evening—and this time I talked to a man who identified himself as Mr. Katz, an employee and a broker of this company. I told him about my telephone call to Mr. Engelman on February 15, and I told him that I had just come home from work a few minutes previous and was very confused to find out that not only had I lost \$1,000 but that I now owed the company \$380.50. I said:

I do not see how I could owe the company, after advising Mr. Engelman by phone that under no circumstances was he to exceed the \$1,000.

Mr. Katz said:

I will tell you what—if you can dig up \$2,000 by next Wednesday morning, there is a deal coming up in pork bellies; something in pork bellies is going to happen between Wednesday and Friday.

He said:

If you can dig up even \$1,500—

when I indicated that I could not dig up even \$1,000 at this time, he suggested if I could dig up a large portion of this by Wednesday morning that he felt sure that he would not only make my deficit but would have my funds back for me.

The 19th of February, I received a telephone call from Mr. Engelman. He claimed that I was the only person in his career where this situation ever occurred; this is, the deficit. Mr. Engelman said that he would like for me to talk to the boss. A man came on in a rather brusque manner and identified himself as the head of the organization. I believe his name was something like Comenzo.

When he came on the phone he said words to this effect:

You were the one who set the police on us. We thought it was you who sent the CEA man here.

He said:

A man was in here with his badge this morning from the New York Office, asking to see the records. Well, the CEA man was here, he has checked your records, and finds that nothing is out of order.

He said:

You have now put yourself in a position, by your contacting the CEA, where you have left me no alternative but to put a suit against you for this money. On Wall Street, we do not deal in this fashion. We try to make arrangements among ourselves. We do not call in the police.

And "by police", he was referring to, obviously, the Commodity Exchange Authority. He said that I owed him this money, and when I proceeded to tell him about my dealings with Mr. Engelman, that Mr. Engelman knew that I had opened an account with borrowed funds, he said:

I do not care whether it is borrowed funds or what it is, that is none of my concern. My only concern is that your account shows a deficit, and the CEA demands that the deficit be paid.

He said:

When they come in, a deficit must be paid. You leave me no alternative. Unless you pay this we will institute a suit against you.

After my conversation with this man—he did put me back on the phone with Mr. Engelman who, again, said that he felt awfully bad about the whole deal.

At 4:45 p.m., on March 2, 1965, I had a long distance from New York. On the phone there came this man who identified himself as the head of the company, whose name I do not know how to spell but I believe it is Comenzo—again in his brusque, fast-talking manner, he said:

Mr. Hean, I understand that you have refused to pay your debt, that you have talked with Mr. Engelman and that you are refusing to pay your debt to Harney, Burns. Is this correct?

I said:

I do not owe you a debt. It may be true that there was a deficit of \$380.50, but I do not consider this my responsibility, because of my instructions to your broker.

Mr. Comenzo said:

You have a deficit of \$380.50, and when the CEA comes in they expect the \$380.50 to be paid. Mr. Hean, we hate to hurt anybody here. Perhaps, arrangements could be worked out—

that it was a lot of trouble to them to get a lawyer and to go all over this business.

He asked me if I would be willing to make an arrangement with them.

I said, "Do you mean would I be willing to settle for a portion of this so-called debt?" And he said, "Yes." He asked what I would be willing to give them if they would consider this affair closed. He said, "We have to do something, but the CEA must not know."

Within 9 trading days, from the time I opened my account on the 15th of February of 1965, as indicated by the transaction slips, they had not only gone through the \$1,000 but also acquired the debit balance of \$380.50.

It might be interesting to note that on such a small amount of capital that there were nine commissions involved, nine so-called P. & S. slips. This is known, I believe, as churning the account; sort of a bucketshop operation, if you will.

But at any rate, I am not a lawyer, nor do I consider myself an expert on commodities, but I do believe that my account has been mishandled. I believe that traders in a market should have more protection. People like those I dealt with should not be allowed to act as brokers. Also, if people are cheated the broker should be put out of business right away.

I understand that Mr. Engelman has pleaded guilty to this fraud, but is not yet in jail. A lot of people were hurt before these people were put out of business.

I thank you.

The CHAIRMAN. Thank you, Mr. Hean.

Your prepared statement will be made a part of the record at this point.

(The prepared statement submitted by Mr. Hean reads in full as follows:)

STATEMENT BY JOHN E. HEAN, ARLINGTON, VA.

In the fall of 1964, around September or October, I saw an ad by Harney, Burns, Inc., in the Wall Street Journal offering to send a weekly commodity report at no charge to anybody who cared to see such. Accordingly, I sent to this company asking to be mailed their free commodity letter. They proceeded to mail me the 8-page weekly report that is prepared by the Commodity Research Bureau in New York. After about a month, a Mr. Frank Engelman of this company contacted me by phone at home. He asked me if I had been receiving the weekly commodity report, did I enjoy receiving it and would I like to be continued on their mailing list. I told him that I enjoyed getting it and that I would like it to continue. He then asked me, "Are you interested in doing any trading? We would very much like for you to open an account with us." I told Mr. Engelman that I was very much interested in commodity trading and had done some in the past but that at the moment I did not have any funds to invest. I said "Do you have managed accounts there?" He replied "Oh, yes we do." I said, "Are there any particular charges for this type of service?" and he said "No, other than the regular commissions that any broker would be paid; that is how we charge for a managed account." He said, "Our company has an excellent record of profits; we have been doing extremely well lately with our accounts"; and "You would very much find it to your advantage, I am sure, if you are able to open an account with us." I told him it sounded very interesting as I was always interested in making profits. He said, "We have a good research staff here; we obtain quick execution of orders; and we feel we know our business here at Harney, Burns." This conversation terminated on the note that I had no funds at present; he would continue to mail me the reports and hoped that in the future I might have some funds with which to open an account. This occurred approximately a month after I had sent in for the weekly reports.

After this first phone conversation, I was contacted several times. I believe it was a total of about four or five phone calls at about three or four week intervals. In these conversations, Mr. Engelman said that "Things have been going great with us here; we're making great progress for our people, particularly in soybeans; we've been having excellent results in soybeans and it looks like lots of money to be made with soybeans. Are you in a position to hop aboard and open an account with us?" This was in the second conversation. I said, "No, my position was still the same." I told him that it certainly sounded very enticing to have a managed account with real experts and I only regretted that I didn't have the money. I advised him that my money was tied up. He said that he sure hoped that I would be able to see my way clear to open an account with them because there were some good profits to be made; he again emphasized the excellent profit record of his company.

In the third phone conversation, approximately three or four weeks after the second phone conversation, Mr. Engelman again was very pleasant and asked if my financial position was such that I might be able to open an account. He again told me about profits the company was making; the wonderful record they had for their accounts; and that it certainly was a shame that I couldn't see my way clear. I explained that my financial position still had not changed. I told him the only way I felt I could possibly open an account was that I had a brother who might possibly loan me \$1,000. When I mentioned this to Mr. Engelman, he brought out the point that it was the policy of his company, that their record of trading was so good, that normally within several weeks they were usually able to operate on profits. He said, "If you open an account with \$1,000, \$5,000 or \$10,000, for example, it is the practice of our company after we make sufficient profits to return the original investment to our client." He said, "That way you have your original investment back and we are operating strictly on profits that were made." I said that this was certainly very enticing, very interesting, and that perhaps under these circumstances I could borrow the money from my brother. I said, in other words, as soon as sufficient profits would be made, I could withdraw \$1,000 so that I could return it to my brother. He said, Oh yes, it is our policy to do so. At any rate, he had me so interested I said that I would write to my brother; that I didn't know whether he would loan me the \$1,000 but that I thought that he would, and furthermore, I would even recommend that my brother open up an account because it sounded so good. Mr. Engelman said that he would send me the necessary forms for me to sign. The only written letter was of January 6, forwarding me the forms after about the fourth phone call.

I did borrow \$1,000 from my brother and proceeded to open up this account. Up to this point Mr. Engelman was the only person of this organization that I had dealt with. This was all by phone up to this point other than receiving the commodity letter provided by Commodity Research in New York.

On February 3, 1965, my account was opened and trading commenced on the same day. I received transaction slips in the mail, usually about two days after a transaction would occur. I noticed that the transactions slips I had received up to February 12 indicated my balance was down to \$305. In other words, my balance was reduced to \$305 as shown by adding up the transactions slips. I began to wonder what kind of an outfit this was. I wondered about the large volume of transactions that this company had made for my account and I was rather concerned. I couldn't understand how that they could do it on such a limited amount of capital. At any rate, this was Friday evening, February 12. I was quite alarmed. I figured that things do not seem right here; I had best call them the first thing Monday morning. Commodity houses are normally closed on Saturday and Sunday or I would have contacted them then. So, on the following Monday morning, which was February 15, I called at approximately 10:00 o'clock in the morning. I was informed by a girl in the New York office that Mr. Engelman had not arrived at work and normally did not come in until about 10:30; he would be in between 10:30 and 11:00 and would I please call back then. I did call back between 10:30 and 11:00 and at this time I did get Mr. Engelman. Mr. Engelman was put on the phone. I told him that I was calling him because I was quite concerned. I told him that I couldn't understand being in so many contracts with such a limited amount of capital, but what really had me concerned was that I noticed my balance was down to \$305 based on transaction slips received up to this point. I said, "I implore you"; I used the words "implore you"; I said whatever you do, you know this money that I opened the account with was borrowed money and I am advising you, am telling you, that under no circumstances can I answer a margin call. I said, as you know, when I sent the check for \$1,000, it was borrowed funds. So, on February 15 I told Mr. Engelman that I was concerned that my account was down to \$305 and that under no circumstances could I answer a margin call or produce additional money beyond the \$1,000 I had put up. He said that the worst that could happen to me was that I would lose the \$1,000 and he was not going to let that happen. He said the soybean market during the last few days had been rather erratic or unusual due to the dock strike and the situation in Vietnam and that these things happened once in a while. He said my balance was around \$600 which cheered me up somewhat. I told him that I wanted to make certain that he knew that this was all the money I had. I told him that under no circumstances could I answer a margin call, or produce additional money. This phone call terminated with the definite feeling of assurance on my part based on what Mr. Engelman had told me. Since he said my balance was about \$600, I figured that he already had made some of the money back on February 15, 1965.

The next thing I heard from Harney, Burns was on February 18, Thursday, when I got home from work. That night I saw a letter from Harney, Burns, opened it up, and there were transaction slips in there which totalled \$685.50. In other words, at the point I had called him, that is, Monday morning, February 15, he told me that my balance was about \$600 and that the worst that could happen was losing the \$1,000, etc. My next contact with him was this letter received when I returned from work on Thursday, February 18. I opened this up and to my shock and dismay there were transaction slips which totalled up to \$685.50 of losses. This, added up to my previous balance, showed my account as now having a deficit of \$380.50. I was so alarmed at this point, this was about 5:30 in the evening, that I, in desperation, decided to call New York and I hoped that I might catch him at his office. I called New York, and asked for Mr. Engelman and was advised that Mr. Engelman wasn't there but a man who identified himself as Mr. Katz, an employee and broker of the company, spoke with me. Mr. Katz said that perhaps he could be of some help to me. I identified myself and said I was one of Mr. Engelman's accounts. I told him about my telephone call to Mr. Engelman on February 15 and I told him that I just came home from work a few moments previous and was very confused to find transaction slips which added up to me owing the company, not only that I had lost the \$1,000 but I now owed the company \$380.50. I said I want to be straight on this because I wanted to know if the implications of this were that I should not be concerned or just what the situation was. He said if I would hold on a moment he would go to Mr. Engelman's records and check. In a moment he

came back and said that according to their records I owed the company \$380.50. I said I didn't see how I could owe the company money after advising Mr. Engelman by phone that under no circumstances was he to exceed the \$1,000. I said that Mr. Engelman knew this was borrowed money and furthermore had assured me in a telephone conversation on the 15th that the worst that could happen to me was losing the \$1,000. Mr. Katz said that the loss was unavoidable and therefore I was liable for the loss. Mr. Katz said that I sounded like such a nice fellow and he hated to see the company have a bad name. He said, "I tell you what. If you can dig up \$2,000 by next Wednesday morning, there's a deal coming up in pork bellies." He said that about twice a year they got the word that something's going to happen. He said that of course he couldn't tell me whether it's taking a long or short position, but that something big in pork bellies was going to happen between Wednesday and Friday which would be the 24th through the 26th of February. I said, "Mr. Katz, the very reason I'm calling is because of the problem of my funds. You're suggesting that I try to dig up another \$2,000. My problem in even opening an account was borrowing the \$1,000." He said, "If you can dig up \$1,500." When I indicated that I couldn't dig up even \$1,000 he suggested that if I could dig up a large portion of this by Wednesday morning that he felt certain he would not only make up my deficit but would have my funds back for me. I again assured him that I could not dig up \$2,000 or any portion of it; that my very reason in called was my concern about the \$380.50 deficit and what the implications of this were. The up-shoot of this conversation was that he said I owed the company \$380.50 and that I was expected to pay. I proceeded to tell Mr. Katz that I did not consider that I owed Harney, Burns any money; that I felt a broker's word was his bond and that I, under no circumstances felt I owed any money. At this point my conversation with Mr. Katz on Thursday evening was terminated.

The volume of contracts engaged in for my account could not possibly be handled with this amount of margin, and long before this point, any reputable house would have called me for additional margins. At no time, up to this point, was I called or written that additional funds would be necessary.

On Friday, the 19th of February, I received a telephone call from Mr. Engelman. I was not at my desk so I returned his call. Mr. Engelman said that I didn't realize how sorry he was that this had happened to me. He claimed that I was the only person and the first person in his career where this situation ever occurred of a deficit. I went on to recall my conversation of the 15th with him and also the circumstances under which I had opened my account. I told Mr. Engelman I was operating with borrowed capital and that I implored him on the 15th that whatever he did, not to go beyond the \$1,000. That my balance, he told me, on Monday, the 15th, was \$600 which left me with a feeling of reassurance. I said that Mr. Katz, last night, told me that I owe your company \$380.50. Mr. Engelman said "Yes sir, this is so. You do owe the company \$380.50." I insisted that I did not because of my instructions to him. At any rate, Mr. Engelman said that he would like me to talk to the boss. A man came on with a rather brusque manner who identified himself as head of the organization. I believe his name was something like Cozmeno, an Italian or Latin name. He was a rather fast talking, brusque individual. When he came on the phone he said words to the effect, "So you were the one who set the police on us. We thought it was you who sent the CEA man here." He said, "A man was in here with his badge this morning from the New York office asking to see the records." This man who was supposed to be head of the company said, "Well, the CEA man was sent here, he has checked your records and finds that nothing is out of order." He said, "You have now put me in a position by having the CEA man come here that we are now required, the CEA requires that we collect the deficit." He said, "You have now put yourself in a position, by your contacting the CEA, you have put yourself in a position where you have left me no alternative but to put a suit against you for this money." He said, "On Wall Street we do not deal in this fashion. We try to make arrangements among ourselves. We do not call in the police." By police he was referring, obviously, to the Commodity Exchange Authority. At any rate, in his very brusque manner, he said that I owed them this money and when I proceeded to tell him about my dealings with Mr. Engelman; that Mr. Engelman knew that I had opened an account with borrowed funds, he said, "I don't care whether it's borrowed funds or what it was; that's none of my concern. My only concern is that your account shows a deficit and the CEA demands that deficits be paid." He said, "When they come in, a deficit must be paid. You leave me no alternative. Unless you pay this we will institute a suit against you." After my conversation with this man he did put me back on the phone with Mr. Engelman who again said he felt awfully bad about this whole deal.

When Mr. Engelman came back on the phone he said that he was awfully sorry that this has happened; that this was the first time this has happened in his life and that I was the first account this had ever happened to. Mr. Engelman, on Friday the 19th, before the conversation was terminated, told me that he would call me on Tuesday, February 23, the day after Washington's birthday, and he said he was going to talk to the boss to see if something could be done about this. The conversation was terminated with the view that he would call me on Tuesday the 23rd. However, I did not receive any phone call from Mr. Engelman at all during this week of the 23rd. On the 27th of February in the mail I received a monthly statement and a request for funds. Upon receiving this, my feeling was one of indignation and one of accusing myself of self-stupidity for not having gone to CEA a week after I talked to Mr. Robinson on Friday the 19th. But I had made an effort to be cooperative with these people, to be decent, figuring that they would come up with at least a reasonable thing honoring their broker's agreement with me. I figured that I would give this man the maximum of opportunity and call him on Tuesday. Since I had not heard from Mr. Engelman on Tuesday, February the 23rd, as he had promised to call me, by March 2nd a week had elapsed. I had received this statement. I still figured that I would give him the courtesy of a call despite his very discourteous treatment of me in failing to call me as he said he would. When I called Mr. Engelman on Tuesday, March 2nd, he was placed on the phone. I said I wondered why he had not called me Tuesday as he indicated he would. I told him that I had intended to go to the Commodity Exchange Authority in Washington and he had asked me to hold off until I heard from him. I said it is now a week beyond the date that you promised to call me. My position is that I don't know why you haven't called me. I said it's true the transaction slips may show a deficit of \$380.50, but I consider my power of attorney was limited to the \$1,000 because of my previous phone call to you. In fact, you assured me the worst that could happen was losing the \$1,000. I do not intend to pay this debt because I do not consider it a debt of mine. Mr. Engelman again told me how sorry he was about the whole thing; that if he had \$1,000 of his own he would be glad to give me the \$1,000 back; that it was a very unfortunate case. Then he said, I'll tell you what, I feel awfully bad about this and I promise to call you by Friday. He said he thought something could be worked out. I was going to talk to the boss. This was at approximately about 4:00 o'clock that afternoon, Tuesday, March 2nd. He left with, "Mr. Hean, I will call you by Friday", which would be tomorrow; "I'm sure that something can be worked out. Let me talk to the boss." I said, in other words I should do nothing until Friday. He said that's right. Rest assured you will hear from me by Friday. At 4:45 that day I had a long distance call from New York. On the phone came this man who identified himself as the head of the company and whose name I do not know how to spell but I believe it's Cozmeno. Again, in his brusque, fast-talking manner, he said, Mr. Hean, "I understand that you have refused to pay your debt; that you have talked with Mr. Engelman and you are refusing to pay your debt to Harney, Burns. Is this correct?" I said, "I do now owe you a debt." I said it may be true that there is a deficit of \$380.50 but I do not consider this my responsibility because of my instructions to your broker. Mr. Cozmeno said that I have a deficit of \$380.50 and when CEA comes in they expect the \$380.50 to be paid. Then there were a series of things back and forth; I insisted I had no debt and so therefore I would not pay a debt I did not owe. He went on insisting that I did have a debt.

Finally, he said, "Mr. Hean, we hate to hurt anybody here." He said perhaps arrangements could be worked out and that it was a lot of trouble to them to get a lawyer and to go all over this business. He asked me if I would be willing to make an arrangement with them. I said, "Do you mean that would I be willing to settle for a portion of this so-called debt" and he said "Yes." He asked what I would be willing to give them if they would consider this affair closed. He said we have to do something but that CEA musn't know. He said that CEA does not allow a deficit to show on the books. I said if I owed you a debt this would be very nice to know; that an arrangement could be made.

Regarding my phone conversation of Tuesday afternoon, March 2nd, with Mr. Frank Engelman, the broker, Mr. Engelman stated that he had been called to the CEA office in New York and spent approximately one-half an hour with them and that they found nothing out of order in the transactions and that I owed this money.

In my conversation with the man who is head of Harney, Burns he said that the deficit had to be paid by March the 8th; I owed the money and he gave me the impression that the CEA found nothing wrong with the records and when he stated that they found nothing wrong with the records, I assumed this to mean that the CEA also considered that I owed them \$380.50. At least this was the impression that I was given.

Within nine trading days, from the 3rd to the 15th, as indicated by transaction slips, they had not only gone through the \$1,000 but also acquired this debit balance of \$380.50. It might be interesting to note that on such a small amount of capital that there were nine commissions involved. Nine so-called P&S slips. This is, I believe, known as "churning" the account. Sort of a bucket shop operation if you will. At any rate, I am not a lawyer or do I consider myself an expert on commodities, but I do believe that my account has been mismanaged. I believe that not only do I not owe them a deficit but I also hope that there is some recourse through which I might get back my money that was mishandled.

(This statement was made by me to the Commodity Exchange Authority on March 4, 1965. I believe traders in the market should have more protection. People like those I dealt with should not be allowed to act as brokers. Also, if people are cheated, the brokers should be put out of business right away. I understand Mr. Engelman has pleaded guilty to this fraud but is not yet in jail. A lot of people were hurt before these people were put out of business.)

The CHAIRMAN. Are there any questions of the witness?

Mr. MAYNE?

Mr. MAYNE. Right at the end of your statement, you made a statement that Mr. Engelman had pleaded guilty to this fraud?

Mr. HEAN. Right.

Mr. MAYNE. Are you referring to this specific transaction that you had with them? Was he charged with a criminal act?

Mr. HEAN. Right. This entire firm, Mr. Engelman and several others, members of Harney, Burns, were. I read the Wall Street Journal every day. I have kept in touch. When I went on my own volition to the Commodity Exchange Authority, when I initially made a complaint in the form of a statement, I have kept in touch with them and also have read the Wall Street Journal, and the members of this firm, Comenzo, the man who is the boss that I spoke about, Katz and this Engelman—Comenzo, I believe, has already received a 2-year sentence. The others have pleaded guilty, among which is this Mr. Engelman who, I believe, shortly will receive sentencing.

I might add, with interest, that this Mr. Engelman, as I understand from reading the Wall Street Journal—I do not have the issue with me—he had previously, as a stock broker, been guilty of misdoings and had been barred from dealing in stocks. I hope that answers your question, sir.

Mr. MAYNE. Thank you. This man who did have the unfortunate experience in connection with this, he did go to the prosecutor and make a complaint, and these people were prosecuted.

Mr. HEAN. I am the person who had the experience. I am John E. Hean. I had it; I am the trader. I am here as a private individual, as a small commodity trader who opened what was supposed to be a managed account with this firm, and because of the promises of profits, and so on, naturally, I went for this.

My purpose here—my \$1,000 that I lost is immaterial; others have probably lost more. What my protest is as to the way you have people in this type of business who are unethical, unprincipled business people and should be stopped. This man Engelman who already had

had trouble with stock dealings before and winds up in this—and, apparently, some of the people in this firm, as I understand, later opened another firm.

Mr. MAYNE. In what court was it prosecuted?

Mr. HEAN. This was in New York City. I am, myself, a resident of Arlington, Va. My transactions were by mail with them at the time I was living in Washington, D.C.

Mr. MAYNE. Was it in the U.S. district court?

Mr. HEAN. As I understand, this was in the district court in New York City, sir.

Mr. MAYNE. Thank you.

That is all, Mr. Chairman.

The CHAIRMAN. Mr. Kleppe?

Mr. KLEPPE. Did you pay the \$380.50, Mr. Hean?

Mr. HEAN. No, I did not. I did not pay that. And I might add they even had a lawyer call me up. And once I wrote this letter explaining what the situation was, they tried to bulldoze me into this, but I had informed the broker by phone that \$1,000 was my limit. No, certainly, I did not pay it.

Mr. KLEPPE. I just want to say that I am glad that you did not pay that. This happens to be a business that I know a little bit about. You did not owe it, and I am glad that you did not pay it. I am glad that you came down here to give us your testimony. It is unfortunate that there are people like this who operate unethically in the business and that many people get took.

Mr. HEAN. Right; thank you.

Mr. KLEPPE. That is all, Mr. Chairman.

Mr. POAGE. Are there any other questions?

If not, Mr. Hean, we are very much obliged to you.

We appreciate your testimony.

I believe that this completes the witnesses that we had scheduled for today.

Tomorrow, we will first meet in executive session, and then we will come into open session and continue the hearings on H.R. 11930.

The committee will stand in recess until tomorrow morning.

(Whereupon, at 11:45 a.m., a recess was taken until after an executive session Wednesday morning, August 16, 1967, at which time hearings will be resumed herein in open session.)

AMEND THE COMMODITY EXCHANGE ACT

WEDNESDAY, AUGUST 16, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The committee met, pursuant to recess, at 11:10 a.m., in room 1301, Longworth House Office Building, Washington, D.C., the Honorable W. R. Poage, chairman, presiding.

Present: Representatives Poage, Gathings, Abernethy, Purcell, O'Neal, Foley, Vigorito, de la Garza, Dow, Montgomery, Belcher, Teague of California, Mrs. May, Dole, Hansen, Goodling, Miller, Burke, Mathias, Mayne, Zwach, Kleppe, Price, and Myers.

Also present: Christine S. Gallagher, clerk; Hyde H. Murray, assistant counsel; and Francis LeMay, consultant.

The CHAIRMAN. The committee will please come to order.

The committee must apologize to our witnesses for the delay, but we have been in executive session on other important legislation.

We are now going to make a change in the list of witnesses. We will move just as rapidly as we can.

I am going to ask the members of the committee to forego questioning as much as possible.

I see that we have several witnesses from out of town; one from New York, one from Fort Wayne, Ind., one from Kansas City who must return to their homes. I wonder if we could start with them.

I wonder, Dr. Mehren, if you would care to get back to your shop this morning and be back here tomorrow.

Dr. GEORGE MEHREN (Assistant Secretary of Agriculture). I will be very pleased to do that, Mr. Chairman.

The CHAIRMAN. Thank you, very much. We appreciate that co-operation on the part of the Department. We are running this thing backward, because we have not had a general explanation that we should have had, but we will call now on Mr. Watts, chairman of the board of governors of the New York Mercantile Exchange, so that we may take these gentlemen from out of town as fast as we can.

The Department, therefore, will be excused until tomorrow morning. We will be glad to hear from you now, Mr. Watts.

STATEMENT OF LLEWELLYN WATTS, JR., CHAIRMAN, BOARD OF GOVERNORS, NEW YORK MERCANTILE EXCHANGE

Mr. WATTS. Mr. Chairman and members of the committee.

I am chairman of the board of the New York Mercantile Exchange which will celebrate its 95th year of existence next month. For some years our exchange has been designated as a contract market and is supervised by the Commodity Exchange Authority.

We are advised that H.R. 1930 was introduced in the House of Representatives at the request of the Department of Agriculture. Essentially the bill gives more power to the CEA to enforce the provisions of the act and imposes greater penalties for violation of the act.

This bill asks for much less power for the Secretary of Agriculture than the previous bill proposed by the CEA in 1966. The power to control margins on futures exchanges is deleted; the powers of the Commodity Exchange Commission are retained; and the controversial definition of manipulation has been withdrawn.

We believe the Commodity Exchange Authority, with the cooperation of the exchanges has done a good job of administering and enforcing the act. The CEA wants to do a better job and asks the Congress to give it more power for that purpose. We believe that what the CEA needs is not more power but more funds so that its overworked and undermanned staff can better perform its functions.

We note that some progress along these lines was made early this year when the Bureau of the Budget authorized the employment of electronic processing to review the records required to be maintained by clearing members and brokers. The CEA changed its regulations to require records to be kept in such manner that with its new equipment it could investigate promptly and at much less cost transactions and practices which it was unable to handle under its normal procedure. This should go a long way toward tightening enforcement of the act.

It is our view that the act can be adequately enforced without changing its language; that consideration of H.R. 11930 should be deferred until the CEA has had an opportunity to work with its new equipment; and that if there is still concern about the adequacy of enforcement, additional funds be appropriated to that end.

There are a few provisions of the bill on which I would like to comment.

We agree with the other commodity exchanges that there should be no change in the weight of evidence rule. Whatever reasons may exist for using the substantial evidence test for other administrative bodies we see no need for it here. Litigations involving disciplinary proceedings against violators of the act have been so far, that when a litigant appeals he should be entitled to have the court review the case as fully as if it came up on appeal from a lower court.

The fixing of minimum financial requirements for commission merchants is a thought in the right direction. Nobody wants to see a customer lose money because of the insolvency of a commission house. However, we have seen a commission house with millions of dollars of capital close its doors in recent years, while many small houses with little capital have always met their obligations. A satisfactory balance sheet is not a guarantee of either integrity or conservatism. We would not like to see standards applied which would put the small house out of business.

The requirement that the rules of an exchange be subject to the disapproval of the CEA does not seem to us to be necessary from our experience. We have always submitted our bylaws and rules to the CEA. Where we are considering a rule about which we have doubt, we consult the CEA. I know of no situation in which the CEA has disapproved one of our rules. If it did we would talk it out and resolve

our differences since we would not want to adopt a rule which the administrators believed to be illegal.

We wish to thank the committee for giving us the opportunity to express our views.

The CHAIRMAN. We thank you very much, Mr. Watts.

Are there any questions of the witness.

Mr. Purcell?

Mr. PURCELL. I cannot tell by reading your statement, Mr. Watts, what has been your experience or the experience of your exchange in working with the CEA in maintaining an orderly and useful market. What has been your experience in this regard?

Mr. WATTS. Our experience has been very satisfactory.

Mr. PURCELL. Then, one further question.

In your dealings with them have you found that they are dealing fairly with you, or that their rules have been arbitrary or capricious?

Mr. WATTS. No.

Mr. PURCELL. Thank you.

That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

If not, we are very much obliged to you, Mr. Watts.

Mr. O'Neal?

Mr. O'NEAL. I have one question. I understand from what you say—I believe it is in about the third paragraph of your statement, concerning a policy to control margins on futures exchanges—does anyone have the authority to set margins?

Mr. WATTS. We do.

Mr. O'NEAL. You do, yourself?

Mr. WATTS. We do, ourselves.

Mr. O'NEAL. What is your present rule on margins?

Mr. WATTS. We have an escalated clause on margins. Our margins will run 15 to 20 percent of the value of the contract.

Mr. O'NEAL. Never as low as 5 percent?

Mr. WATTS. Oh, no, no; 10 percent, about.

Mr. O'NEAL. Thank you. That is all.

That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions of the witness?

If not, Mr. Watts, we thank you very much again for your appearance here this morning.

We will now ask Mr. Robert Parrott of Fort Wayne, Ind., chairman of the Commodity Exchange Committee of the Grain & Feed Dealers National Association, to come forward.

We will be glad to hear from you now, Mr. Parrott.

STATEMENT OF ROBERT B. PARROTT, EXECUTIVE VICE PRESIDENT OF CENTRAL SOYA CO., INC., AND CHAIRMAN OF THE COMMODITY EXCHANGE COMMITTEE OF THE GRAIN & FEED DEALERS NATIONAL ASSOCIATION, FORT WAYNE, IND.

Mr. PARROTT. Mr. Chairman, and members of the committee. First, Mr. Chairman, may I say that I greatly appreciate your efforts to accommodate my time schedule for which I thank you.

I am Robert B. Parrott, executive vice president of Central Soya Co., Inc., Fort Wayne, Ind. I am also a director and chairman of the

Commodity Exchange Committee of the Grain & Feed Dealers National Association, for whom I make this appearance today.

It is again a privilege to appear before you, as I did last year in the same capacity on H.R. 11788, an earlier bill to amend the Commodity Exchange Act. I described at that time our organization, which speaks for much of the grain and feed marketing and processing industry. I also reviewed the functions of futures markets and stressed their importance to us. We applauded at that time the desire to improve regulation of futures markets and we expressed support for many good features in the bill proposed then. At the same time, we objected to certain other features which, in our opinion, reflected basic misunderstanding of futures trading. There were three proposals to which we raised strongest objection; namely, (1) a definition of "manipulation"; (2) a grant of authority to the Secretary of Agriculture to control margins in commodity futures transactions, and (3) authorization for the use of cease-and-desist orders and injunctions for violations of the act which are not clearly defined or immediately identifiable.

We are pleased to observe that the first and the second of these features—relating to manipulation and margin control—have been deleted from the present bill. We must conclude that last year's hearings were very helpful, certainly, to us as well as to the draftsmen of the present bill, and we reaffirm our intention to approach this bill in a constructive spirit, underlined by recognition of the need for improvement.

I shall not burden you with a section-by-section analysis of the bill, which would necessarily duplicate some of the testimony developed last year. Instead, I shall record our agreement with its major thrusts, although with minor reservations in several areas, and very strongly reiterate our concern over two remaining areas which we think are inappropriately handled and reflect continuing misunderstanding of the fundamental concept of futures trading.

One major feature of the present bill is strengthening of the provision guaranteeing financial responsibility of those who trade in contract markets. We support this effort fully, not because financial irresponsibility has presented a problem where futures contracts are concerned, but because we believe that extra ounce of prevention is desirable. Last year, we opposed a provision which would have given the Secretary authority, in the first instance, to prescribe minimum financial requirements, because we did not know what level of substance he deemed adequate, and because we were concerned that unreasonable requirements might exclude smaller firms which have contributed so much to the vigor of competition on futures markets. The proposal in the present bill, which would permit contract markets to formulate their own standards subject to the approval of the Secretary, seems a worthwhile improvement.

The present bill also would authorize the Secretary to disapprove any bylaw, rule, regulation, or resolution of a contract market which relates to terms and conditions in contracts of sale, or to other trading requirements. We believe that this is an improvement over a provision in last year's bill which would have given the Secretary authority to prescribe, in the first instance, contract market rules. We support this new approach.

The bill also requires the maintenance of records, in form prescribed by the Secretary, of futures transactions, cash transactions by members, and meetings of contract markets and its governing committees, and requires that these records be made available for inspection by representatives of the Department of Agriculture and Justice. These changes would improve both the scope and efficiency of enforcement procedures.

We support these changes, including financial responsibility, market rules, and recordkeeping, with but one reservation. The bill should clearly state in each case that the Secretary's requirements are reasonable.

Another major focus in this bill is upon penalties which, for some violations are made more severe, and in other cases are made more precise in their application. We also support these changes, with the single reservation that the proposed enforcement procedures involving certain types of offenses are not yet adapted to market realities. This we will discuss a bit later.

We also concur in the proposed addition of coffee, sugar, livestock, and livestock products, but here we would go even further. On the principle that abuses which occur on any futures market may reflect adversely upon others, we believe that all futures markets in the United States should be subject to the same fair and rigorous regulation. This would include such nonagricultural commodities as copper and silver, both of which trade much more actively than coffee. Parenthetically, I will say that inclusion of nonagricultural commodities raises a question of the appropriateness of maintaining this regulatory function in the Department of Agriculture. We will address this question in our concluding remarks.

It is anomalous, in any event, that some futures markets should be regulated while others are not; and the anomaly is only accentuated by the piecemeal addition of certain commodities alongside the conspicuous omission of others, more actively traded.

While in the foregoing major particulars, and in many unmentioned details, we understand and endorse what we believe the draftsmen of this legislation are trying to do, we retain serious misgivings concerning some of the proposed enforcement procedures. Two are especially important to us.

First, the bill would authorize the Secretary to issue and enforce cease-and-desist orders and to seek injunctions against manipulation. We believe these remedies are inappropriate in the case of suspected manipulation. Indeed, they are fundamentally at odds with the realities of futures market trading. Establishing the existence of manipulation requires, among other things, a finding that an unwarranted or unreasonable price change has occurred as a result of actions attributable to the accused. We cannot agree that the Secretary is able, or possesses the clairvoyance, to identify unwarranted or unreasonable price change while it is occurring.

The Secretary has at his disposal after the fact the information and resources 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. It is simply not possible to say this in advance. Indeed, this is why

we have futures markets where differing opinions of prospective price changes can be reflected and reconciled, in price development. 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 what price change is unreasonable or unwarranted as it occurs.

It is common knowledge, and surely 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 market. The Secretary's opinion of "warranted price change" differed from the market's opinion and the Secretary was proved to be wrong.

If the Secretary had the ability to anticipate unwarranted or unreasonable price change, he would, by the same token, know what prices were warranted and reasonable. Under these circumstances, there would be no need for markets. The Secretary simply could be empowered to set the prices at appropriate levels.

Given the authority to act on such beliefs—by issuing and enforcing a cease-and-desist order, or by seeking an injunction against a suspected manipulator—the Secretary could prevent price changes fully justified by facts but not then known to him. The result could be inestimable damage not just to the accused but to other traders who shared his assessment of values. The latter have no way to recover losses even if the Secretary is later shown to have been wrong.

It is in the public interest that artificial price levels and unwarranted price changes are to be avoided, including those that might be caused by the Secretary of Agriculture through the use of cease-and-desist or injunctive procedures in situations which can only be assessed after the fact.

In this light several provisions of the proposed bill are seen as inappropriate: (1) Section 16(a) would authorize the Secretary, upon evidence that suggests manipulation to issue an order prohibiting the accused from trading on any contract market, and require all contract markets to refuse him trading privileges. (2) Under section 17 violation of such an order would constitute a felony punishable by imprisonment for as long as 5 years, notwithstanding the fact that later appeal exonerates the accused. (3) Under sections 11 and 15 the designation of a contract market could be suspended or revoked for refusal to enforce such an order. (4) Section 26 would authorize the Secretary to secure injunctions in the case of suspected manipulation. These sections pose very grave threats to effective operation of contract markets. They should be stricken from the bill.

A second major flaw in proposed enforcement procedures involve right of appeal from decisions of the Secretary and the Commission under the act. Section 15, for example, provides that no order of the Commission suspending or revoking the designation of a contract market "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." The same standard is proposed in section 16(b) governing right of appeal from the Secretary's finding of manipulation and section 18, which provides for fine and imprisonment for failure of a contract market, or its

managers or employees or observe a cease-and-desist order. Under this proposal an appeal court would be required to sustain an order of the Secretary or of the Commission in cases involving fines up to \$10,000 and imprisonment for periods up to 5 years, even though the weight of the evidence supports reversal.

The danger of this proposed procedure is underscored by the record of enforcement proceedings before the Commodity Exchange Authority. So far as we can determine, no respondent has ever prevailed in a proceeding which went to a decision by the Secretary. On the other hand, decisions of the Secretary often have been reversed by appeals courts.

It is true that there are administrative agencies whose decisions are subject to judicial review where the reviewing court must accept the agencies' findings if they are supported only by substantial evidence. The powers of the Secretary of Agriculture under the Commodity Exchange Act, however, are exceedingly broad. That power could be characterized as the power to inflict an "economic death" penalty. At least one appellate court has also indicated that it may not look into the severity of penalties imposed under the Commodity Exchange Act if the findings of a violation be sustained. Thus, only through judicial review of findings of fact can the courts offer significant protection to those who wrongfully are found by the administrative agency to have violated the act and who are punished severely therefor. The present law, with its somewhat broader scope of review, conforms to the American tradition that severe penalties should not be inflicted without some safeguards provided by courts experienced in the judicial craft of weighing evidence. The cases decided under the Commodity Exchange Act do not indicate that the safeguard of relatively broad judicial review has hampered enforcement of the policies of the act.

Both orderly administration of the act and basic considerations of fair treatment to the accused support the elimination of this concept from the bill.

I shall conclude with a more general observation about regulation and enforcement of fair practices on contract markets. We observe that these important institutions cannot flourish without public confidence. For this reason, and for protection of the public, they should be subject to fair, constructive and otherwise enlightened supervision. We have already noted that extension of the act to futures trading in nonagricultural commodities raises a question about the appropriateness of maintaining the regulatory authority in the Department of Agriculture. We would mention still another, more important consideration which points toward the same conclusion. The Secretary of Agriculture has major responsibilities to influence agricultural prices—responsibilities which often are inconsistent with and interfere with the free functioning of public markets. To the extent the Secretary seeks to achieve price levels or price behavior patterns which are not characteristic of what free markets evoke, there is basic conflict between his price stabilization and market regulatory function. This strongly implies that the regulation of the marketplace might better be vested in an autonomous Commodity Exchange Authority.

With the changes we have suggested, we strongly support enactment of the present bill. We congratulate the committee for having patiently

heard and studied a wide range of viewpoints and evidence in exemplary demonstration of the legislative process.

Thank you.

The CHAIRMAN. We thank you very much.

We are very much obliged to you for your statement.

Mr. Dole?

Mr. DOLE. I have one question. I have others, but in the interest of time I will confine it to one question.

On page 6 of your statement, you state:

"So far as we can determine, no respondent has ever prevailed in a proceeding which went to a decision by the Secretary. On the other hand, decisions by the Secretary often have been reversed by appeals courts."

I wonder if you might add to that information as to the number of decisions?

Mr. PARROTT. I am not familiar with the number. We will be very happy to provide the record with the precise number.

Mr. DOLE. Plus information about how many have been reversed by the appeals courts, if you will, please.

Mr. PARROTT. We will be very glad to provide that information. I am sorry I cannot provide it at the moment.

Mr. DOLE. Thank you. That is all at the moment.

That is all, Mr. Chairman.

The CHAIRMAN. That will be made a part of the record at this point.

(The information referred to follows:)

Dr. Mehren, Secretary for Consumer and Marketing Service, U.S. Department of Agriculture, testified as follows: "May I point out that although there were orders by the Secretary in 14 administrative cases which were appealed in the Federal courts, one criminal case has been appealed to a higher court, only in three of such cases have we been reversed." See page 44.

The CHAIRMAN. Mr. Kleppe?

Mr. KLEPPE. Mr. Parrott, it is quite obvious that you are very concerned about manipulation in these markets in this futures trading.

The stock market has the Securities and Exchange Commission. The commodities market now has CEA.

If I understand your statement correctly, you are indicating that there is a conflict, a lack of knowledge on the part of the Secretary to make certain decisions relative to manipulations and prosecutions as it were, and in the latter part of your statement you indicate that you think it would be better to have an autonomous CEA make these rulings and the decisions. Is that basically correct?

Mr. PARROTT. I think you have asked about three questions.

We question the wisdom of anyone, including the Secretary, at any time during the price development period, to determine whether it is motivated by a speculative situation.

We do feel that there is an indigenous conflict—that the Secretary of Agriculture, in his position, in charge of our agricultural policies and in charge of the CEA which is administering the futures markets.

Mr. KLEPPE. You do not contend that there need not be some control on manipulations, however, do you?

Mr. PARROTT. Not at all. I tried to state that rather clearly in the statement.

Mr. KLEPPE. I gathered that from your statement.

Mr. PARROTT. Surely.

Mr. KLEPPE. You feel that it is necessary that the confidence of the public must be maintained and kept, and, of course, manipulation is one of these things that needs control. And you and I know that.

Mr. PARROTT. Very definitely.

Mr. KLEPPE. So, I think that I understand your statement, but I wanted to get that clear for the record.

Mr. PARROTT. That is right.

Mr. KLEPPE. Thank you.

That is all, Mr. Chairman.

The CHAIRMAN. Thank you again very much.

Mr. PARROTT. Thank you.

The CHAIRMAN. We appreciate your attendance here this morning, Mr. Parrott.

We will next call on Mr. Rice B. Ober, president of the American Cotton Shippers Association, who is accompanied by Neal P. Gillen and J. Anthony Moran.

We will be glad to hear from you now, Mr. Ober.

STATEMENT OF RICE B. OBER, PRESIDENT, AMERICAN COTTON SHIPPERS ASSOCIATION, ACCOMPANIED BY NEAL P. GILLEN, VICE PRESIDENT, WASHINGTON OFFICE, AND J. ANTHONY MORAN, LEGISLATIVE COUNSEL, AMERICAN COTTON SHIPPERS ASSOCIATION

Mr. OBER. Mr. Chairman, I am Rice B. Ober of Los Angeles Calif., and I am associated with the firm of J. G. Boswell Co., of that city. This morning I am accompanied by Neal P. Gillen, vice president, Washington office, American Cotton Shippers Association and Mr. J. Anthony Moran the association's legislative counsel. My firm has been engaged in the cotton merchandising business since 1927. In connection with this operation, we have utilized the various commodity exchanges, particularly the New York Cotton Exchange for cotton futures.

I appear here this morning as president of the American Cotton Shippers Association. The ACSA was founded in 1924 and is basically comprised of merchants, shippers, and exporters of raw cotton who are members of six affiliated associations located throughout the cotton belt: Arkansas-Missouri Cotton Trade Association, Atlantic Cotton Association, Oklahoma State Cotton Exchange, Southern Cotton Association, Texas Cotton Association, and Western Cotton Shippers Association.

The association members are actively interested in a useful and functioning cotton futures exchange—which we hope will be possible as the loan level is reduced sufficiently to permit a return to a market price system.

The cotton futures exchange has been an extremely useful merchandising facility in the past, and the new contract which has just been introduced in the New York Exchange has resulted in some increase in cotton futures trading this season. We are opposed to any new statutory provisions which will make it less useful for hedging merchandising operations when it can function freely.

Those provisions of H.R. 11930, which deal with the protection of customers and control of broker operations do not concern us directly, and we believe are likely to be useful and acceptable to the exchange.

Section 3 amending section 4a(2)(B) of the Commodity Exchange Act makes it unlawful to "hold or control" futures in excess of the prescribed limit instead of "to buy or sell" futures that result in establishing a position in excess of such limit. The purpose of this change is not entirely clear but it is possible that under the present wording a merchant with a large short-hedge position in futures could liquidate his stock of spot cotton and retain all of his futures, or retain a long futures position after he had satisfied his short spot commitments. Under the new language he would have to liquidate his future position as he closed out his spot position, down to any prescribed limit. Since this is the ordinary course which a hedger would follow in any event, we do not regard the proposed amendment as hurtful, though we recognize that it may on occasion be more restrictive than the present law.

Section 4 amends section 4a(3) of the Commodity Exchange Authority Act apparently to make it consistent with the amended section 4a(2)(B). The provision seems consistent with the actual part administration of the Commodity Exchange Authority Act, and our only concern is with possible interpretations which will tend to restrict the freedom of choice of a merchant in the placement of a hedge against a particular spot transaction or position. If we interpret this amendment correctly, however, it does not give the CEA any greater authority to control the merchant's discretion in the placement of hedges than now exists.

This leads up, however, to a provision to which we do object, and that is section 16(b) on page 15 which substitutes "substantial evidence on the record as a whole" for the present "weight of evidence" rule. This change would in effect make a decision of the Secretary of Agriculture final as to whether a transaction or position was in fact hedging, or as to whether the maintenance of a position constituted manipulation or not. With the Secretary acting as policeman and prosecution, we believe it is important that a reviewing court retain its existing authority to consider whether the Secretary's decision is supported by the "weight of the evidence," not just "any substantial evidence."

We feel rather strongly about this because of the *Volkart* case which was decided in 1962. We note that H.R. 11930 does not contain the objectionable definition of the word "manipulate" which the Department proposed in H.R. 11788 in the 89th Congress, but if a reviewing court is limited as section 16(b) proposes, there is still no opportunity for consideration by a really impartial tribunal.

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 that 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 Bros. 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 rule of law proposed; that is, the "any substantial evidence" rule proposed in section 16(b), 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 so long as the whole policing, prosecuting, and adjudication functions are placed in the Secretary of Agriculture that the present court review rule be maintained. The very great pricing functions entrusted to the Secretary by other legislation, and the Department's large speculative position in cotton and other commodities adds further support to the need of wide court review.

Perhaps the importance of this is made more obvious by the fact that proposed section 25 amends section 2(b) to make any manipulation or attempt to manipulate a felony punishable by \$10,000 fine and 5 years imprisonment or both. Section 27(b) would provide that the Secretary need not report minor violations for prosecution, but it does not require much imagination to see the pressure which can be put upon anyone suspected of an "attempt to manipulate" to accept an administrative penalty rather than run the risk of felony prosecution. We do not believe this offense should be raised from a misdemeanor to a felony, particularly with the very wide powers to be given the Secretary to handle such offenses administratively.

We view with some apprehension the provision of section 26 which would authorize the use of temporary injunctions, without bond, and writs of mandamus to compel compliance with provisions of the act. This provision while it requires action by the courts still would make it possible to impose tremendous damages on a trader, with no possible recoupment if the final decision favored him.

We respectfully urge that the remedies otherwise provided are quite adequate and that this section 26 should be omitted. With reasonable cooperation of the Commodity Exchange Commission with the markets, adequate steps can be taken to avoid or liquidate situations which are regarded as questionable. In fact, such cooperation can be far more effective than any amount of regulatory power.

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 di-

rectly involved in seeing that this is accomplished. While the DeAngelis 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 happy that there is no such proposal in H.R. 11930.

Mr. Chairman and members of the committee, I thank you for permitting me to appear here today and make known to you the views of the American Cotton Shippers Association on H.R. 11930. With the committee's permission, I would like to submit for the record the opinion rendered by the U.S. court of appeals in the *Volkart* case.

The CHAIRMAN. That opinion is a public record now. It could well be filed with the records of this committee. It will not be included in the printed record of these hearings, because it has already been printed.

Mr. OBER. Thank you.

The CHAIRMAN. We are very much obliged to you, Mr. Ober.

Does anyone want to question Mr. Ober?

If not, we thank you again.

Mr. OBER. Thank you, very much.

The CHAIRMAN. And we will now call on Mr. W. C. Theis, president of the Kansas City Board of Trade, who is accompanied by Mr. J. S. Chartrand.

We will be glad to hear from you now.

**STATEMENT OF WILLIS C. THEIS, PRESIDENT, BOARD OF TRADE
OF KANSAS CITY, MO.; ACCOMPANIED BY J. S. CHARTRAND,
SECOND VICE PRESIDENT, KANSAS CITY BOARD OF TRADE**

Mr. THEIS. Mr. Chairman and members of the committee, I have accompanying me the second vice president of the Kansas City Board of Trade, Mr. J. S. Chartrand.

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. Our association was officially licensed under the 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 and find some changes we can accept; others merely incorporate into the law what our market has been doing for the past 90 years; and those that would be highly detrimental to us.

The first point is: Expansion of the Commodity Exchange Commission.

As proposed, the word "commission" in section 2(a) would be redefined as follows:

The words "the commission" shall mean the Commodity Exchange Commission, consisting of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General, or an official or employee of each of the executive departments concerned, designated by the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General, respectively; and the Secretary of Agriculture or his designee shall serve as chairman.

Throughout the entire act "the commission" is given extensive powers which today are lodged with the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General acting together. Under the proposed amendment any official or employee appointed by those three will be able to act as a "commission" with the same stature as the Secretaries and the Attorney General.

One very important power delegated to that commission includes authority to suspend or to revoke the designation of any board of trade as a "contract market"—section 6(a). The present language, in effect since the inception of the act, states:

A commission composed of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General 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 . . .

The Congress did not rely upon a definition of "commission" in delegating this power to "a commission composed of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General."

Section 6(a) provides for the suspension or revocation of the designation of any board of trade as a "contract market" if it "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 or the commission thereunder." Therefore, a new source of authority will make rules, regulations, and orders by which the markets will be bound, adding to the existing mass of Federal regulation. We maintain that the present power vested in the Secretary of Agriculture, the Commodity Exchange Commission, and the Commodity Exchange Authority is fully adequate to regulate the activities of any contract market. The proposed amendment carries with it a probable lack of continuity in an employee-commission whereby the designees would change from time to time instead of having these important duties delegated to the chief executive officers—the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General.

We oppose any expansion of the Commodity Exchange Commission because the act is replete with references to "the commission" and enumerates its powers over contract markets. To date, these powers have been vested in the two Secretaries and the Attorney General. We respectfully request that the present Commodity Exchange Commission remain unchanged.

The second point is: Burdensome and irrelevant recordkeeping by the contract markets.

Section 5a of the Commodity Exchange Act reads in part:

Each contract market shall . . . *keep all books, records, minutes, and journals of proceedings of such contract market, and its governing board, committees, subsidiaries, and affiliates in a manner that will clearly describe all matters discussed by such contract market, governing board, committees, subsidiaries, and affiliates and reveal any such action taken in such matters* . . . (Italic indicates language added.)

The Kansas City Board of Trade has always kept proper records and minutes of the proceedings of our governing board and committees. The proposed language would require us to keep all books, records, minutes, and journals of proceedings in a manner that will clearly describe "all matters discussed" by such contract market, governing board, committees, subsidiaries, and affiliates, which goes far beyond things pertinent to the Commodity Exchange Act. Secondly, it is one

thing to have our records and minutes show the action taken by our governing board, committees, et cetera, and something entirely different to "clearly describe all matters discussed."

We believe this an unwarranted inquiry and an infringement upon our freedom of discussion, an unduly burdensome requirement, and completely irrelevant to administration of the Commodity Exchange Act.

The third point is: Control over the rules of a contract market by the Secretary of Agriculture.

For over 90 years the Kansas City Board of Trade has maintained established rules and regulations regarding the terms and conditions in contracts of sale and other trading requirements. The preamble of our constitution states:

The objects of this Association are: to maintain a Board of Trade; to promote uniformity in the customs and usages of merchants; to inculcate principles of justice and equity in business; to facilitate the speedy adjustment of business disputes; to inspire confidence in the business methods and integrity of the parties hereto; to collect and disseminate valuable commercial and economic information; and generally to secure to its members the benefits of co-operation in the furtherance of their legitimate pursuits, and to promote the general welfare of Kansas City.

Throughout these years the principles of justice and equity have been maintained; we have facilitated the speedy adjustment of business disputes; and have inspired confidence in the business methods and integrity of the parties.

Under the proposed language in section 5a(8), the contract markets are required to enforce all bylaws, rules, regulations, and resolutions "which have not been disapproved by the Secretary of Agriculture," and are required to "revoke and not enforce any such bylaw, rule, regulation or resolution made, issued or proposed by it or by the governing board thereof or any committee, which has been so disapproved * * *." This language gives the Secretary of Agriculture complete power over the rules, bylaws, regulations, and resolutions of all contract markets.

Our board of trade has proven that it is capable of establishing rules and regulations pertaining to trading requirements, and has done so for the past 45 years as a licensed contract market—and for another 45 years prior to the Grain Futures Act. In the past 45 years we have worked in cooperation with the Commodity Exchange Authority maintaining rules and regulations that are consistent with and not in contravention of the Commodity Exchange Act. We have a special chapter in our book of rules which states in part:

In order to comply with the Act of Congress known as the Commodity Exchange Act, as amended, it is hereby provided that all rules of the Association shall be construed with reference to and shall be deemed subject to and modified by the provisions of the said Act and by any lawful regulation or order made by the authority of said Act.

At no time have we been unresponsive to the wishes of the Commodity Exchange Authority in carrying out the purpose of the act. The impact of the new language in section 5a(8) is that it affirmatively states that each contract market shall "enforce all of its bylaws, rules, regulations, and resolutions, etc.," and other sections add statutory penalties for any departure therefrom. Section 6(a) authorizes suspension or revocation of a contract market upon a

showing that such board of trade is not enforcing or has not enforced its rules of government. Section 6b makes any director, officer, agent, or employee of such contract market guilty of a misdemeanor if the rules and regulations of the contract market are not enforced or have not been enforced.

The upshot of section 5a(8), section 6(a), and section 6b, when read together, is that full responsibility is thrust upon the market and its employees for enforcing the Commodity Exchange Act and rules approved by the Secretary, or they shall suffer the penalties attached thereto. We maintain that this is an unwarranted shift of responsibility from the Commodity Exchange Authority to the commodity exchanges. There is no evidence in the last 45 years to warrant this drastic action by the imposition of statutory penalties against the individuals of an exchange or a suspension and revocation of the contract market's license. The purpose of these amendments is to put teeth into the act where they are not warranted. Our reputation as a contract market while under Federal regulation has been one of cooperation and compliance and not one of defiance. We respectfully urge that these sections be deleted from the bill as unwarranted legislation or control.

Secretary of Agriculture's control over minimum financial standards for future commission merchants:

Section 5a(9) states in part:

Each contract market shall enforce all its bylaws, rules, regulations, resolutions... which provide minimum financial standards and related reporting requirements for futures commission merchants... which have been approved by the Secretary of Agriculture.

This requirement is coupled with provisions of section 4f(2) which requires that futures commission merchants conform to the minimum financial standards set by a contract market "and approved by the Secretary of Agriculture." The language requiring us to enforce our rules in this respect is likewise an unwarranted shift of responsibility from the Commodity Exchange Authority to the markets. As a penalty, the license of a contract market can be suspended or revoked, or the employees thereof be deemed guilty of a misdemeanor subject to fine and imprisonment.

It should be said at this point that our market has had minimum financial requirements far longer than the Commodity Exchange Authority. Recently we had an applicant whose financial status was not the strongest, and because of this impending change in the act, we contacted the Commodity Exchange Authority hoping to ascertain whether or not the minimum financial standards we deem sufficient would square with their requirements. We were advised that the Authority had no minimum financial standards or could even give us a "rule of thumb" to follow. All of a sudden now, the Secretary of Agriculture is going to be empowered to "approve" minimum financial standards of futures commission merchants and control our standards. We maintain that the financial standards that we have been applying over the past 90 years have been adequate—adequate protection to the public and to our members in all of the millions of transactions that have transpired. There is no justification for an authority that has no minimum financial standards to take over—and impose the severest of penalties if we do not enforce its approved standards. We

maintain that there is no justification that this authority be vested in the Secretary of Agriculture—nor for the fine, imprisonment, suspension, and revocation penalties set forth in the proposed amendment.

The fifth point is: Burden of proof.

The last sentence of section 6(b) is being changed to read:

Upon the filing of the transcript the court shall have jurisdiction to affirm, to set aside, or modify the order of the Secretary of Agriculture, and the findings of the Secretary of Agriculture as to the facts, if supported by substantial evidence on the record considered as a whole, shall in like manner be conclusive.

This section presently provides that the findings of the Secretary shall be conclusive if supported "by the weight of evidence." Rather than an order being supported by a preponderance of proof, it could be supported by a nebulous range from a bare minimum of evidence to that supported by an arbitrary and capricious action. Any order of the Secretary that would result in denial of trading privileges should be supported by undisputed proof of its violation of the law rather than minimum requirements. In like manner, section 6(a) which authorizes the suspension or revocation of a contract market's license has the new "substantial evidence" rule. That section states in part:

No such order of the commission 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 . . .

We maintain that whether it be the Secretary of Agriculture or "the commission" who issues an order that will suspend or revoke the license of a contract market or a futures commission merchant, it should be supported by undisputed proof rather than minimum requirements of evidence.

The sixth point is: Unwarranted disclosure of confidential information.

The proposed amendment to section 8 of the act would expand the department or agencies to whom the Secretary of Agriculture would disclose information relating to the amount of commodities purchased and sold by each of our traders and any other information in the possession of the Department of Agriculture relating thereto. The added language reads as follows:

. . . 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 any such department or agency except in any action or proceedings under the laws of the United States to which it, or the Secretary of Agriculture, or the United States is a party.

In our opinion, this is an unwarranted extension of the disclosure by the Secretary of Agriculture and makes available to any department or agency of the executive branch of the Government complete information relative to the purchase or sale of commodities on our exchange. We maintain that this is a further encroachment on private business by departments or agencies not directly connected with the Department of Agriculture.

We respectfully request that the present provision of the act with regard to disclosures of such information should not be expanded as proposed.

The seventh point is: Unwarranted penalties for errors of omission. Section 9(c) states, in part:

... 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 cost of prosecution, for any person . . . to fail to evidence any contract mentioned in Section 4 of this Act by a record in writing as therein required.

Section 4 requires that it shall be unlawful for any person to make or execute a contract except where such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its price, and the terms of delivery. The keeping of records in writing for contracts so made is presently in effect and subject to scrutiny by the Commodity Exchange Authority. All of the futures transactions are completely documented from the time the trade is made until it is consummated, and our cooperation with the authority has been fully evident. Now specific money and imprisonment penalties are to be imposed if any one of our members "fail to evidence any contract by a record in writing as required in section 4." As proposed, any unintentional error of omission would be subject to fine or imprisonment, or both, because there is no qualification attached to the failure to make such a written record. If such failure is to be deemed a misdemeanor, it should be accompanied by words of intent such as "willfully" or "knowingly." Without language showing intent, any failure to make a record in writing is subject to a penalty.

We respectfully request that unless the language is revised to read in part: "to willfully fail to evidence any contract mentioned in section 4 of this act by a record in writing as required therein," that that phrase be eliminated from section 9(c).

Our eighth point is: Further evidence of intent.

In order to maintain evidence of intent, the first part of section 13(a) which presently reads:

Any person who commits, or who willfully aids, or who abets, counsels, commands, induces, or procures the commission of, a violation of any provision of this Act . . .

should be changed to read as follows:

Any person who willfully commits, aids, abets, counsels, commands, induces, or procures the commission of a violation of any of the provisions of this Act . . .

This would place the word "willfully" where it properly belongs ahead of all of the verbs contained in this language in order that "commits" not be left unattended by the intent requirement. In another part of the same section the word "willfully" precedes the word "causes", thus carrying out the requirement that intent be shown. In order to make the entire section consistent, the aforementioned change in language should be made in section 13(a).

We thank the Committee on Agriculture for the opportunity to appear and be heard today on H.R. 11930 in which our members are vitally interested.

Thank you.

The CHAIRMAN. Thank you.

Are there any questions of the witness?

If not, we are very much obliged to you.

It is to be regretted that we could not complete all of the list of witnesses. Tomorrow morning we will start with Dr. Mehren, and, in addition, we have four other witnesses who are listed for today. We have listed for Thursday seven more witnesses. I doubt very much if we will complete them. We will do our best to hear the out-of-town witnesses first tomorrow.

The committee stands in recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:10 p.m., a recess was taken until 10 a.m., Thursday, August 17, 1967.)

AMEND THE COMMODITY EXCHANGE ACT

THURSDAY, AUGUST 17, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 1301, Longworth House Office Building, Washington, D.C., Hon. W. R. Poage, chairman, presiding.

Present: Representatives Poage (presiding), Gathings, Jones of Missouri, Purcell, O'Neal, Foley, de la Garza, Vigorito, Montgomery, Belcher, Teague of California, Dole, Miller, Burke, Mathias, Mayne, Zwach, Kleppe, and Myers.

Also present: Christine S. Gallagher, clerk; Hyde H. Murray, assistant counsel; and Francis LeMay, consultant.

The CHAIRMAN. We are met this morning for further consideration of H.R. 11930.

Our first witness is the Assistant Secretary of Agriculture, Dr. George Mehren.

We will try our best to accommodate as many witnesses as we can, although we will meet this afternoon.

I want everyone to know that the chairman has to leave this meeting to appear before the Rules Committee at 10:45 and I want you, accordingly, to know why I am walking out whenever I do.

We will now be glad to hear from you, Dr. Mehren.

STATEMENT OF GEORGE L. MEHREN, ASSISTANT SECRETARY FOR MARKETING AND CONSUMER SERVICE, ACCOMPANIED BY ALEX C. CALDWELL, ADMINISTRATOR, COMMODITY EXCHANGE AUTHORITY; RODNEY E. LEONARD, DEPUTY ASSISTANT SECRETARY; AND MRS. LOTUS (THERKELSEN) PROKOF, OFFICE OF THE GENERAL COUNSEL, U.S. DEPARTMENT OF AGRICULTURE

Dr. MEHREN. Mr. Chairman, members of the committee:

I am here today to urge the Congress to amend the Commodity Exchange Act to provide the minimal authorities necessary to assure honest, open, and efficient futures trading in regulated agricultural commodities. The Department has frequently submitted amendatory bills for this purpose. This bill, H.R. 11930, does not include all we have requested in earlier bills, but does provide proper and necessary instruments to carry out the original intent of the Congress in regulating commodity trading under conditions which prevail today.

We are requesting specific—and thus limited—authority to disapprove exchange bylaws and rules of exchanges which are contrary to the Commodity Exchange Act; to issue cease-and-desist orders; to require minimum financial requirements for commission merchants.

We ask that four commodities, now totally unregulated, be brought under this act. We ask that the courts be given injunctive power under carefully specified requirements to halt violations in process. We ask for several provisions intended to protect customer funds held by brokers. These and other provisions are intended to achieve the intent of Congress to adequately regulate commodity markets.

We do not ask—as we did before the 89th Congress—to give the Secretary authority to designate new commodities or to prescribe margins or trading rules. Nor do we ask to eliminate the Commodity Exchange Commission or to define the term “manipulate.”

This statute, the present one, if unamended, will provide an inadequate basis to govern the 17 million transactions involving \$75 billion in annual volume now done by commodity exchanges in regulated commodities alone. The great bulk of trading is done by people motivated solely by wish for speculative profit.

I do not make this statement as a judgment between good and evil. This is not my purpose. Futures trading is neither evil or bereft of economic sense—although a grain corporation president once described it as “like a roulette wheel with elbow, wrist, and knee control.” Neither is it a model of perfect, honest, fully competitive activity in the absence of which this economy would be crippled.

I am not here, however, to debate the propriety or usefulness of futures trading. This point is not at issue. We seek only to close some major, and glaring, loopholes which now render the present statute less effective than we believe the Congress intended. The cold facts are that in these generally useful and honest operations there is a long history of manipulation, fraud, and dishonesty inimical to the exchanges and to those who use them—and quite clearly hostile to the interest of the public.

And I am not here to ask to limit speculation. Speculation may not be evil, but neither is it “a thing of beauty and a joy forever” as one academician last year testified. Speculators are doing no more than arbitraging—the nontechnical word is betting—on which of different expectations of future prices will be right. But that is not at issue here. Every competent person knows what speculation is, and why it is needed.

We ask only for the minimal regulatory instruments necessary to insure that futures trading be honest, open, and efficient.

The regulations now prevailing have had no adverse impact on trading. That is clear. Trading volume has peaked at record level for 5 straight years. So, with full respect, I say again that we are not here to argue the general philosophy of market regulations. We are here to ask for specific, and limited, authority to protect the public of this Nation against the continuing threat of serious offense to its interest.

There have been pleas that the exchanges can and have regulated themselves. That plea is unfounded. There are documented abuses by the score—from petty thievery to operations of confidence men, to swindling—like paying a “sucker” high and fictional “dividends” for a few weeks to encourage larger deposits which then are embezzled.

Much such violations do not involve market members. Many do involve market members. One of the largest speculators in history operated by persuading eight prominent brokerage houses knowingly

to falsify their records in order cooperatively to conceal his speculations. This speculator stated when apprehended that due to what he called "harassment and interference" by Federal Government, he would sell out his long grain position and go back to Canada. He had no long position. He had a short, a very large short position. His threat was false, but not foolish. Its purpose was to depress the market so he could buy in his short position at a profit.

A large company once sold oat futures heavily at Chicago with offsetting purchases on the Winnipeg Grain Exchange. Then they moved actual oats from Winnipeg to Chicago to depress Chicago prices in relation to Winnipeg.

Abuses in spot and future markets are often interrelated and we need authority to inquire into both. One prominent speculator once lost heavily in a manipulative attempt partly financed by warehouse receipts on soybeans—yet the elevators were empty when his creditors tried to redeem the receipts.

Thus where cash trading is merely an adjunct to futures operations, it too should be observed. Cash handling has in fact been used to protect and promote large manipulative and speculative futures activities instead of using futures to protect actual commodity transactions.

I cannot believe in this regard that the DeAngelis scandal—a \$150 million swindle—can be distorted to prove there is no need for further regulation; that harassment and interference must be avoided, and that this trade can, does, and always will regulate itself. The New York Stock Exchange—whose member firms contributed some \$12 million to prevent loss to the customers of one member firm—is not quite so pious. It imposes and enforces special requirements on members who also deal in commodity futures.

These examples are not simply horror stories. They are offered not as a means of showing how to get clipped in commodities, nor as a generalized disparagement of futures trading. They are offered to show with cold, hard, costly, and often dirty cases that regulation is still inadequate.

We propose no regulations that will impair the market liquidity necessary both to hedging and price determination. But neither of these functions is served by massive speculation in which powerful interests slug it out to make the market go the way that best will serve their own speculative positions.

We know that a balance must be struck in regulation to contain erratic or artificial price gyrations, yet not to dry up trading so as to limit efficient hedging. Pleas that the provisions of this bill would dry up trading, or commissions, are unfounded.

Some exchanges have long had business conduct committees intended to assure financial integrity and prevent abuses. As in all trading, longs and shorts compete. Accordingly, the CEA and exchanges—a fact that is also of record—have generally functioned by persuasion, not force. There were predictions in 1922, 1936, and at every other attempt by the Department to plug open holes that these somehow "sinister" efforts would destroy these markets. The committee knows that trading today is at its highest volume in history.

CEA has operated responsibly, soberly—even cautiously—and wherever it could, in cooperation with those exchanges that have and

actually enforce rules of conduct and standards of responsibility. The courts generally have shared the view of CEA that market power can be used to manipulate price, to cheat, defraud, and impair the efficiency of a market which cannot be considered the private domain of those who are members.

May I point out that although there were orders by the Secretary in 14 administrative cases which were appealed in the Federal courts, one criminal case has been appealed to a higher court, only in three of such cases have we been reversed.

Every American has a direct stake in the honesty, the efficiency and the competitive natures of these activities.

INCLUSION OF UNREGULATED COMMODITIES

There often is heavy if sporadic trading in coffee, sugar, livestock, and livestock products now utterly unregulated or even observed. Regulation has been and is needed. About coffee, the Federal Trade Commission reported in 1954:

Sudden and unreasonable price fluctuations intrinsic in a "thin" market are amplified by the failure of the New York Coffee and Sugar Exchange to institute proper safeguards followed by regulated exchanges and to prevent trading abuses and irregularities.

The Commission also stated:

Furthermore, the New York Coffee and Sugar Exchange has failed adequately to police its members and enforce established trading rules and procedures.

The Department of Agriculture reported after study that excessive and totally unregulated speculation in sugar futures stimulated the price explosions of 1963. The Subcommittee on Consumer Affairs of the House Committee on Banking and Currency also studied the sugar situation. Mrs. Leonor K. Sullivan, the subcommittee chairman, later testified her committee found—

a great deal of important information to show that trading in sugar on this exchange (the New York Coffee and Sugar Exchange) should be brought into regulation.

Mrs. Sullivan also testified that:

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 (coffee and sugar)—resulting in wild swings in prices which were reflected in quick order in much higher consumer prices. Both of these episodes (the coffee market in 1953 and 1954 and the sugar market in 1963) could have been prevented, or at least sharply contained, by effective Federal regulation.

Traders and exchanges have argued that imported commodities should not be regulated—and cannot be. Sixty percent of our sugar is domestic and the rest is imported under Federal program. Nearly all of our coffee is imported, but it is a major item of commerce and consumption in this country. There is nothing inherent in these two markets that would preclude effective regulation of noncompetitive or dishonest activities.

Contracts for pork bellies—as one livestock product—spiralled from 400 contracts in 1961 to 727,000 in 1966, and now run about 950,000 to 1 million contracts per year. Of 72 trading days in 1965, price fluctuation limits were hit on 21 days. Of 20 trading days, November 22 through December 20, 1965, limits were hit on 12 days.

On 7 trading days between December 6 and December 14, the market hit the top limit the first 3 days, the bottom the next 2 days, and the top again on the last 2 days. These are violent fluctuations not often seen, and are generated by speculation alone. On December 17, 1965, there were 3,121 speculators trading frozen pork bellies and only 68 hedgers. Speculators held some 12,000 long contracts and 13,000 short contracts. Hedges totaled only 2,000 long and 1,000 short contracts. This was no hedging market. Two percent of the traders were hedgers. Ninety-eight percent were speculators.

CEA has no authority over livestock products, and the trade knows this. Yet a large part of the complaints sent to CEA involve these products. We can do nothing about them.

The need for stability and fair, open, and honest practice is no different for these four commodities than for any others. Regulation would not limit activity that is legitimate; witness the volume of trade in regulated commodities.

PROTECTION OF CUSTOMERS

Many customers trading in regulated commodities entrust funds and orders to a registered brokerage firm which they believe to be reputable and responsible, and to have met statutory standards of financial security as a condition of registration.

This is not true.

The act says nothing about an applicant's fitness or his solvency. We are required to register people who are insolvent, or who are crooks, provided they pay the registration fee. The act sets no financial requirements for the registrant. This deficiency of the present act opens the gates wide for persons inadequately financed, and even confidence men, to obtain Federal brokerage licenses and handle customers' funds and trades.

A few years ago a Las Vegas, Nev., resident, operating under various assumed names and who had been charged both with operating a "bookie" establishment and with grand theft, registered as a futures commission merchant. At the same time, he applied for and obtained membership in a leading commodity exchange under one of his assumed names. Shortly thereafter he defrauded his commodity customers under pretense of making profits in nonexistent future trades and lost the customers' funds in trading for his own account in unregulated sugar futures. He hurriedly left the country and for several years was a fugitive from justice. Recently he was apprehended. He is now serving a term in a Federal penitentiary—which is small consolation to the customers who lost approximately \$60,000 in the brief operation of his firm.

More recently, a corporation without assets applied for registration as a futures commission merchant. It was registered by CEA because we had no authority to deny the application. It filed a financial statement showing substantial cash in the bank and an equivalent amount in capital and surplus. It appears that the financial statement was false. This firm also obtained membership on a leading exchange. The firm went bankrupt. The customers of the firm will lose more than \$22,000 because the firm diverted customers' funds to finance the general operations of the business. The corporation and its principal officers have been indicted by a Federal grand jury and are currently awaiting trial.

In the public interest, neither of the firms should have been registered and permitted to handle customers' trades.

The proposed bill would give the Secretary of Agriculture the authority to deny—under careful requirements of due process—registration to persons of this character who are unfit to engage in the brokerage business. It would also give the Secretary authority to establish minimum financial standards which would help to insure that firms handling customers' trades and funds are adequately financed for this purpose.

There are other situations in which a registrant is completely honest, but just does not have adequate financial resources to operate as a futures commission merchant. A 1- or 2-day rise or drop in a market, and a single customer's failure to supply margin requirements, can seriously jeopardize the funds of other customers of the firm. For example, a Chicago registrant recently filed a statement showing total assets of approximately \$440. It did not include any cash in bank or on hand. In another example, a New York firm had total assets of \$450, almost half of which was machinery and fixtures. The danger of loss of customers' funds under these conditions is abundantly clear.

INJUNCTIVE POWER

Many of these documented abuses—and virtually every market investigation ever made discloses violations—also manifests the need for injunctive power. This is the most vital of the amendments we are submitting for your consideration. It would enable the Secretary to move in a timely fashion under stringent conditions of law and equity, to terminate violations. Now, we must undertake protracted administrative or criminal proceedings before a final order can be issued or a conviction obtained. Often irreparable damage is done, especially where continued fraud or manipulation is occurring. We can cite cases, large and small.

If injunctive authority were granted under the Commodity Exchange Act, a Federal Court would have the power—if a satisfactory showing were made—to enter a temporary restraining order or preliminary injunction to put an immediate stop to the violation.

This provision would carry ample safeguards for the public.

First, the Secretary would have to determine that a violation is occurring. He would then have to convince the Attorney General who, in turn, would have to go into Federal court and convince a judge. The American judicial system provides full and effective safeguards in the use of injunctive power. The use of injunctions has been commonplace with regulatory agencies for many years. There is no basis to fear that it would be, or in fact could be, abused in commodity market regulation.

Nor are there special attributes of commodity traders or markets which give them license not given to others for continued violations. The volatility and fast action in these markets do not endow them with unique status, but, in fact, argue with unique logic that prompt corrective measures should be available.

One example of the need for injunctive authority occurred late in 1963. A new company was organized in New York and registered as a futures commission merchant to handle customers' trades in reg-

ulated commodities. The firm did not hold a membership in any exchange. It had no apparent source of income. It was later learned that the firm was being financed by "under-the-table" kickbacks from two firms which were exchange members and through which its trades were cleared. The company's three major officers had been associated with Anthony DeAngelis prior to his bankruptcy in November 1963, in the so-called salad oil scandal. Two of the firm's salesmen were former securities broker-dealers whose registrations had been revoked. They had pleaded guilty to securities fraud in another case and were awaiting sentence, and two of their salesmen also were named in a land fraud case the previous year. Mr. John Hean testified yesterday that he lost considerable money because of "churning" in his account, and he was referring to this broker.

In view of the individuals involved in the firm, the CEA placed it under close observation. Numerous violations of the law were found including the overtrading or "churning" of customers' accounts. It was found that the secretary-treasurer of the company actually controlled the trading in 44 customers' accounts through powers of attorney issued to him or to other officers or employees of the firm. The practice was to get these customers into and out of the market as rapidly as possible in order to build up commissions for the firm. During an 8-month period the 44 customers who had a net investment of \$55,300 were charged a total of \$43,500 in commissions. In 1 month the total commissions were 150 percent of the average daily equity in these accounts.

It was obvious that the customers were being systematically defrauded; but we had no authority to require the company to stop this type of trading or to discontinue handling customers' accounts. The CEA took the only course of action open. It developed evidence to support administrative and criminal action against the company and its principals. Through an administrative complaint, the firm and two of its officers have been denied trading privileges on contract markets for long periods of time. One officer and three employees pleaded guilty to criminal charges. Two have been sentenced and two are awaiting sentence. A criminal indictment against another officer is pending.

Effective action ultimately was taken. But the company, of necessity, was permitted to continue operation and to handle customer's accounts long after it became apparent that it was defrauding its customers. If the Secretary of Agriculture had had the authority to go into the courts through the Attorney General to seek an injunction as provided by the proposed legislation, in all probability the illegal activities of the company could have been stopped and customers' losses substantially reduced. Again, there appears to be no reason for people dealing in commodity futures to enjoy special license to defraud or to violate the law free of restraint.

WILLFUL AIDING OR ABETTING VIOLATION

There seems no argument at all against finding that a person who willfully aids or abets another person in violation of the act should also be prosecuted.

CEASE-AND-DESIST ORDERS

We ask for cease-and-desist orders because we feel the penalties now provided by the act are too severe for certain types of minor violations. Cease-and-desist authority would permit the Secretary to stop minor violations without imposing a penalty which could put some firms or individuals out of business. For example, suspending the registration of a large brokerage firm would mean closing its regulated commodity business for the period of the suspension. Obviously, this would be too severe a penalty if the violation had been minor. The proposal actually is a relaxation of the present penalty provisions of the law. Ample protection would be afforded all parties since the provision would require that the respondent be given an opportunity for a hearing on the charges and an opportunity to appeal the Secretary's decision to the courts.

CHEATING AND FRAUD

The cheating and fraud provisions of the act now apply only to members of contract markets, their employees, correspondents, or agents. We ask that this provision be extended to cover all persons who handle customers' orders or funds. There is need for this change. As an example, in Chicago, a man, who was neither an exchange member nor associated with any exchange member, established a company to handle commodity futures trading for others. His advertising material spoke of "a new concept in account supervision" through which an agile trader could reap sizable profits in the futures market. Some 40 persons opened accounts and gave the firm or its president authority to make futures trades for them. The president traded both for his customers and for his own account. After the trades were made, he would put the "good" trades in his own account and the "poor" trades in the accounts of his customers. In 5 weeks he made a profit of about \$4,500 while the customers lost approximately \$26,000.

This was a clear case of cheating customers. However, since neither the company nor its president was a member of an exchange or a correspondent, agent, or employee of a member, we had no jurisdiction under the Commodity Exchange Act and no charges could be brought against the management company or its president. The proposed legislation would correct this situation and give customers who deal in commodity futures with nonmembers the full protection of the law.

OFFENSES AND SANCTIONS

Classifying embezzlement and certain other serious offenses as "felonies" rather than "misdemeanors" is a needed change. The Las Vegas and other cases described above are excellent examples of situations which would be covered by the proposed amendment. Embezzlement resulting in major losses to customers should not be brushed off as a minor violation. Heavier penalties for these specific violations would be an effective deterrent to would-be violators.

REPORTS AND RECORDS

Members of a contract market must now keep a record of cash or spot transactions made only on the market. The bill would require record of cash or spot transactions made subject to the rules of the exchange, even though not physically made on the exchange. It would also require persons holding positions of a reportable size in commodity futures to keep a record of all cash or spot transactions and inventories in those commodities. Cash or spot and futures operations in the futures market are often so interrelated that it is almost impossible to determine whether violations have occurred without investigating both types of operations. The absence of adequate records regarding cash or spot transactions makes it difficult for the Department to investigate alleged or suspected violations, or to determine whether futures positions reported as hedges actually qualify as such. The bill seems to correct this deficiency.

SUBSTANTIAL EVIDENCE

The Commodity Exchange Act provides that certain administrative actions shall be sustained upon judicial review if supported by the "weight of the evidence." This is not the standard usually provided in regulatory statutes. It raises questions 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." I might note that the provisions in no measure are relative to any criminal actions or sanctions thereunder. Most of the existing provisions for judicial review of administrative actions under regulatory statutes specify "substantial evidence" as the standard. 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 Federal Reserve Board, the Civil Aeronautics Board, and the Federal Aviation Administration. I might add that what we are talking about here are administrative actions. As the lawyer, members of the committee will immediately recognize criminal actions under the act require a completely different and more rigid standard of proof. Therefore, actions entailing fines or prison sentences are not in question here.

BYLAWS AND RULES

The proposal would give the Secretary authority to disapprove bylaws and rules of contract markets relating to terms of contracts or other trading requirements. He must find that such rules or bylaws violate or will violate any provision of the act, or the regulations or orders of the Secretary issued pursuant to the act. It seems obvious that when there is a conflict between an exchange rule and the law, or regulations, or orders issued pursuant to authority granted by the law, the exchange rule should be revoked or so changed as to bring it into compliance.

The proposal would also require exchanges to enforce all of their bylaws and rules which relate to contract terms and other trading requirements. At first glance, a provision of this type would seem redundant. When an exchange adopts a bylaw or rule, it is logical to expect enforcement, especially in light of the plea of self-regulation. In a number of instances, however, exchanges are extremely lax in enforcing important trading rules.

For example, regulations of the act prohibit the matching of buying and selling orders of different customers unless this is done under an established procedure set forth in an exchange rule. A number of exchanges have adopted such a rule, designed to protect the customers in such situations.

A recent CEA trade practice investigation revealed the absence of enforcement. Although the exchange in question had a rule of this type, and there was a considerable amount of matching customers' orders, it was not enforced. For that matter, neither the exchange officials nor the employees who were charged with supervision and approval of the trades under the rule were even aware of the provisions of the rule. This kind of "self-regulation" cannot assure honest, open, and efficient trading.

CUSTOMERS' FUNDS

Under the proposal, futures commission merchants would no longer be permitted to invest customers' funds in "investment securities," as defined in section 5136 of the Revised Statutes, as amended, or to lend customers' funds on the collateral of warehouse receipts. The provision for investment in "investment securities" is difficult for commission merchants to interpret, and we have found instances in which firms have inadvertently violated the law by investing customers' funds in securities which were not approved for this purpose. The Department has also encountered difficulty in administering this provision and feels that it is unnecessary because investment of customers' funds would still be permitted in Federal, State, or other governmental securities. So far as we know, the provision for loaning customers' funds on the collateral of warehouse receipts has never been used. It does, however, create a potential danger. It is obvious that if customers' funds had been loaned by a futures commission merchant on the collateral of the false warehouse receipts issued by Anthony DeAngelis during the "salad oil scandal," the customers' funds would have been lost.

BOOKS AND RECORDS

The law now requires a contract market to permit representatives of the Department of Agriculture or the Department of Justice to examine the books, records, minutes, and journals of proceedings of the market, its governing board, and all committees. The proposed legislation would merely require that these books and records be kept in a manner that will clearly describe all matters discussed and action taken by the market or its various committees.

GENERAL PROVISIONS

Presently, futures commission merchants are required by the act to segregate customers' funds in separate accounts. However, the act does not specify how such funds are to be handled by banks and clearing associations which serve as depositories for the funds. Under the proposed legislation, depositories would be prohibited from treating the funds as belonging to the futures commission merchant or any person other than the customers, and would thus be prevented from using such funds to offset any liabilities of the futures commission merchant.

The bill would make it a violation of the act for anyone against whom an order denying trading privileges has been issued to in any manner exercise such privileges during the effective period of such order. Heretofore, the restraint was only on persons extending the privileges without any affirmative restraint on the person against whom the order was issued.

Under the bill, all persons executing orders for others would be required to be registered as floor brokers. At present, certain traders who trade actively for their own accounts can also fill orders for others without being subjected to the provisions covering registered floor brokers.

Instances of unfortunate activity in the futures market which have been mentioned are carefully documented, along with many others of the same type.

SUMMARY

We have sought to exclude issues not relevant to consideration of this bill.

We have stated:

- (1) The provisions we see as minimal necessities under present conditions to assure that we meet the intent of the Congress expressed earlier;
- (2) Why these amendments are needed; and
- (3) Specific examples of abuses now prevalent that could be mitigated or eliminated through these amendments.

My colleagues and I will be happy to answer any questions directed to us by the committee.

We thank you for this opportunity to present this statement to you.

Mr. GATHINGS (presiding). Thank you very much, Mr. Secretary. Chairman Poage and the ranking minority member of the committee Mr. Belcher have had to leave to attend a meeting of the Rules Committee.

I was greatly impressed, Mr. Secretary, with the statement you have made. You have discussed the injunctive powers provision on page 10 of your statement.

I wish that you would explain to the committee this particular section as to the frequency this need has arisen under the regulations that you are now working under.

Dr. MEHREN. I will, if I may, pass this on to Mr. Caldwell who is the Administrator. I believe that in the 4 years I have been here it

has ranged, perhaps, from 1 to 4 years, and the issue here is that some types of violations may continue while the accused is availing himself of the right to defend himself.

Mr. CALDWELL. We have an example right now of a case which has been pending for many years. The alleged violation occurred in May of 1963, and the case is not yet concluded.

Mr. GATHINGS. Are there any further questions?

Mr. Kleppe?

Mr. KLEPPE. Dr. Mehren, this is a proposition that I feel very concerned about, because I was a registered representative of the New York Stock Exchange that deals in securities as you know. There are rules and regulations, as you know, under the Securities and Exchange Commission and under the various exchanges that protect the customers. In this type of system such as ours, and in this particular speculative system of ours, we must afford protection to the customers. This is, apparently, what has been lacking in commodity trading, and this legislation is designed, as I understand it, to correct and plug up some of those loopholes. I know of nothing worse than a man setting up a bucketshop and swindling the public on a commodity transaction, such as some of the examples you have quoted show.

I have one question I would like to ask you, and I would like to have your candid answer if I can get one.

It seems to me—and this, by the way, happens to be one thing about this legislation that troubles me somewhat. This is the authority that is placed in the hands of the Secretary of Agriculture. In the securities business, you do not operate except through a commission and it operates through various exchanges. There is no one man in a position to say to you: "You are a spurious operator", or "You are unscrupulous", or this or that, but under this proposal the Secretary of Agriculture can say so. I am wondering: Do you think there would be a better way of establishing the authority at the top, rather than just in the hands of the Secretary of Agriculture?

Dr. MEHREN. The difficulty I presume you are alluding to is the commission?

Mr. KLEPPE. Yes.

Dr. MEHREN. You asked for a candid answer. The difficulty is and has been the getting of three full Cabinet officers present at the same time and their taking the time to handle such matters. We have here, also, a proposed amendment which we did not directly allude to, permitting each of those three Cabinet officers to designate representatives.

I would take exception, since you asked for a candid answer, sir, to the statement that the injunctive powers, to which I think you refer here, places any unique or single or exclusive power in the hands of the Secretary of Agriculture. We have powers in most of our other regulatory statutes.

Here, as in every other, the Secretary would be required, as a responsible officer of the Cabinet of the United States to make a determination under standing administrative rules of procedure. He would then have to persuade the Attorney General of the United States, another responsible and quite separate Cabinet officer, of the probative value of the allegation, and the standard procedure would be that the

courts of the United States would be required to say that the nature of the alleged offense was such that the interest of the public or others required termination under an injunction.

So, this proposal does not, in any measure, violate the processes used in almost all other regulatory statutes and does not vest in the Secretary of Agriculture any single or unique power on his own, acting alone to enjoin any action whatsoever.

Mr. KLEPPE. Further, then, I would gather from your remarks that you are satisfied with the recommendation covered in your statement that these Cabinet officers, to the extent of administering and using the injunctive powers in connection with the Commodity Exchange Act which you feel are all right and would function and would not bring serious complaints from the public.

This is what I have been concerned about. We need to protect the public, yes, but I am wondering about the attitude the public, the public investors, toward the fact that maybe this can be too political. This is a political decision that is being made for or against this operator, and, certainly, you have no concern about this. Is that right?

Mr. MEHREN. Well, again, I would give you a candid answer—in the original frame of your question. I have seen the matter of injunction applied in the Department in the 4 years I have been in it on this stretch. I have never found it easy to persuade the legal advisers of the Secretary of Agriculture that a determination, leading to a recommendation of an injunction be made. These are responsible, sober, and competent legal people. Having done that, I have found that the Office of the Attorney General, the Department of Justice, does not lightly undertake enjoinder action. It is not, in fact, a simple or easy matter to persuade the Attorney General that any action should be enjoined.

Finally, having covered those two hurdles, one within the Department and one with a separate department of the executive branch, both of which departments, everybody knows, will be reviewed by a court, we then have to go to court. This, really, is a series of activities taken for generations under the American law, and it is not unique. You will note that there is no deviation here from the careful protection that has always been given to a defendant. But I say, based on these 4 years' experience, that in the types of cases to which Mr. Caldwell has referred, because of the absence of this carefully restricted injunctive power recommended here, we have not been able to terminate continued and protracted violations.

Is that responsive?

Mr. KLEPPE. My question is that, that I know we do not want to protect the crook—quite the contrary. I do appreciate your candid answer.

Thank you.

Mr. GATHINGS. Mr. Dole?

Mr. DOLE. I also appreciate your statement. I recognize this is a technical and difficult field and, probably, none of us fully understand it.

We had hearings last year. I understand this bill has been somewhat revised, but I note on pages 2 and 3 and probably through page 5 of your statement, Mr. Secretary, that you make some rather serious charges about the industry. You state on page 2 that there is a long

history of manipulation—fraud—in commodity trading, and on page 3, that can be documented by the score, and petty thievery and operation of confidence men and swindling. You have indicated that the industry cannot regulate itself.

As I recall, this was not your testimony last year. Has all of this happened since last year?

Dr. MEHREN. No, very little of it. Part of this long history has transpired since last year.

Let me say, first, in listing the specific violations and abuses, I meant personally and the Department means officially that we are not accusing the traders or the exchanges or anybody else of generalized and continuous violations. This year we are merely giving you and this committee examples of specific abuses and violations.

With respect to the long history, there are some 106 cases which have been inventoried.

Mr. DOLE. Since when?

Dr. MEHREN. 1936 to 1962, and another large number from 1962 to 1967. We have them available. They support every statement that has been made in this testimony, Mr. Dole, and if the committee wishes, Mr. Chairman, we will be happy to submit this list of administrative and criminal actions taken by the Commodity Exchange Authority to date.

Mr. DOLE. How many enforcement actions has the CEA brought in the past year, since you were here last year?

Dr. MEHREN. Five or six, Mr. Caldwell says.

Mr. DOLE. There are a great many transactions at all the boards of trade around the country and everybody talks about the percentages and how bad it is. Just what percentage of all of the cases you have documented; that is, what percentage of the total does that represent?

Dr. MEHREN. I would have no way of answering your question, Mr. Dole. I am quite certain that nobody else would, either, because we do not have a record of the specific number of millions of trades which, in all likelihood, involved no deviation whatever from common morality, public morality, business morality, the regulations, and the like. All that we have, and all that come to my office at any rate, are the violations.

I repeat, there is a long history of many different types of violations in this massive trade which, in all likelihood, represents a minutely small part of the transactions; although I cannot say what proportion. But they have gone on. They have always gone on. That is, with this many people and with this much business, I think that one would expect them to continue to go on. I am most anxious to have this understood by the committee but, in asking that these holes be plugged and in specifying instances of the kinds of actions associated with these, we are not accusing the exchanges of generalized dishonesty.

Mr. DOLE. I think that we all share this view.

But because of the injunctive provision that you are asking for, the market might suffer irreparable damage on the part of those who are enjoined, without notice, restraint. What about those? In other words, the innocent man who might be enjoined from the practice of his business where the injunction is later dissolved, 6 or 7 months after he is put out of business, what recourse does he have there?

Dr. MEHREN. There is always, I think, in any meticulous, careful legal activity, enjoinder or anything else, the possibility of miscarriage. I would say, however, that the restrictions and the mechanisms surrounding the use of the writ of injunction are such that this likelihood is very small.

Mr. DOLE. Would it be a temporary restraining order?

Dr. MEHREN. Provision is made for temporary restraining orders. I am not a lawyer, as I think I made myself clear earlier.

Mr. DOLE. Without notice to the defendant?

Dr. MEHREN. No, no; this requires a finding by the Secretary—a determination by the Secretary—as well as the persuasion of the Attorney General, and then recourse to the courts.

Mr. DOLE. Before there is a temporary restraining order, is the defendant notified and entitled to be present with counsel before the restraining order is issued?

Dr. MEHREN. I am advised that this is our procedure, by counsel. It is the usual procedure as in all injunctive proceedings.

Mr. DOLE. Those are the requirements involved?

Dr. MEHREN. There are three requirements that I know of: the determination by the Secretary, the determination by the Attorney General, and the appearance in court.

I do not believe that an injunction under any normal circumstances can be issued against anybody without appropriate legal notice; is that not true?

I will ask Mrs. Prokop to answer.

Mrs. LOTUS (THERKELSEN) PROKOP. I think that would be certainly true. There would be notice to the person who had been adversely affected before a permanent or even temporary or preliminary injunction would be issued. In most cases, this would also be true under the rules of civil procedure with regard to temporary restraining orders. Before a court would go ahead with a temporary restraining order without notice to the opposite party, the Government would have to show that they had made some effort to notify him or had been unable to do so, and they would also have to meet some other requirements under the rules.

Mr. DOLE. I have obtained temporary restraining orders without notice to anyone. Then, it is set down for a hearing; and then a temporary injunction is or is not issued. That is when the defendant gets the notice; not when the temporary restraining order is issued, and, finally, a final hearing as to whether the injunction should be made permanent.

If we are going to correct abuses we ought, at the same time, protect the poor guy who may be innocent and may have irreparable harm done to him.

You continue in your statement to bring up the *DeAngelis* case. I recall specifically last year, in fact, it was my understanding that the *DeAngelis* case involved forgery of warehouse receipts and had nothing to do with futures. Nonetheless, sprinkled throughout your statement, there is a reference to this case. I think you, yourself, indicated last year, Mr. Secretary, that perhaps the *DeAngelis* case was not relevant.

Dr. MEHREN. I testified last year, as I recall, as a laymen, to two major elements of the criminality involved in the *DeAngelis* case, the

forgery and the fraud; that, certainly, the major offenses did not involve the Commodity Exchange Act. To my knowledge, there has been little, if any, evidence made available during the past year which would change that opinion. But I do think that if we had had financial requirement legislation, if we had had injunctive powers based upon financial requirements, if we could have investigated thoroughly into his financial situation, it is possible that the appropriate and careful use of some of the authority here could have protected the exchanges and the people who were defrauded by Mr. DeAngelis.

If I may say this: I am not using the DeAngelis case here in any measure to indicate that its primary element was a violation of the Commodity Exchange Act, I am merely using that as an index to point out that some of these provisions might well have helped us to contain or mitigate or possibly even eliminate some of those abuses. If I stated otherwise, I had no such intention.

Mr. DOLE. Was there any failure of self-regulation by the exchanges in the *DeAngelis* case?

Dr. MEHREN. Well, I am not qualified to state, since I am not a lawyer.

I do know that his position became awfully large. It was never defined as a speculative position conclusively. I really could not answer that question.

Mr. DOLE. What about any failure of regulation by the CEA with all of the powers it had?

Dr. MEHREN. I believe that I testified on my first day of service as Assistant Secretary that I became aware of some unusual activity. I would say that once, twice, or oftener, every day thereafter, until November 18, I inquired of all concerned if there were any legal actions we might take to contain what appeared to be, putting it mildly, the emergence of a distressing situation. My advice from all of the legal people in the Department was: No; there was no power under the Commodity Exchange Act that we could have used and did not use, and that is still the legal opinion in this respect.

Mr. DOLE. And if this bill had been in effect, what powers would CEA have had?

Dr. MEHREN. Probably the only major power in this proposed set of amendments would be the financial requirement. We could directly have made an unequivocal inquiry into his financial status—an inquiry to determine that—and had we found it to be inadequate, we then might have taken appropriate action under the terms of the law. I do not know of any other.

Is there any other provision here that would have been useful, Mr. Caldwell?

Mr. CALDWELL. First, let me say that this financial requirement that we are asking for would apply only to futures commission merchants; it would not apply to traders such as Mr. DeAngelis. It would have had an effect on the firms that were carrying his position at that time.

As you perhaps recall, one large firm went bankrupt and went out of business; another firm had to be taken over by a still larger firm; a third firm had to work out some arrangements with the banks in order to continue operations; and a fourth firm was in financial difficulties.

Had we had the financial requirement at that time, I believe that these firms perhaps would not have gotten into the trouble that they did.

Mr. DOLE. Would there have been any power under this act that you did not have before, to stop the activities of Mr. DeAngelis?

Mr. CALDWELL. No.

Mr. DOLE. We could not then infer from your reference to the *DeAngelis* case that any sure-fire remedy is contained in this proposal?

Mr. CALDWELL. The financial requirement would have been a help. Also, there is a provision in here that banks and other depositories, including clearing associations of exchanges would have to keep separate the funds of the customers and of the brokerage firms which they do not have to do now.

We had a situation in the *DeAngelis* case in which one of the banks actually took over funds of customers of one of the brokerage firms to offset liabilities of the firm.

In that case, we were able to explain to the bank that these were trust funds, and they put the funds back in the customers' accounts. We had no authority to require this, however.

Mr. DOLE. As to the reference to the injunctive power requested and the cease-and-desist power, how many times could it have been applied, had you had it?

I assume you would have sought injunctions the past year had you had that power; and, if so, how many times would you have sought it?

Dr. MEHREN. I think we have a list of such.

Mr. CALDWELL. We do not have it broken down by years.

We do have a partial list of cases which we feel would have been subject to the injunctive relief.

There are 16 cases that we have on this partial list.

Mr. DOLE. Pending cases?

Mr. CALDWELL. No; these are closed cases, for the most part.

Mr. DOLE. How long a period of time is involved?

Mr. CALDWELL. This goes back for a period of 15 years, or so.

Mr. DOLE. The point is that you do not plan an expanded use of this power?

Dr. MEHREN. I think that in any of our regulatory activities, some of which I have become acquainted with, we do not lightly use the injunctive power, and it is only in conditions that are extreme in nature that we would consider taking the enjoinder route. I would expect a relatively light use and an infrequent use, and a use only under extreme conditions, of the proposed injunctive power. And this, I can tell you, personally, is the basis upon which we use the power in any case.

Mr. DOLE. There is another area I do not understand.

You talk about keeping records and to describe all matters discussed at one of these meetings. For example, there might be many irrelevant matters discussed, as well as relevant matters. It would be rather difficult to write down a proper book or record of those.

Dr. MEHREN. I think that in this instance there is now a specific definition of what is a full and complete record. I think, however, there are many records filed in exchanges which are subject to our examination which are inadequate.

There is, for instance, the Chicago Mercantile Exchange "Minutes of a Regular Meeting of the Board of Governors held July 20, 1967," an item of "67.337," which says: "Report of President— The report of the President was submitted." P-e-r-i-o-d. End of the report.

What we would like to know, since it is our statutory duty to protect the public as well as the exchanges and the traders thereon, what was the report of the President. This is not a very useful report to us.

Mr. DOLE. You say, keeping books and records.

In addition to that, they must describe all matters that are discussed. This is asking for an infringement of their right to discuss anything that may or may not be of concern to the CEA.

Dr. MEHREN. I believe that we should have the authority to inquire on any matters that are specifically, and beyond equivocation, within the responsibility of the CEA, that the books and records indicate clearly unequivocally, directly, that which was discussed and the action taken thereon.

Mr. DOLE. Who determines whether all matters are included and have been discussed?

Dr. MEHREN. I believe on matters which are certainly within the responsibility, not solely the jurisdiction but the responsibility of the CEA, that regulations could be formulated which would clearly indicate at least the minimal information that the CEA should have in order to know what was proposed and what action was taken upon that, because in the absence of knowing of what was proposed and the action taken upon it, we have no way whatever of knowing whether the terms of the statute were or were not met. So, I would say that a rule of commonsense here would ultimately emerge, but this kind of thing, with no disparagement—I am sure that there is no such thing contained within it—is inadequate to provide for the duties assigned to us by the Congress as it is.

Mr. DOLE. I agree. In another area: Is there anything in this bill that gives the CEA the power to set the margins?

Dr. MEHREN. None whatever.

Mr. DOLE. I make specific reference to Section 23, which gives the Secretary the power to disapprove or to approve bylaws, rules, regulations, or resolutions issued to the public by contract markets. Since contract markets do now regulate margins, could the Secretary, in effect, establish margins by disapproving market regulations of a contract market?

Dr. MEHREN. That is not the intent of the language submitted here. I think that you will recall that last year we asked for the affirmative authority for the Secretary if and when necessary. The only rules or bylaws at issue here are those which are directly relevant to trading; therefore, the margins would not be at issue.

Mr. CALDWELL. If I could make a comment on that?

The reference to disapproving rules applies only to those rules which are in violation of the Commodity Exchange Act, not to rules generally. The provision with regard to trading rules is merely that the exchange must enforce the rules it has adopted. We are not asking for authority here to disapprove general trading rules.

Mr. DOLE. Then, there is some concern that, perhaps, this same section gives the Secretary, in effect, the power to affect the price, because he has the duty, under the price-support program, to support commodity prices.

Could he, by disapproving certain rules and regulations in the contract market, regulate the contract and thereby affect the prices?

Dr. MEHREN. I think only this would be the impact of that, that it would be in the other direction, that is, by executing and following the terms of certain price or stabilization practices, he might constrain the latitude of trading for the commodities, for instance. But this has been in the past, and I would say that there are no additional components in the impact, indirectly, of other activities that the Secretary might have upon futures trading.

Mr. CALDWELL. If I could comment on that, Mr. Dole.

On the question of disapproving rules, it seems that this is merely precautionary. We do not seek authority to disapprove the rules of the exchanges generally. All we want is to have limited authority to disapprove those rules which are in actual violation of the law.

Mr. DOLE. In another area: How much time can elapse from the time that he serves the notice on the defendant to the time a cease-and-desist order is issued? A day or 2 days, or what?

Dr. MEHREN. The cease-and-desist order follows hearing procedures in the Department of Agriculture, through an agency of the Department which, in fact, operates totally independent of the Secretary's office. I guess that the time required for the judicial officer ultimately to make a finding on the cease-and-desist order depends largely on the nature of the issue and the nature of the allegations made by the Department. There is a stopgap in the judicial process prior to the issuance of the cease-and-desist order, and there is also the court decision with respect to the order.

Mr. DOLE. When do you issue a cease-and-desist order? And if, as a result, the defendant suffers an economic loss, and then is absolved from liability, does he have any recourse for damages?

Dr. MEHREN. I do not know of any. I am not competent to answer that. That has never come up in my 4 years with the various regulatory activities.

Mrs. PROKOP. I do not believe so. I would think that the cease-and-desist order would be held in abeyance, pending the outcome of his appeal in court.

Mr. DOLE. He could carry on his activities until determined by the appeals court?

Dr. MEHREN. I do not know of any instance.

Perhaps Mr. Leonard does. I do not know of any instance in which a cease-and-desist order, subject to appeal—well, it could not be enforced at all until the court enforces it, so that we could not possibly be of damage to him. If he appeals it, it is either affirmed by the court or it is not effective. So, I would think that reparation would not be a relevant matter, Mr. Dole.

Mr. DOLE. What is the primary reason for going from the rule of the "weight of the evidence" to the rule of "substantial evidence"?

I recognize that other regulatory agencies have adopted this procedure. It possibly may be a good rule in another department but a bad rule for the Commodity Exchange Commission.

Dr. MEHREN. I would like to ask the committee if I may refer that one to the General Counsel's office, because I, frankly, am not competent to distinguish between substantial and the weight of evidence.

May I ask Mrs. Prokop to answer that question?

Mr. GATHINGS. Yes.

Dr. MEHREN. I will be interested in the answer myself, too.

Mrs. PROKOP. Let me give you my married name. It is P-r-o-k-o-p.

I use my maiden name for professional reasons.

I testified here on the meat inspection under my married name, so as to keep the record straight.

First, I would like to point out that on this question of substantial evidence that there are a good many regulatory statutes that do make this the criterion for the review of administrative orders. Among these, we have the Clayton Antitrust Act, the Securities and Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Natural Gas Act, the Federal Power Act, the new drug provisions of the Federal Food, Drug, and Cosmetic Act, the Federal Alcohol Administration Act, the Fair Labor Standards Act, and the Federal Aviation Act of 1958.

Mr. DOLE. What about the agencies that require the weight of evidence rule?

Mrs. PROKOP. The only statute that I know about which provides for the weight of the evidence is the old Walsh-Healey statute, which is a very old statute.

I might add that in addition to the list that I just read which refers to substantial evidence, there are provisions in the Labor-Management Relations Act and in the pesticides chemicals provisions of the Federal Food, Drug, and Cosmetic Act which requires substantial evidence when considered on the record as a whole. And this latter criterion has been read into the substantial evidence language in some of the other statutes that I mentioned first.

We feel that there is not really a great difference between the substantial evidence rule that we are proposing here, and the weight of the evidence rule that is specified in the statute, because of the effect of the *Great Western Food Distributors* case. This case changed the rule that had been announced in the *General Foods* case. In the *General Foods* case, the court of the seventh circuit has said that the weight of the evidence criterion as used in the Commodity Exchange Act required the court to weight the evidence—we had to show by the preponderance of the evidence that our order was correct.

In the *Great Western* case, the same seventh circuit court took a different view, and this is what they said—and if you will bear with me, I will read it:

It would seem, then, that the function of this court is something other than that of mechanically reweighing the evidence to ascertain in which direction it preponderates; it is rather to review the record with the purpose of determining whether the finder of the fact was justified, i.e., acted reasonably, in concluding that the evidence * * * supported his finding.

So, under the *Great Western* decision, we have something that comes pretty close to establishing the substantial evidence rule, although, however, if we put this substantial evidence language in the statute, it will eliminate uncertainties, and it will be a clarifying amendment. This is what we are after.

Mr. DOLE. What is your record on appeal now?

Dr. MEHREN. There have been three reversals only, I think, in the history of the CEA Act.

Mr. CALDWELL. That is correct.

Mr. DOLE. Out of how many?

Dr. MEHREN. I believe there have been 150 cases. There have been 15 appeals, and three reversals only at the circuit court level. No reversals to my knowledge have gone past the circuit court.

Mr. DOLE. You have done very well. You have never, I understand, lost any of the 142 administrative cases?

Dr. MEHREN. I do not believe that is correct, Mr. Dole.

Mr. CALDWELL. We have had 150-some-odd administrative cases. Some of those we have lost at the level of the judicial officer; at least, we have lost certain respondents in those cases at that level. We have had 14 of these administrative cases referred to the circuit court for review, and have lost three of them.

Mr. GATHINGS. I would like to say that the bells have rung.

I wonder if you would care to come back this afternoon, Mr. Mehren?

Apparently, there will be a number of other questions that the members wish to ask.

Can you come back at 2 o'clock this afternoon?

Mr. ZWACH. I have some questions, but we do not have the time now.

Dr. MEHREN. Very well.

Mr. GATHINGS. We have a long list of witnesses yet to hear.

We will reconvene, then, at 2 o'clock this afternoon.

(Whereupon, at 11:20 a.m., a recess was taken until 2 p.m., this same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will please come to order.

I understand Dr. Mehren had not finished his testimony and we will therefore proceed with Dr. Mehren.

Are there any further questions of Dr. Mehren?

Mr. DOLE. Yes.

The CHAIRMAN. How many?

Mr. DOLE. I do not know.

The CHAIRMAN. I just want to know. I do not mean to cut you off, if it is going to be an hour or more, I want to advise these other people.

Mr. DOLE. I do not know how long they will be, not knowing how long the answers will be.

The CHAIRMAN. Will, Mr. Purcell, preside, please.

Mr. DOLE. When we adjourned—I am not certain where we were, but we were generally talking about the rules of evidence, whether they should be changed to require what is called substantial evidence, leave it the weight of evidence or adopt some rule of clear and convincing evidence.

As I understand, despite your very fine record on appeals, you feel the present rule should be changed to one requiring only substantial evidence? You asked somebody else to answer that question.

Mrs. PROKOP. I am sorry, sir.

I am involved in two conversations.

Mr. DOLE. I want to get back to the testimony with reference to whether there is a need to change the rule of evidence to one requir-

ing only substantial evidence or whether—why the weight of evidence rule should be retained?

Mrs. PROKOP. I think the important purpose in getting this change made is to bring the language of our act more into conformity with these other statutes. In view of the decision in the *Great Western* case, it would not be a major change in criteria, as we see it, from what is now in the law, to what we are proposing. It would simply clarify the situation somewhat from our standpoint.

Mr. DOLE. As stated earlier, you have a very good record on appeals. I understand that out of 16, you have been reversed only three times. Unless you want 100 percent, why the necessity of the change?

Mrs. PROKOP. I have not analyzed those three cases that we lost, but I have a feeling that the different criterion would not have made any difference to us. We did not lose them on the basis of a lack of adequate evidence.

Mr. DOLE. There is really no need for the change, then.

Mrs. PROKOP. If we do not get the change, I doubt if it will seriously impair the enforcement of the act. If we do get it, it will bring the language of our act more in line with these other statutes. It might avoid some questions. But it does not seem to me that this is an extremely critical issue.

Mr. DOLE. You are familiar with the report issued by the Comptroller General in July 1965, which discusses the need to strengthen regulatory practices and points out as far as they are concerned certain shortcomings in the operations of the Commodity Exchange Authority. I am wondering what has been done since that report was issued to strengthen your activities.

Dr. MEHREN. If I may, I will turn that over to Mr. Caldwell.

Mr. CALDWELL. The primary recommendation of the report was that we do more trade practice investigational work. We have recognized for a great many years that there was this need and we agree completely with the report in this respect. Heretofore, we have been doing all trade practice investigations on a manual basis.

Perhaps I should explain a little bit about what a trade practice investigation is, first of all. It is an investigation in which we analyze all the trading during a particular period of time. We get a complete picture of every trade. The floor broker on each side, the clearing member on each side, and in many cases, the customer on each side. We analyze those to determine whether there are any violations of the Commodity Exchange Act. We have been doing this manually for a great many years and as market activity has increased, we have found we just could not keep up with it on a manual basis. We have now devised a system of doing this work on automatic data processing equipment and we are in the process right now of testing out the system. If this is successful, as we expect it will be, we will be able to examine approximately 250,000 transactions per year as compared with about 3,000 transactions which we have been able to examine under the manual method.

Another recommendation was that we make examination of the minutes of the boards of directors and committees of the various exchanges. We also agree with this recommendation. We have been making regular examinations. We have found that those minutes are

not adequate for this purpose, and for that reason, we are requesting in this proposed legislation that the minutes be made more complete.

Thirdly, they recommended that there be made an investigation of floor trading. Floor trading is the type of trading where the members on the floor of an exchange buy and sell for their own account. We agree that there is a need for this type of investigation, but we do not feel that it has a very high priority at the moment and we have not had an opportunity to make that type of investigation thus far.

Mr. DOLE. Do you think basically, then, you have carried out the recommendations contained in the July 1965 GAO Report?

Mr. CALDWELL. We feel that we have.

Mr. DOLE. Have you, as pointed out on page—I think 20 or 21 of the report—sort of kept your pledge to step up your investigatory operations, you have increased the number of staff people available or have you relied more on the computer?

Mr. CALDWELL. We are relying greatly on computers, but we are having to increase our staff as well. We could not do this type of operation with an increase in staff only. It is just too big. We have to computerize it.

Mr. DOLE. There was also a suggestion in the report that perhaps additional funds should be available to do all the things recommended in the report. Has there been an increase in the funds since that time?

Mr. CALDWELL. Yes, there has. There was a \$57,000 increase in the 1968 budget for this particular purpose.

Mr. DOLE. Do you anticipate a further increase will be necessary if H.R. 11930 should be implemented?

Mr. CALDWELL. Yes, sir; it would require an additional appropriation.

Mr. DOLE. Do you have any estimate of how much?

Mr. CALDWELL. We estimate that it would cost approximately \$688,000 per year for this program. About \$400,000 of that would be for the four new commodities that would be brought under the act.

Mr. KLEPPE. Would the gentleman yield?

Mr. DOLE. Yes.

Mr. KLEPPE. How much was appropriated for this purpose in fiscal 1967 as compared to that \$688 million you just referred to—thousand, I mean, excuse me.

Mr. CALDWELL. Are you speaking of the entire appropriation of the Commodity Exchange Authority?

Mr. KLEPPE. Yes.

Mr. CALDWELL. In 1967, the appropriation was \$1,434,000.

Mr. KLEPPE. \$1,434,000?

Mr. CALDWELL. Yes.

Mr. DOLE. Most of us on this committee are, of course, concerned about farmers, too, and there would not be any need for the contract markets if the farmers did not produce the commodity. Do the changes being sought in 11930 primarily seek to extend authority over some now nonregulated commodities to protect customers from unscrupulous brokers? Is there anything in this legislation that might be of benefit to the American producer, the farmer, to see that he gets a fair shake in the market?

Dr. MEHREN. It would have some indirect effect on sugar, Mr. Dole. But I think it would be a remote effect. This is certainly not its primary effect here. Price stability and price formation are of relevance to any American producer. I think as you know, we have very, very little coffee. I think that what we have around Kona is the only domestic we have. This would not be relevant to coffee producers in view of the fact that we do not have any. But it is not in any measure directly related to the stability programs normally operated by the Department.

Mr. DOLE. Is it fair to say that CEA is principally an arbiter between grain brokerage houses and their customers and that your primary interest in the establishment and maintenance of a future market system is to protect the farmers to the maximum extent possible?

But your primary function is to arbitrate between—

Dr. MEHREN. I would say "no." The declared purpose of the statute as enunciated in the statute itself encompasses vastly broader purposes passed by Congress in earlier years. Basically it is a statute designed to maintain open—by that I mean competitive, noncollusive, nonconspiratorial, nonmonopolistic—competition which is fair and honest and operating under the rules and in conformity with the rules established by the Congress of the United States. In that sense, I believe that all people in this country have an interest in the activities of the authority here.

Mr. DOLE. Mr. Teague asked me as he left about the discussion we had with reference to restraining orders, temporary injunctions and permanent injunctions this morning. He was wondering in the event this provision should remain in the act or should be modified some way, if you had any objection to providing before the issuance of the restraining order putting the offending person on notice in order that he be heard. I recognize this is to be used very sparingly—that is the history. But this is the question he had.

Dr. MEHREN. I am not personally competent, Mr. Dole, to respond to the implication of the question. My understanding is that in the other injunctive authorities used by regulatory agencies of the Department and regulatory agencies of other departments, such notice is given. I would assume and I have been so advised by our general counsel that all of the protections given to any American under law or equity and all of the processes required of Government in the issue of any such rights would be applicable here. In consequence, I see no difference here in the status of the individual with respect to sustained or protracted violation from that which prevails in the very large battery of activities subject to enjoyment under many other statutes in the Federal Government.

Mr. DOLE. And possibly, there are cases where notice could be provided? There is probably some area where it would not be possible in any event.

Dr. MEHREN. I do not know of any, myself, sir.

Mr. DOLE. What about the criminal penalties in the proposed amendments? Are there any basic changes in the criminal penalties, whether they are defined as misdemeanors or felonies?

Mr. CALDWELL. The changes we are proposing would raise certain violations to felonies. No violations are now classified as felonies under

the act. It is our feeling that the serious ones such as price manipulation, such as the willful dissemination of false market information, and such as embezzlement are the type of violations that should be felonies.

Mr. DOLE. In other words, if a man were violating some order and he appealed under the substantial evidence rule, and did not win a reversal, then is he subject to possible criminal prosecution for a felony?

Mr. CALDWELL. No; not under the appeal of administrative action. Any action that would involve a criminal penalty would not be under this substantial evidence rule, but under a much broader—

Mr. DOLE. You are not trying to change the beyond-a-reasonable-doubt rule in criminal cases?

Mr. CALDWELL. No, sir.

Mr. DOLE. That stays the same?

Mr. CALDWELL. That stays.

Mr. DOLE. In other words, you are saying a person who violates an order is not subject to both civil and criminal procedure?

Mr. CALDWELL. A person who violates an order would be subject to—it is an administrative order we are speaking of now.

Mr. DOLE. Yes.

Mr. CALDWELL (continuing). Would be subject to further administrative action. Almost any action in which there is an administrative complaint drawn may also be a criminal case. As a matter of fact, in the event of a violation of any provision of the Commodity Exchange Act that is classified as a criminal provision we are required to submit to the Department of Justice evidence of the violation. So it is possible that a person could be charged criminally and administratively on the same case. The administrative action would be, under this bill, under this substantial evidence rule, and the criminal action would be under the usual requirement for every criminal case.

Mr. DOLE. Is it possible that a man might be convicted on a criminal charge and after his conviction, be absolved from violation of the order in a civil case?

Mr. CALDWELL. The usual thing is to handle the civil case first and then refer the matter to the Department of Justice for its consideration of criminal prosecution.

Mr. DOLE. In that case, there would not be any danger?

Dr. MEHREN. Mr. Chairman, I have just been handed rule 65, paragraph (b) of the Rules of Civil Procedure, which covers the question you have asked.

A temporary restraining order may be granted without written or oral notice to the adverse party or his attorney only if (1) it clearly appears from specific facts shown by affidavit or by the verified complaint that immediate and irreparable injury, loss, or damage will result to the applicant before the adverse party or his attorney can be heard in opposition; and (2) the applicant's attorney certifies to the court in writing the efforts, if any, which have been made to give the notice and the reasons supporting his claim that the notice should not be required.

Then it is required that every such notice be endorsed with the date, the hour, the reason for not giving notice. The time over which this temporary injunction may be effective is limited to a maximum of 10 days except by concept of the adverse party. It is by rule to be given by order in hearings. All of these are general to any enjoyment

action in any Federal court, I am advised. So that the protection given to any person, any adverse party under temporary injunction with respect to notice, would apply here.

Mr. DOLE. Then finally, the witness yesterday from the Kansas City Board of Trade suggested that section 27 providing for a new section—I think 13-A—should be changed. In other words, he changes the position of the word “willfully.” I think the act now reads, or the section, that any person who commits, willfully aids, abets, and so forth. He would move “willfully” ahead of “commits.” Is there any objection to that?

Mr. CALDWELL. That is a legal question. My answer, sir, is I don't know.

Mr. DOLE. From a legal standpoint?

Mrs. PROKOP. Maybe I can make a comment on this one.

Mr. DOLE. I was confused myself.

Mrs. PROKOP. What we are trying to accomplish here is to make applicable to administrative proceedings, the same type of responsibility that applies in criminal proceedings under the provisions of title 18 U.S.C., section 2. Now, title 18 U.S.C., section 2, does not have the word “willfully” in it. It is perhaps inherent under the decisions in regard to offenses like abetting and I think it would be implied with respect to counseling, commanding, inducing, procuring, and so forth. It is not so clear that it is inherent in the word “aiding.” We did not tend to hold someone responsible for an unintentional aiding of someone's improper actions in an administrative proceeding. So we put in the word “willfully” in conjunction with “aiding,” feeling that this would solve the problem from the standpoint of the trade who were concerned.

Mr. DOLE. In other words, you mean one can commit a violation unknowingly or unwillfully and be punished under section 27?

Mrs. PROKOP. No.

You see, we put the word “willfully” ahead of “aiding,” because the word “aid” under some of the decisions was not clearly limited to situations in which there was a knowing participation. It did not seem to be necessary to add that word with respect to the rest of the activities in that series, because inherently, they include some element of knowledge.

What we are trying to do in this section is to make applicable to administrative proceedings the same standard that would apply under 18 U.S.C. 2.

Mr. DOLE. So really, it would not make any difference if the word “willfully” were moved ahead of the word “commits?”

Mrs. PROKOP. As long as it was understood that this is not going to add any requirement beyond what we would have to show in a criminal case.

Mr. DOLE. I do not know. I just asked for information.

Mrs. PROKOP. I think that is a fair statement, with that background.

Mr. DOLE. I do not think anyone wants to increase your burden in protecting the customer. Does it make any difference from the legal standpoint where the word “willfully” goes, whether it should be “willfully commits,” or “willfully aids.” I do not think you are going to proceed unless somebody has willfully done this thing.

Mrs. PROKOP. If it is an unknowing action, we would not hold him, certainly.

Mr. DOLE. I thank the chairman for that long exchange, but I feel it is important that we have some record on this very important legislation.

Thank you very much.

Mr. FOLEY. Mr. Chairman.

Mr. PURCELL (presiding). Mr. Foley.

Mr. FOLEY. Any question I put to you in the legal field, I will stipulate can be answered by counsel.

Does the criminal provision of the Commodity Exchange Act cover all possible cases of manipulation, fraud, and dishonesty that could arise in commodity trading?

Dr. MEHREN. I think my answer in lay terms would be no, but I would, if I may, like to refer this to counsel, sir.

Mrs. PROKOP. I think my answer would be no, too, because your question is framed very broadly.

Mr. FOLEY. I intended it to be so. In other words, there are aspects of manipulation, fraud, and dishonesty that are not criminally actionable under the statute?

Dr. MEHREN. It is very obvious, Mr. Foley, that certain types of violations are specified in this and many other regulatory statutes as being of a misdemeanor characteristic. So, in some statutes it is even specified that the Secretary may take some special action if they be of unimportant nature, others by definition, and nearly all by definition, are defined as felonies.

Mr. FOLEY. The point of my question is, Do the criminal provisions of the statute reach every case of manipulation, dishonesty or fraud, under the broad definitions of those terms which might occur in commodity trading? In other words, are there instances of dishonesty, fraud, overreaching, or manipulation, which could not be reachable by statute? I think that is answerable "Yes" or "No." Is there any one case of dishonesty or fraud that you feel you could not reach if you knew all the facts under your criminal statute?

Mr. CALDWELL. If I may answer that, yes, there are cases that are not covered under the criminal statute and we are trying to cover that.

Mr. FOLEY. In other words, you can only reach a fraction of the cases of manipulation, dishonesty, or fraud under the criminal provisions of the statute?

Mr. CALDWELL. I know of no instances in which manipulation would not be covered, but I do know of numerous instances in which fraud would not be covered.

Mr. FOLEY. Considering that fact, to your knowledge, are all cases of dishonesty, fraud, or manipulation reported to the Department?

Mr. CALDWELL. No; I would say no.

Mr. FOLEY. Of those cases that might exist, are they always known to the victim?

Mr. CALDWELL. Are they known to whom?

Mr. FOLEY. To the victim?

Mr. CALDWELL. I would think anyone who defrauds somebody else knows he is defrauding.

Mr. FOLEY. Is that true of the victim?

Mr. CALDWELL. The victim in most cases probably does not know.

Mr. FOLEY. Of those cases where there is defrauding or dishonesty or manipulation and it is known to the victim, is there sometimes a reluctance to report it?

Mr. CALDWELL. I do not think there is too much reluctance to report. Quite often, the victim does not know where to report it.

Mr. FOLEY. It is sometimes true that there is reluctance?

Mr. CALDWELL. Yes.

Mr. FOLEY. And some cases to your knowledge or to your judgment would definitely be secreted or hidden from disclosure by the victim out of embarrassment?

Mr. CALDWELL. It is possible.

Mr. FOLEY. Is it not a well-known fact in law enforcement that swindles are not always reported, particularly when perpetrated against businessmen of reputation because of their fears that their revelations of being duped may be harmful?

Mr. CALDWELL. You are quite right.

Mr. FOLEY. In fact, one of the great swindlers in American criminal history used to prey on bankers; did he not? History tells us a man known as Yellow Gloves limited his frauds to bankers on the grounds that they almost never reported violations.

Of those cases that are reachable by the criminal statute that are known to the victims that are reported to the Department, of those, some are not, in the judgment of the legal department and the Department sustainable in court, is that correct?

Mr. CALDWELL. That is quite right.

Mr. FOLEY. In other words, there are some cases where you feel there has been fraud or dishonesty, but you don't feel you can prove it?

Mr. CALDWELL. That is correct.

Mr. FOLEY. Particularly under a statute which requires proof beyond a reasonable doubt?

Mr. CALDWELL. That is right.

Mr. FOLEY. Are there cases where the Department feels it should be turned over to the Justice Department for its judgment as to what to do about it?

Mr. CALDWELL. That has occurred.

Mr. FOLEY. Then, of course, there is always a question where if the Justice Department does, in fact, prosecute the case, the jury or the court will find the defendant guilty?

Mr. CALDWELL. Yes, sir.

Mr. FOLEY. Then there is always the possibility that if the jury or court finds the man guilty, he may appeal.

Mr. CALDWELL. Yes, sir.

Mr. FOLEY. And that the appeal may be reversed on some technical grounds and that the defendant will be relieved on the appeal because of some technicality.

Mr. CALDWELL. That is correct.

Mr. FOLEY. There is nothing wrong with the facts in the case; the man may, in fact, have done the act, but you cannot sustain the case because of a technicality?

Mr. CALDWELL. That is right.

Mr. FOLEY. So we start out taking the cases reachable by the statute. Secondly, you have the cases that are actually known to be

performed by the victim. Then you have a fraction of that, that the victim's report, and you have a fraction of that that is sustainable in the judgment of the Department. And you have a fraction of that, that is sustainable in the judgment of the Justice Department. And you have a fraction of that, that is convicted, whether it is a major fraction or a minor fraction, and a fraction of that, that is sustained on appeal.

So is it not true that you have to make a judgment as a man of commonsense that the 106 or 60 cases which you prosecute under the criminal statute represent a fraction of a fraction of a fraction of a fraction of a fraction of a fraction of those violations that actually have occurred?

Mr. CALDWELL. I would think that would true of any law enforcement agency.

Mr. FOLEY. We are really dealing only with a very, very minor percentage of any law enforcement cases that reach prosecution and conviction compared to the actual incidents of violation, are we not?

Mr. CALDWELL. Yes, sir.

Mr. FOLEY. Any prosecuting official knows that it may be a very, very small percentage.

Mr. CALDWELL. You are quite right.

Mr. FOLEY. So that it is not really a fair summary to say that out of so many particular acts of trading in the commodity market, only 106 are culpable or 107 are culpable because that happens to be the number of convictions you can bring?

Mr. CALDWELL. That is quite true.

Dr. MEHREN. So long as it is compatible with the statement that no man or no person, natural or legal, is guilty until he is proven guilty. I would not want to depart from that premise in any measure.

Mr. FOLEY. We are talking about the things, aren't we, Mr. Secretary? I, like some other members of this committee, am a lawyer, and I have done my stint in defending and prosecuting cases. I think anybody who prosecutes criminal cases knows that there are people on the streets who commit robbery, murder, rape, every kind of crime you can mention, and they are legally innocent and that is our system. But they have in fact committed the act which is the basis of the criminal law. They have in fact by their hand killed another person or they have robbed a bank or they have done something else they have not been convicted of. But it would be foolish for us to assume that because a court can't find a man guilty under our rules of evidence, so how that wipes away the physical acts that lead to that prosecution. That would be in evidence for us to think; would it not?

And the fact of the matter is that in the field of financial operation, the commodity market has not had the kind of regulation, for example, that the stock market has had; is that not true?

Mr. CALDWELL. I would think that is true.

Mr. FOLEY. And if you are taking the broad field of financial transactions, there is more fraud, more manipulation, and more dishonesty in the commodity market than in any other field of financial operation?

Mr. CALDWELL. I am not too familiar with the other fields of financial operation, so I doubt I could answer that.

Mr. FOLEY. Let's take stock market operations in terms of the National Stock Market Board. There is more than there is in trading on the stock market?

Mr. CALDWELL. I really do not know that.

Mr. FOLEY. Don't you have an opinion on that?

Mr. CALDWELL. I am not in a position to express an opinion. I do know what the situation is in the commodity market, but I am not an expert on the security market.

Mr. FOLEY. I am not going to put that question to you alone. I say this without any denigration of the industry. There is a problem, is there not?

Mr. CALDWELL. There is a real problem and I think I would agree entirely with your premise as I understand it, but we are only prosecuting a very small portion of the violations in the commodity markets.

Mr. FOLEY. Do you have any reason why a legitimate operation in the commodity market should fear the kinds of authority that are placed in this bill, Mr. Secretary?

Dr. MEHREN. No, if we thought so, Mr. Foley, we would not suggest these amendments.

Mr. FOLEY. As a matter of fact, is it not in the interest of the legitimate elements, of the responsible elements of the industry, to have this kind of regulation which is not internally involved—

Dr. MEHREN. This is my opinion personally, yes.

Mr. FOLEY. Is it not the opinion of the Department?

Dr. MEHREN. Yes, it is.

Mr. FOLEY. So that you are not offering this legislation in any hostility to commodity trading or commodity exchanges?

Dr. MEHREN. We are offering it explicitly for the reasons I stated this morning, that there are loopholes which, in the interest of the exchanges, the people who use them—the producers, processors, handlers and the public at large—we think should be plugged up.

Mr. FOLEY. Is there any way that you know of through the criminal law to substitute for the kinds of enforcement that could be provided by injunctive means?

Dr. MEHREN. As a layman, I know of none, sir, no. I know that on a criminal proceeding, I would be most reluctant to recommend any deviation from the protections traditionally given to accused persons in this country, and those are timetaking. There are, however—rarely,

but sometimes—situations in which violations may well occur while such remedy is being exhausted.

Mr. FOLEY. In the meantime, there is no assurance that violation is not going to be continued or that other violations of similar character are not going to be perpetrated?

Dr. MEHREN. I think that is the situation in any injunction provision, sir.

Mr. FOLEY. Do you think this bill will be substantially weakened if the injunctive provision is removed?

Dr. MEHREN. We testified this morning, sir, that we consider the injunctive provision to be the most vital element——

Mr. FOLEY. This is the heart of the amendments, is it not?

Dr. MEHREN. This is the major amendment we offer.

Mr. FOLEY. Can you think of any reason why legitimate aspects of the industry should want any special treatment in the field of injunctive relief other than accorded citizens of the United States in the Administrative Procedure Act?

Dr. MEHREN. I have heard arguments that the volatility and the fast action of these markets render it somehow peculiarly unsuited to injunctive remedy. I must say I am unable fully to understand or in any measure to agree with those judgments.

Mr. FOLEY. This is another matter I should ask a representative, too. It is unfair to ask only of you. You in the Department see no reason to treat the commodity exchange people differently? Injunctive relief—if the committee decides to give the authority to use injunctive relief, there is no reason for special treatment of the commodity exchange people?

Dr. MEHREN. If anything, the people of the Department see a greater need for injunctive power here than we do in the regulation of some markets not so volatile and not so rapid in their activity.

Mr. FOLEY. I am referring specifically here to the question of whether the injunctive relief procedure could be like that in which the usual provisions of the Administrative Practice Act apply. Rule 65, which you just read to the committee, applies under that general statute. It is my understanding that the Department sees no reason why those general provisions should not apply if in fact the committee decides to give injunctive powers to the Department.

Dr. MEHREN. That is correct, sir.

Mr. FOLEY. There is a substantial question of fairness to any possible defendants we have a question of enforcement is raised, is there not?

Dr. MEHREN. Yes.

Mr. FOLEY. But the main concern that the Department is now exhibiting in this recommendation is that of protection for those honest operators who believe that there are provisions under enforcement where in fact there is not?

Dr. MEHREN. That is correct.

Mr. FOLEY. Is commodity trading on the increase or the downgrade?

Dr. MEHREN. Commodity trading in regulated commodities have peaked at a record for 5 consecutive years and is presently peaking at a record volume.

Mr. FOLEY. Is there any indication that that trend is going to change?

Dr. MEHREN. None whatever, sir.

Mr. FOLEY. In fact, more and more Americans are involved in commodity trading every day, is that not so?

Dr. MEHREN. There are more and more transactions every day; yes, sir.

Mr. KLEPPE. Would the gentlemen yield?

Mr. FOLEY. Yes, sir.

Mr. KLEPPE. May I ask you, Mr. Secretary, in this regard, the market peaking rate in here, do you consider this particularly a healthy situation or adversely so, in your own opinion?

Dr. MEHREN. Professionally, my opinion is that this is a desirable matter, yes.

Mr. KLEPPE. That it is desirable?

Dr. MEHREN. Yes. We have never in any measure, in this testimony or any other, Mr. Kleppe, reflected adversely upon the economic effects of commodity trading as such, nor are we now. I tried most carefully this morning to detach that issue from the specific and pragmatic consideration of specific and pragmatically oriented amendments.

Mr. KLÉPPE. I thank the gentleman for yielding.

Mr. FOLEY. Mr. Secretary, just a few more questions.

Who are the people who engage in commodity trading? Are they limited to professional traders only and people who make their full living in investment and commodity fields, or do they include the average citizen?

Dr. MEHREN. Well, I will speak broadly as a layman and then ask Mr. Caldwell to correct me if I am wrong.

Generally speaking, 50 percent of the people on the average in commodities markets are professional traders who avail themselves of extremely short-run price fluctuations hourly—certainly no more than daily—perhaps less than hourly. And I would say that a very large proportion of the remainder are professional speculators who quite respectably are operating on differential expectations of what prices may be in the future. Then thirdly, I would say that sporadically, at least, there are heavy infusions of amateurs who are not professional short-term operators nor professional hedgers or speculators who come in and out of a market.

Is that a fair statement and an accurate statement, Mr. Caldwell? You may have numbers there.

Mr. CALDWELL. I have here a complete breakdown of the open positions in the corn futures market on the Chicago Board of Trade on January 27, 1967, which tells specifically the type of people who were in the market at that point in time. If you would like to have this submitted for the record—

Mr. FOLEY. I ask unanimous consent to have that provided for the committee's record.

Mr. PURCELL. Will you repeat what it is you are about to provide?

Mr. CALDWELL. I have here a complete breakdown of the open positions in the corn futures market on the Chicago Board of Trade on January 27, 1967, showing the occupations of the various traders who were in that market.

Mr. PURCELL. How long or big is it?

Mr. CALDWELL. One page.

Mr. PURCELL. Without objection, it will be allowed.

(Document referred to above follows:)

CORN FUTURES—OCCUPATIONAL DISTRIBUTION OF ACCOUNTS BY NUMBER AND CLASS OF ACCOUNT, CHICAGO BOARD OF TRADE, JAN. 27, 1967

(Positions in thousands of bushels)

Occupational group ¹	Speculators			Hedgers			Total		
	Number of accounts	Positions		Number of accounts	Positions		Number of accounts	Positions	
		Long	Short		Long	Short		Long	Short
Grain merchandisers, exporters, and elevator operators.....	450	9,480	3,785	973	71,975	191,340	1,423	81,455	195,125
Processors and refiners of corn.....	27	395	330	52	34,309	18,990	79	34,700	13,920
Feed manufacturers.....	35	540	45	45	3,635	3,550	60	4,195	3,680
Cash grain brokers.....	10	1,035	1,020	2	73	10	12	70	1,030
Feed and seed dealers.....	134	2,985	4,305	65	4,305	1,445	199	7,290	2,220
Livestock feeders and dealers.....	179	4,420	1,020	21	295	0	200	5,030	1,315
Producer cooperatives and cooperative feed mills.....	7	60	10	2	325	0	9	385	10
Total.....	842	18,915	7,070	1,160	115,300	215,230	2,002	134,215	222,300
Processors and refiners of grains other than corn.....	15	1,835	1,750	7	1,510	10,380	22	3,345	12,130
Dealers in agricultural commodities other than grain or livestock.....	61	1,650	1,860	8	265	20	69	1,915	1,880
Farmers and farm managers.....	4,032	53,500	14,480	269	6,870	850	4,301	60,370	15,330
Employees of grain merchants, elevators, and processors.....	85	2,775	2,080	10	300	600	95	3,075	2,680
Brokerage houses and employees.....	261	20,845	19,255	10	639	465	271	21,530	19,720
Floor traders.....	125	36,295	35,400	4	55	70	129	36,350	35,470
Professional speculators.....	80	16,545	11,370	0	0	0	80	16,545	11,370
Commodity and investment counselors.....	87	3,040	3,030	1	200	0	88	3,240	3,050
Doctors, dentists, trained nurses, pharmacists, etc.....	385	4,500	2,300	0	0	0	385	4,500	2,300
Lawyers.....	178	2,810	2,950	2	30	0	180	2,840	2,950
Accountants and auditors.....	194	1,810	1,435	0	0	0	194	1,810	1,435

Chemists and engineers.....	400	2,885	2,135	1	0	10	401	2,885	2,145
Teachers.....	195	2,035	2,945	0	5	0	196	2,040	2,945
Other professional occupations, such as architects, contractors, social workers.....	291	4,780	2,445	0	0	0	291	4,780	2,445
Semiprofessional occupations, such as aviators, draftsmen, radio and television operators.....	105	1,135	635	0	0	0	105	1,135	635
Bank officials and employees, financiers, and capitalists.....	136	4,740	3,105	1	10	0	137	4,750	3,105
Manufacturers (other than corn), wholesale trade proprietors, managers, food brokers.....	126	2,540	2,875	4	135	0	130	2,675	2,875
Retail proprietors and managers: Grocery, food, apparel, furniture, automobile sales and services, etc.....	569	8,750	4,025	2	30	0	571	8,780	4,025
Other proprietors, managers, and officials (excluding farm)	817	13,785	6,975	11	725	295	828	14,510	6,220
Salesmen and purchasing agents.....	293	3,400	1,930	0	0	0	293	3,400	1,930
Insurance and real estate persons.....	315	6,415	2,425	3	45	10	318	6,460	2,435
Clerical, sales, and kindred nonmanual workers, such as bookkeepers, cashiers, stenographers, office machine operators, etc.....	122	955	510	1	10	0	123	965	510
Craftsmen, foremen, electricians, machinists, and kindred skilled workers in plants and factories.....	131	1,035	605	0	0	0	131	1,035	605
Service occupations, unskilled workers, and laborers.....	284	2,690	975	0	0	0	284	2,690	975
Transportation, communication, and utility workers.....	105	1,170	860	3	130	0	108	1,300	860
Housewives.....	339	6,665	3,320	0	0	0	339	6,665	3,320
Students.....	766	795	640	0	0	0	766	795	640
Retired persons.....	776	10,040	4,765	11	130	35	787	10,170	4,800
Miscellaneous.....	284	2,610	1,580	0	0	0	284	2,610	1,580
Total.....	10,867	221,920	132,610	349	11,135	12,735	11,216	233,055	145,345
Unclassified.....							6	55	85
Grand total.....	11,709	240,835	139,680	1,509	126,435	227,965	13,224	367,325	367,730

1 Occupations have been grouped from specific descriptions as reported by futures commission merchants.

Mr. FOLEY. Will you summarize briefly what that shows in terms of those who may not be professional traders?

Mr. CALDWELL. At that time, there were 13,224 accounts in the market. Grain merchandisers, exporters and elevator operators held 1,423. Processors and refiners of corn, 79; feed manufacturers, 80; cash grain brokers, 12; feed and seed dealers, 199; livestock feeders and dealers 200. Producer cooperatives and cooperative feed mills, 9. That is a total of 2,002 in those particular categories which are related directly to the corn trade.

Mr. FOLEY. How many total contracts were there?

Mr. CALDWELL. That represents on the long side, 134 million bushels and on the short side 222—

Mr. FOLEY. You misunderstand my question. Just give me the number of people who are related to the commodity itself, related to corn?

Mr. CALDWELL. 2,002.

Mr. FOLEY. What is the total number of classifications?

Mr. CALDWELL. 13,224.

Mr. FOLEY. Where are the remainder?

Mr. CALDWELL. The remainder are such categories as processors and refiners of grain other than corn, brokerage house employees, floor traders, professional speculators, doctors, dentists, trained nurses, lawyers, accountants, chemists, teachers, retired persons, and so forth.

Mr. MAYNE. Will the gentleman yield?

Mr. FOLEY. Yes.

Mr. MAYNE. Any Congressmen?

Mr. CALDWELL. No, sir.

Mr. FOLEY. In other words, some of those latter categories—doctors, lawyers, nurses, accountants, teachers, retired persons and so on—they are just people of general occupation not connected with commodities trading in any special way except as investors?

Mr. CALDWELL. That is true.

Mr. FOLEY. Are their numbers growing?

Mr. CALDWELL. Their numbers are growing and you will find that the majority of traders in almost any market are of that type.

Mr. FOLEY. The majority of traders in any market are of that type?

Mr. CALDWELL. Yes, sir.

Mr. FOLEY. The nonspecialist category?

Mr. CALDWELL. Right.

Mr. FOLEY. Do they have a special problem in knowing the circumstances of brokerage or operation in which they may be placing confidence?

Mr. CALDWELL. They certainly do.

Mr. FOLEY. Are they equipped to make judgments always on these matters by background and information?

Mr. CALDWELL. Some are. Others must rely on information and advice given by brokerage firms or their friends.

Mr. FOLEY. The point of my question is obvious. These are the people that need to be protected, are they not?

Mr. CALDWELL. Quite a few of them; yes, sir.

Mr. FOLEY. One other question: you brought how many criminal actions in the life of the act?

Mr. CALDWELL. In the life of the act——

Dr. MEHREN. If I may interrupt, Mr. Foley, I do not think that the protective purposes of the Commodity Exchange Act are restricted to professional traders, amateur traders, or traders alone. This is a major element in price formation. In consequence, its impact impinges upon everybody—producer, handler, processor, consumer. Everybody is involved here.

Mr. FOLEY. Its economic consequence is much broader.

Dr. MEHREN. Yes, sir.

Mr. FOLEY. I am talking about the cases of defrauding, though, Mr. Secretary, the individual investor who is likely to be overreached by the defrauder, or dealt with dishonestly, I assume, is more likely to be the nonprofessional trader who is less likely to know the——

Dr. MEHREN. But I would respond that if fraud, dishonesty, or any other activity adversely affects normal pricemaking, then all people are involved in this, and the purpose extends to all of them.

Mr. FOLEY. I certainly agree with that, and I am glad you mentioned it. I did not intend my question to seem to limit the nature of the act to just protecting the individual trader.

Did you have an answer to my question on the number of cases?

Mr. CALDWELL. If I may, I would like to submit that for the record. I do not have an accurate count at this moment.

Mr. FOLEY. Could you give me a generalization? Is it under 500?

Mr. CALDWELL. Oh, much under. I would say nearer 50.

Mr. FOLEY. And how long has the act been in effect?

Mr. CALDWELL. Forty-five years.

Mr. FOLEY. About one criminal case a year on the average?

Mr. CALDWELL. That is right.

Mr. FOLEY. It seems to me, considering the millions of acts of trading on the commodity market, the Department, if anything, could not be accused of overzealousness or using its power destructively to harass the commodity markets and bring criminal prosecutions. I, for one, do not think you are going to use the power improperly if it is given to you in injunctive form.

Thank you, Mr. Chairman.

Mr. PURCELL. To follow up one of the questions in line with what Mr. Foley was asking, with the vast amount of increased activity on the commodity market, I do not remember in Dr. Mehren's statement any figures other than those dealing with sowbellies, pork bellies, whatever others there were. Contracts went from 461 up to over a million contracts per year at the present time.

Now, Mr. Foley was making a comparison between the criminal acts and how important it is to have those reached by legislation. It seems to me we want to keep in mind also that although we have here a business that has had only 50 criminal complaints filed against it in 40 years, while its business activity increased from 400 to a million, that we seem to be creating an administrative maze of regulations and maze of lawyers and checkers of all kinds running around.

Does the Commodity Exchange Commission have one of these provisions where you get a little card before you can practice with

them? Does it make a practice of having you get a little card before you show up as a lawyer over there?

Dr. MEHREN. I could not answer, but I do not think so.

Mr. PURCELL. Ask your lawyer. I think they do.

Mrs. PROKOP. I do not know of any such requirement.

Mr. PURCELL. You do not even have to be a lawyer, you will find if you check around. If you get a little card that says you are a member of the Exchange Commission, you get a license to go hunt for anybody violating anything. If you have a million contracts on pork bellies, and that has been going on for 4 or 5 years, and you cannot find any more than 50 criminal acts in 45 years, I just want to observe that we are, at least to some degree, placing more and more restraint and trouble and difficulty in a segment of our business that has had a pretty good record.

Our crime rate that Mr. Foley was referring to is going up in direct opposite proportion to what the criminal activity in this particular business happens to be, and I, for one, just want to observe that this bill may be good—I am not making any judgment on that—but business itself must be making a better record than society as we have not been passing laws to make it against the law to murder, rape, and rob, and passing more and more of them that have to do with making what we consider very legitimate business easier to carry on. Especially, the part that Mr. Dole was bringing out awhile ago and what I want to emphasize, is that there are some of us who happen to be lawyers who do not like you to pick up some fellow who does not even have a license to practice law and give him a little card that says he is a counsel for the FCC or the commodity outfit, or something of that kind, when we can be a little bit more businesslike and a little more—well, fill a requirement for reasonableness in all this.

I do not know whether that is a question, a speech, or an observation, but if you have some comments, we will be glad to hear you.

Dr. MEHREN. I would like briefly to comment and then ask Mr. Caldwell to. As I understand the burden of your statements, first, trading in pork bellies is new. The increase in volume is nothing to which we take exception. We would say, however, that a trade which is approaching a million transactions should probably be subject to the same kind of surveillance and observation with respect to fraud and honesty as our other very large trades are. Not to do so would fail, I think, to meet the intent of the Congress with respect to this kind of trading.

Secondly, I think, implicit in your observations was some feeling that gratuitously or fortuitously, we permit anybody to see anything. I believe that the disclosure of information of any sort, or the status of any people to undertake any activities involving data in the Department of Agriculture are quite carefully regulated by statutes passed by the Congress. So that there is no irresponsibility in this area of work, Mr. Purcell, any different from what irresponsibility may exist, but probably does not, in the handling of the Department in similar activities in other phases of our work.

Do you have a comment, Mr. Caldwell?

Mr. CALDWELL. Yes, if I may.

The Commodity Exchange Commission does not have any employees at all. It relies entirely upon the employees of the Commodity

Exchange Authority of the Department of Agriculture to make investigations that the Commission later acts upon. The Commodity Exchange Act now permits the Department of Agriculture employees and Department of Justice employees to examine various records that are required by the act. The Department of Agriculture, through the Commodity Exchange Authority, makes investigations of possible violations. These are all Department employees; they are not outside persons at all. They are subject to control of the Secretary, and I do not feel that they are making any investigations which they are not permitted to make under the authority of the act.

Anything they get in connection with their investigations is confidential and is not going to be revealed to anyone except as provided by law. I do not feel that there is any way in which this is an undue burden upon the people who may be investigated for possible violations of the act.

Secondly, I would like to say that this question of number of criminal cases is not really a good criterion for determining the effectiveness of the regulation under the Commodity Exchange Act. In addition to the criminal cases, we have another 150 administrative cases that have been brought.

But more importantly, we feel that our function is to prevent violations wherever possible, rather than to prosecute violators after the damage has been done. We do in every instance we possibly can, try to foresee instances of violation developing and take action to see that they are stopped before they get to the complaint stage or to the criminal prosecution stage.

Mr. PURCELL. Let me observe that in making my comment about the fellows having the card, I did not mean to imply that people are climbing around looking at records that do not have any business knowing about them. I am an attorney. One time I had a case I might have gotten paid a fee on had I had a card, and I would not get a card because I thought I had all the license I needed. I do not like these superimposed requirements, and I am not even sure that in this particular instance, they are required.

But my point is that this has been a pretty well disciplined segment of our economy. The law may need strengthening. But I just would like to have something in the record that reflects, at least, somebody's opinion other than the fact that this is some business that is filled with fraud, deceit, and things of that kind, because there are administrative regulations imposed upon this segment of our business community that are over and above the normal requirements of each citizen not to murder, nor rob, nor rape.

This segment of our business has been operating under rather strenuous rules imposed by each exchange, and by the Department, with authority granted under law that now exists. Of course, the Department does have the authority to use their own investigators plus whatever appears in their good judgment to be necessary to turn over to the Department of Justice to be further investigated.

So at least there are about three layers of investigative authority that this segment of business is subjected to over and above that of each citizen. This is the point I am making. Is this not fairly accurate?

Dr. MEHREN. I think, sir, the same thing can be said about the rather special provisions that impinge upon attorneys at law, members

of the medical profession, certain types of research people. The Congress wisely, I think has made special provisions, especially tailored to the conditions prevailing within differential professional activities and, probably in some measure, related to the possibilities of public damage or private damage uniquely associated with the attributes of these professional activities.

Mr. PURCELL. But in each of these professions you have named, so far as we know, their professional conduct has been above that that should ordinarily be compared with murderers, rapists, and robbers; is this not so?

Dr. MEHREN. Yes, I think that the provisions applicable to people who operate in commodity futures are, for very good reasons, different from and in some cases in addition to the general statutes designed to maintain public order and morals, generally, and for very good reasons.

Mr. PURCELL. All right, sir.

Now, I have three other short questions.

Dr. Mehren, this morning—and I do not know where to refer to it in your testimony now—I think reference was made to 16 cases where injunctive relief was desirable. There was some comment about the effect it had on the ability to enforce the law.

Now, my question, in connection with these 16 cases, is this: Do you have any figures that show what loss, if any, there was to the customers whose money got involved in these 16 cases?

Dr. MEHREN. I do not, personally, Mr. Purcell. I will ask Mr. Caldwell, if he may answer, and if not, we will try to supply for the record as best we can the data you have requested.

Mr. PURCELL. All right.

Mr. CALDWELL. Three of these cases we referred to this morning were cases involving undersegregation; that is, not separately accounting for a customer's funds. I would have to check to find out the amount of money, if any, lost on each of those cases. That can be supplied for the record.

Secondly, five of the cases involved violations of the speculative limits. Those are the limits applied by the Commodity Exchange Commission in certain commodities. For example, the speculative limit on wheat is 2 million bushels on the amount of trading that can be done in a day, and the amount of positions that can be held. Violations of this type do not have a monetary loss for any customers.

Violations of the speculative limit have an effect upon markets, and it is impossible to measure the effect of anything like this on the various people who may be using the markets for hedging or for price basing.

Six of these cases involved manipulation. Here again, this is the type of violation that affects the market and has a much wider effect than a violation of the segregation requirements or of cheating, for example. It is impossible to tell how many people price their cash commodity on a wrong basis as a result of manipulation, and therefore lose money. It is also impossible to tell how much the hedgers are affected by manipulation.

Two of the cases involved cheating. In cases of this type, we can very easily discern the amount of money that customers lost. I will supply that for the record, if I may.

(The information above-referred to, follows:)

PARTIAL LIST OF CASES WHICH THE DEPARTMENT FEELS WOULD HAVE BEEN SUBJECT TO INJUNCTIVE RELIEF

CEA Docket No.	Principal violation	Respondent(s)	Loss to customers
63	Undersegregation.....	Myers & Co. et al.....	1 None
89	do.....	Charles Keeshin, Inc. et al.....	1 None
145	do.....	Milrose Brokerage Co., Inc. et al.....	1 None
66	Speculative limits.....	William Ludwig.....	(2)
81	do.....	Benedict K. Goodman.....	(2)
135	do.....	Arthur P. Gumz et al.....	(2)
139	do.....	Samuel E. Cohen et al.....	(2)
140	do.....	Darrell M. Hills.....	(2)
68	Attempted manipulation.....	Winn & Lovett Grocery Co. et al.....	(2)
69	Manipulation.....	Jacob Stern et al.....	(2)
73	do.....	Vincent W. Kosuga et al.....	(2)
74	do.....	Fox DeLuxe Foods, Inc. et al.....	(2)
90	do.....	Henry H. Cate et al.....	(2)
109	do.....	Internatio (Wool), Inc. et al.....	(2)
111	Cheating.....	Becker Brokerage Co. et al.....	3 26,000
127, 134	do.....	A. James Comenzo; Harney, Burnes Inc.; Dunbeath-Hagen Corp., et al.	4 250,000

¹ Failure to segregate customers' funds always poses the threat of loss of customers' funds.

² Customers' funds not involved. Due to the nature of the violations it is impossible to determine whether losses occurred to others who were using the future market directly or indirectly.

³ \$13,000 of customers' losses reimbursed to customers by the carrying broker.

⁴ Includes losses on nonregulated trades.

Mr. PURCELL. Thank you, sir.

Dr. Mehren, I think it is on page 12 of your statement, where you were talking about there being certain firms indulging in kickbacks, and so forth; now, what exchange were these firms a member of who paid the kickback?

Dr. MEHREN. One was a member of the Chicago Board of Trade; the other was a member of the Chicago Board of Trade in the Chicago Mercantile Exchange.

Mr. PURCELL. As far as you know, have these exchanges taken any action in these matters?

Dr. MEHREN. I do not know. I will ask Mr. Caldwell.

Mr. CALDWELL. Not so far as we know.

Mr. PURCELL. Are there any other questions?

Mr. DOLE. Mr. Chairman, I do not have a question, but in line with what you said, it might well be wise to make an observation. This appeared in the January 1958, "George Washington Law Review," discussing the Exchange and the Review Act.

On page 215, there is the following:

Mr. Justice Holmes observed that "people will endeavor to forecast the future and to note agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophe, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak and that incompetent persons bring themselves to ruin by undertaking to speculate in their time. But legislatures and courts generally have recognized the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain."

The point is, we certainly want to protect those from fraud or dishonesty, but we cannot protect by legislation, ineptness or incompetence or stupidity. I think it is in line with the point the chairman is making.

Mr. FOLEY. Mr. Chairman, if I may just make an observation, too.

I do not think there is any disagreement with what Mr. Dole just said. At least, speaking for myself, I do not think that any reasonable concern should be exhibited by this committee to try to protect people from their pure folly. But I do not think that is what we are trying to deal with here.

We are not trying to protect people from making foolish investments. The existence of the market presumes people making foolish investments. What we are attempting to do here is trying to protect people from being defrauded, from being deliberately overreached, and from being manipulated and from the dishonesty in commodity trading.

I, for one, do not feel that it is in the industry's interest or in the committee's interest to engage in a kind of reassuring self-congratulations which ignores the problem under review and seems to put to rest legitimate concerns that should be brought out into the open, examined, and dealt with.

Dr. MEHREN. If I may respond to Mr. Dole, I have carefully refrained from claiming knowledge of the law, but I am an economist and, if necessary, can produce the papers to prove it, not that I want to.

Mr. PURCELL. I do not think that we will require that.

Dr. MEHREN. Thank you.

But again, the issue of the value of futures trading is present. There is no attack on this at all. However, in a serious response to your comments, I did say, in effect, that malpractice by a tennis professional is not particularly serious in its impact upon anybody or upon the public in general.

Malpractice by a doctor of medicine is. In consequence, those who operate within the professional context of medicine, whose impact upon the public interest of malpractice might be substantially greater than that of a tennis professional, should be, and are, subject to special regulatory provisions associated with that operating context.

This is true of many other activities. It is the position of the Department that taking the facts of commodity trading generally, and with no denigration of the usefulness of commodity trading to which we ascribe fully, personally and as a Department, there are within this operating context now existing loopholes which, in the judgment of the Department, do or could endanger the interests that we are told by this Congress to protect, and it is therefore solely on this basis, Mr. Dole, and none other, that we suggest these amendments.

Mr. PURCELL. Thank you very much, Dr. Mehren.

I believe that is all the committee has for you and your associates.

Mr. MAYNE. Mr. Chairman, may I ask a few questions?

Mr. PURCELL. Excuse me, yes.

Mr. MAYNE. Mr. Caldwell, I believe you are the one who testified about these 16 cases in which the Authority would have used the injunctive process if it had been available. I did not understand over how long a period of time those 16 cases go back.

Mr. CALDWELL. They go back for about 15 years.

Mr. MAYNE. Or about one a year?

Mr. CALDWELL. Yes, sir.

Mr. MAYNE. Now, I certainly want to compliment Dr. Mehren on his very carefully prepared and excellent testimony.

I was particularly impressed, Doctor, with that portion where you, being questioned, volunteered the opinion that you would, under no circumstances, want to do anything that would in any way shortcut or diminish the rights of any person accused of a crime. I am sure the committee is grateful to you for that.

Now, Mr. Caldwell, while you were being led through this series of inadequacies and loopholes in our system of justice, culminating with the point where you, I believe, conceded that under our system, with its imperfections, occasionally a guilty man is acquitted, I am sure you did not mean to denigrate in any way the importance of a fair trial in full protection of the rights of the accused, did you?

Mr. CALDWELL. Not at all.

Mr. MAYNE. You would subscribe to what Dr. Mehren said in that respect?

Mr. CALDWELL. Wholeheartedly.

Mr. MAYNE. If we were going to speculate about the guilty person occasionally getting away, it is also true under our system, is it not, that at some times, unfortunately, it is the other way, and there have been instances where innocent men have been convicted, even under our system?

Mr. CALDWELL. I am sure that has occurred.

Mr. MAYNE. If we are going to speculate, in all fairness, it would have to go both ways, would it not?

Dr. MEHREN. Mr. Mayne, if I may say so, the point here in specifying cases—

Mr. MAYNE. Dr. Mehren, I am going to have some more questions for you. I would sort of like to stay with Mr. Caldwell on this, if I may, if you do not mind.

Now, these cases which you mentioned, about 50 criminal actions—that is an estimate, I understand, that is only one criminal action on the average brought per year in 45 years.

Mr. CALDWELL. It is about that; yes, sir.

Mr. MAYNE. How many were brought in this last year?

Mr. CALDWELL. I believe there was one. I am not positive of that, whether it was in this past fiscal year or not.

Mr. MAYNE. How many in the previous year?

Mr. CALDWELL. I would have to supply that for the record, if I may. I do not have those figures immediately available.

Mr. MAYNE. Apparently, it does not make any such impression upon your recollection, that there was any large ballooning of that number in any 1 year?

Mr. CALDWELL. Ordinarily, about one or two criminal cases a year is about what we would bring.

Mr. MAYNE. In addition, of course, there are, as you said, about 150 administrative cases for a period of 45 years, which would be a little over—an average of three a year on administrative matters?

Mr. CALDWELL. We have, in recent years, in averaging, I would say, around six or seven administrative cases a year.

Mr. MAYNE. So there has been some pickup in that. Is that the same figure you were referring to this morning when you said the authority handled four or five complaints a year?

Mr. CALDWELL. Yes; that is the same one.

Mr. MAYNE. And that is about what you had this last year, all together?

Mr. CALDWELL. I think it was a little higher than that, but not much.

Mr. MAYNE. I was interested in your statement that disclosure of information of any sort in these cases is very carefully regulated by the Congress. You will have to forgive me—this is my first time here, so I am not as familiar with some of these regulations as I no doubt should be. But when the authority gets a definite uncontrovertible statement of fact about one of these brokers, does not the authority have authorization to release that information for the protection of the public?

Mr. CALDWELL. Not unless it is in connection with a complaint. If there have been charges brought, we can release the information, but not otherwise. We are permitted under certain provisions to make the information available to business conduct committees of exchanges for their use, but not to release it to the general public.

Mr. MAYNE. Now, this last procedure you talk about, is that contingent upon the filing of a complaint, or can you give it to the business conduct committees without the filing of a complaint?

Mr. CALDWELL. Without the filing of a complaint. When the Secretary determines that there is a situation that is disturbing the markets, he is authorized under the act to bring it to the attention of the exchange in which the situation is developing.

Mr. MAYNE. Would not his authority be broad enough, the authority be broad enough, so that, for example, if the insolvency of a broker were admitted, he would be authorized to give that to the business conduct committee?

Mr. CALDWELL. We could give it to the business conduct committee. We could not make it public.

Mr. MAYNE. What about this situation where you told about applicants who had only \$450 in assets, none of which were in cash? Do you not think the Secretary has authority to give that information to a business conduct committee?

Mr. CALDWELL. I do not think it would be necessary, because business conduct committees have the authority to get their own financial statement from members.

Mr. MAYNE. In all exchanges?

Mr. CALDWELL. Yes, sir.

Mr. MAYNE. Well, did you mean to give the impression this morning—perhaps this was in Dr. Mehren's testimony.

We are coming back to you now, Doctor.

Dr. MEHREN. Thank you.

Mr. MAYNE. Was it the thrust of your testimony that the Authority was powerless to deny an application to an applicant who had only \$450 in assets, none of which was in cash?

Dr. MEHREN. It is my understanding that any man who can pay the registration fee and who is not under an unexpired suspension order—must be registered by the Commodity Exchange Authority if he so requests.

Is that correct?

Mr. CALDWELL. That is correct.

Mr. MAYNE. And is it a fact that no power on the part of the Secretary or the Authority exists to bring this fact that the broker had no appreciable assets to the attention of anyone who might thereby be protected by the information?

Dr. MEHREN. It is my understanding that every exchange has the authority on its own to ask with respect to the financial status of any applicant for membership therein, sir.

Mr. MAYNE. Could not the Department, with the Authority, do something about bringing this rather shocking fact to the attention of potential customers of this very meagerly capitalized brokerage firm?

Dr. MEHREN. Well I think we should make a division first, such applicants for registration who are members of the exchange, and those who are not. With respect to the latter class, those who are not members, my understanding is, again, that we have no authority to deny registration on any basis other than that which I earlier indicated, namely, an unexpired suspension order.

With respect to the exchanges, I believe, and I will ask Mr. Caldwell to check me, that we do have authority of disclosure to the exchanges with respect to such members who apply. I would also say that the exchanges themselves, however, have initial authority and perhaps initial responsibility to inquire into these matters.

Mr. MAYNE. Well, aside from whether you have to issue the registration to him, are you saying that you could not do anything about warning people about this shoestring operation?

Dr. MEHREN. I can certainly answer that. No, we cannot. We have no such authorization in any statute that I know, to do that.

Mr. CALDWELL. That is quite correct. We are not permitted to advise possible customers of these firms as to the financial condition of the firm.

Mr. MAYNE. Even though there was no question whatsoever of what these assets were, or—let us say there was no question but what the firm was insolvent.

Mr. CALDWELL. Even though the firm is insolvent, we could not tell the customers.

Dr. MEHREN. Under the present terms of this statute, I would not be authorized to answer your question, sir, if you asked me who were these people who applied for registration and received it with assets of \$450, because I would be legally precluded from so doing.

Mr. MAYNE. Would that also be true as to an applicant who is insolvent, and who had admitted in writing that he is insolvent?

Mr. CALDWELL. That would be true with respect to that type of applicant, as well.

Mr. MAYNE. Now, what about a person, as you stated here, elsewhere in your testimony, who had actually been engaged in prohibited practices on a stock exchange, as distinguished from the Commodity Exchange?

Would you be equally powerless to give that information to anyone?

Dr. MEHREN. Under the terms of the present statute, we would have no such power at all.

Mr. MAYNE. Well, that certainly seems to me like a very sad situation which should be corrected.

Thank you.

Mr. GATHINGS. Mr. Chairman?

Mr. PURCELL. Mr. Gathings.

Mr. GATHINGS. What specific requirements would you invoke with respect to financial responsibility if this act as presented here is approved and the bill is passed?

Dr. MEHREN. I think, Mr. Chairman, we would be required to go through the normal rulemaking procedure and specify officially and formally through public notice, public notice of proposed regulations, receipt of comments, data, views, arguments, exceptions; other public hearings if necessary; and then the formal promulgation of such rules. I believe that would be the procedure we would have to follow.

I would like Mr. Caldwell to correct me if I am wrong.

Mr. CALDWELL. That is quite correct. We would have to go through the procedure under the Administrative Procedure Act.

Mr. GATHINGS. That would no doubt require some time?

Mr. CALDWELL. It would; yes, sir.

Mr. GATHINGS. And require additional personnel?

Mr. CALDWELL. The procedure of establishing the regulation would not require additional personnel, but if we are given the authority to establish minimum financial requirements we are going to have to make more complete audits, more frequent audits, and that will require more personnel.

Mr. GATHINGS. And also, by virtue of this bill extending the exchange authority to incorporate coffee, sugar, livestock, and livestock products, it would require additional personnel, too, would it not, on the part of the organization?

Mr. CALDWELL. Yes, sir, that would require additional personnel.

Mr. GATHINGS. How many people do you have now working for the CEA?

Mr. CALDWELL. 140.

Mr. GATHINGS. What do you think would be the necessary number of employees, total, should this bill be approved?

Mr. CALDWELL. We estimate that we would need 85 additional employees.

Mr. GATHINGS. What would be the cost of these 85? Would they be in a high echelon, or would they be in the middle classifications?

Mr. CALDWELL. The total cost in personnel and other matters would be \$688,000, we estimate.

Dr. MEHREN. For our provisions in this, not for the additional four commodities, Mr. Gathings. To effectuate all of these provisions, including the four new commodities, our people estimate we would require an estimated \$688,000 above the present one.

Mr. CALDWELL. About \$400,000 of that would be for the new commodities.

Mr. PURCELL. Thank you very much.

As I understand it, there has been some agreement reached, as to one set of witnesses testifying out of order. I was not furnished with that specific information.

Mr. Marion Rhodes, president of the New York Cotton Exchange, is the next witness.

Mr. MAYNE. Mr. Chairman, could I just say something before we start out? I do not want these gentlemen to be caught by surprise.

After this witness has completed, I am going to attempt to make a point of order that permission has not been obtained by the committee to proceed when the House is debating a very important piece of legislation. I do not want to cut this gentleman off, but I would like the others to know that I am going to raise that point of order after he has completed.

Mr. FOLEY. Would the gentleman yield?

Mr. MAYNE. I am through.

Mr. FOLEY. I just wanted to ask the gentleman a question.

Does the gentleman intend to make his point of order at the conclusion of this witness' oral testimony, or at the conclusion of the questioning of this witness?

Mr. MAYNE. I certainly would not want to deprive any of my colleagues of their full right to question the gentlemen, or to detain him here another day.

Mr. PURCELL. All right; let us proceed.

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

Mr. RHODES. If my full statement will be put into the record, I will be glad to leave out certain sections of it in order to conserve the time of the committee.

Mr. PURCELL. Without objection, it is so ordered.

Mr. RHODES. For a number of years there has been little opportunity for trading in cotton futures. The Government controlled cotton prices; the free market was destroyed; hedging was unnecessary; the New Orleans Cotton Exchange ceased to function; trading on the New York Cotton Exchange diminished and finally almost disappeared.

However, thanks to the Food and Agriculture Act of 1965 policies have now been changed. Cotton is again being sold at competitive prices. The free market is being restored. This will mean that prices will fluctuate and growers, merchants, processors, and others in the marketing system will once again need hedge protection against changes in price. The economic function performed by the futures market when cotton was sold in a free market will again come into play.

Trading on our exchange has begun to develop and we oppose anything that will discourage the return of a free market. What we say about the cotton exchange applies to all other exchanges. If traders are discouraged by the Government from using the futures markets, the markets are less able to perform their functions for the good of the economy.

It is generally recognized by competent economists that futures exchanges perform a valuable economic function. I am glad to note that Assistant Secretary Mehren changed his testimony this afternoon to where he agreed with that statement, himself, although his prepared statement seemed to indicate the opposite.

Our concern is that some sections of H.R. 11930 could dampen interest in futures trading. The bill threatens revocations of licenses, additional fines, imprisonment, injunctions, and cease-and-desist orders.

An example of what I am discussing is found in the enforcement

and penal provisions of the bill dealing with manipulation. Under the present act, a person found guilty of manipulation or attempted manipulation is subject to the following penalties:

(1) He can be denied the privilege of trading on any exchange for such period as the Secretary may prescribe—section 6(b);

(2) His registration as a futures commission merchant or floor broker can be suspended or revoked—section 6(b); and

(3) He may be prosecuted for commission of a misdemeanor and, on conviction, fined up to \$10,000 and imprisoned for up to 1 year; or both.

The new bill would make two changes:

(1) The crime is changed from a misdemeanor to a felony and the term of imprisonment is increased from a maximum of 1 year to a maximum of 5 years—section 25 of the bill; and

(2) The Secretary may issue an order requiring the person charged to cease and desist. If he violates the Secretary's order, he can be convicted of a felony for such violation with the \$10,000 fine and 5-year imprisonment applicable.

I would like to ask: why are these additional harsh provisions added? Is manipulation so rampant that stronger penalties are required?

Despite the dark, dreary, and sinister picture painted this morning by the spokesman for the United States Department of Agriculture, according to the testimony of the Administrator of the Commodity Exchange Authority at the hearings on the last bill presented to Congress by the CEA, in the 31 years since the Commodity Exchange Act was enacted, there have been complaints charging manipulation or attempted manipulation of less than an average of one per year. There were 28 administrative complaints and three criminal charges.

I frankly admit that I am at a loss to understand how these numbers can change so much between a year ago when this same bill was under study and today, since they testified that there has been only five or six cases brought in the past year.

Another provision of the bill gives the Secretary of Agriculture new power to issue cease-and-desist orders against persons violating the act—section 17. According to the Assistant Secretary of Agriculture, who testified in favor of the last bill to amend the act, this power is sought to deal with less serious violations of the act which would not warrant the more drastic remedy of the denial of trading privileges or the suspension or revocation of registration which might put the offender out of business. But this bill provides that if the offender violates the cease-and-desist order he is guilty of a crime and on conviction may be required to pay a fine of up to \$10,000 and may be imprisoned for from 1 to 5 years, depending on the offense.

This "so-called" less drastic remedy can be worse than a criminal prosecution in the first instance. If a person is charged in a criminal proceeding with a violation of the act, he is entitled to a trial in court on the question of whether he violated the act. Under section 17, he could be subjected to criminal penalty without a trial on the issue of his violation of the act, but merely on the question of whether he violated the cease-and-desist order. We do not feel the Department needs this remedy.

Section 6(a) of the present act authorizes the Commodity Exchange Commission to suspend or revoke the designation of a contract market for violation of law or failure to enforce its rules. This is a wholesome provision. But the bill amends this section to provide that the license of a contract market can be suspended or revoked also for a violation of the act by any of its directors, officers, agents or employees—section 15. 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. I assume that this was not intended, but the amendment is broad enough to be so applied.

The CEA seeks power under this bill to disapprove any bylaw, rule or resolution of an exchange, its managing board or committee which relates to the terms of a contract of sale or other trading requirement when he finds that it violates the act, section 23.

In the bill before the committee last year, the U.S. Department of Agriculture openly asked for authority to actually write such rule. It seems to me that the power to disapprove is equivalent to absolute control for orders of disapproval can be issued until you finally write it the way the Department wanted you to write it in the first place.

If the power is exercised when there is doubt as to legality, the result will be that the CEA instead of the exchanges will be writing the terms of the contracts and the trading rules and the governing boards might as well retire. Again, I come back to the question of the real need for this amendment?

One of the most objectionable features of the bill is found in sections 15 and 16(b) where the rule of evidence in an appeal from a decision of the Secretary of Agriculture is changed. This amendment requires the court of appeals to accept the findings of fact of the Secretary if supported by "substantial evidence on the record considered as a whole," instead of the "weight of evidence." In other words, if the court concludes that the decision of the Secretary in punishing a trader is wrong it must approve his erroneous decision if there is substantial evidence in the record on which he relied.

What promoted this amendment? I believe I know. It is an aftermath of the famous *Volkart* case.

In 1958, the CEA charged Volkart Brothers Co., one of the most respected members of the New York and New Orleans Cotton Exchanges, 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 to the commodity futures industry, and was opposed by the cotton futures exchanges, regional cotton associations and by the American Cotton Shippers Association. It was opposed because a futures exchange could not operate under the CEA's theory, and any person trading on an ex-

change with the idea of taking delivery would be in the position of inviting 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 proposal to substitute "substantial evidence" for "weight of evidence" is an attempt to prevent a 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 the court might not have been able to overturn the erroneous decision of the Department.

The amendment proposed will 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. However, when an appeal is taken, there is no justification for limiting the power of the court to correct a wrong decision.

Mr. Chairman, we believe the CEA has ample power under the present act to enforce the law which it administers and needs no new power or the right to impose new penalties.

The New York Cotton Exchange would like to have the record show that it does not believe foreign-produced commodities which are traded abroad on organized futures markets should be subjected to CEA regulations.

The CHAIRMAN (presiding). Thank you, Mr. Rhodes.

Mr. GATHINGS. Mr. Rhodes, I wonder if you would explain to the committee the function of a margin on the futures exchange, and also explain how it compares with stock margins on the New York Stock Exchange? How does it compare with the stock margins on the New York Stock Exchange?

Mr. RHODES. The function of a margin on a commodity exchange is entirely different from the function of a margin on a stock market. In the case of a commodity market you normally have margins that are at a relatively low level because they are only there to protect the clearinghouse which is carrying the contracts.

Take the case of a cotton contract. Assume you buy 100 bales of cotton. You would have to put up a \$500 margin. When somebody buys the opposite side, the clearinghouse picks up both sides of the contract. They hold the margin and whenever the market moves either way to where additional margin is needed, they call for additional margin.

Now, in the case of what is commonly referred to as margin in a stock transaction, that is actually a credit transaction. In the case of stocks, if you buy 100 shares of American Tel and Tel, you are required to put up 70 percent of the cost and you may borrow 30 percent. The stock transfer certificate is issued to you. If stock dividends are declared, you get the stock dividends.

Here, you actually have a credit transaction. Attempts that have been made to compare a margin on a commodity market with a margin on a stock market just do not hold water.

A futures transaction market is not a credit transaction. As you probably know, testimony has been presented this week in another committee in Congress on this very point. The function of a margin on a futures exchange is only to protect the clearinghouse which is the gobetween, so to speak, between the buyer and the seller of the contract.

Control over margins may affect prices on a stock exchange, but will have little, if any, effect on prices on the commodity exchange. If, however, margins are fixed sufficiently high to discourage speculators from coming into the futures exchange, the market will suffer. Any increase in margins beyond the point necessary to guarantee the obligation of the trader may interfere with the operation of the exchange and discourage speculators from performing their normal function as insurers of the risk of price changes.

Mr. KLEPPE. Would the gentleman yield?

Mr. GATHINGS. I yield.

Mr. KLEPPE. Mr. Rhodes, who sets the margin in the commodity market?

Mr. RHODES. The board of managers.

Mr. KLEPPE. The board of managers of the individual exchange.

Mr. RHODES. Yes, sir.

Mr. KLEPPE. Is there any collaboration between the various commodity exchanges throughout the United States on the margin requirements?

Mr. RHODES. Not to my knowledge; not with respect to the New York Cotton Exchange.

Mr. KLEPPE. It may be different in New Orleans, as compared to New York?

Mr. RHODES. New Orleans is closed. It had to abandon ship.

Mr. KLEPPE. All right, some other place. It may be different in New York as against Chicago?

Mr. RHODES. They do vary in different places, yes.

Mr. KLEPPE. They do vary?

Mr. RHODES. Oh, yes. The margin is fixed at the lowest level which is consistent with a sound program. The lower the margin, the more effective the market can be.

Mr. KLEPPE. So this is a provision that is established by each individual exchange.

Mr. RHODES. Yes, sir, and can be changed by each board of directors whenever something happens in the market that makes them feel that for safety, they should go one way or the other.

Mr. KLEPPE. I thank the gentleman for yielding.

Mr. GATHINGS. Thank you, Mr. Rhodes.

The CHAIRMAN. Mr. Rhodes, may I ask the committee—I think I might as well do it off the record.

(Whereupon, there was a short discussion off the record.)

The CHAIRMAN. On the record.

Mr. FOLEY. Mr. Rhodes, do you feel the commodity trading performs a public service?

Mr. RHODES. Yes, sir.

Mr. FOLEY. And accordingly is closed in public interests?

Mr. RHODES. Yes, sir.

Mr. FOLEY. And that it is a legitimate matter of concern to this committee if there are abuses in the commodity trading field?

Mr. RHODES. Certainly.

Mr. FOLEY. Do you know of any cases—I am asking you to name them—in your experience in either the cotton exchange or other exchanges, where they have been instances of defrauding, dishonesty, or manipulation?

Mr. RHODES. No, sir.

Mr. FOLEY. You have never heard of them?

Mr. RHODES. I have only been with the New York Cotton Exchange since 1960. As I pointed out in my statement, we were about out of business at that time. We had a little bit at that time, and we continued to lose business to where in the current year, we had less than 200,000 bales transacted. So our market has been at a very low ebb. But there have been no cases since I have been there.

Mr. FOLEY. Let me ask you generally: Have you ever been convinced personally that there has been any wrongdoing in commodity exchanges at all?

Mr. RHODES. All commodity exchanges? I have no basis on which to make a generalization on that broad a basis.

Mr. FOLEY. You have no opinion or—

Mr. RHODES. I say I have no basis on which to make a generalization on a statement of that kind.

Mr. FOLEY. You made a statement a little bit ago in your own statement, that you thought the Department had recommended a change from weight of the evidence to substantial evidence in order to prevent the righting of a wrong by a court.

Mr. RHODES. No, I did not say that, either. I shall have to restate that for you.

I said that this was brought about because they lost the *Volkart* case. I think anybody who has been familiar with what has happened in the last 5 years, knows that the *Volkart* case was the most important case that has been brought up in years, and it went clear through to the fifth circuit court, and they were reversed, and were reversed largely because of this rule of evidence.

I think everyone knows that that was the real point behind this change, asking for the change in this rule of evidence.

Mr. FOLEY. I heard that part of it, but I also understood you to say that it was the Department's desire, by substituting for the "weight" of evidence, the rule of "substantial" evidence on the record, it was their purpose to prevent a court from righting wrongs such as the court had done in that case.

I will refer to the record; that is the best answer. But that is what I understood you to say.

Mr. RHODES. I did say that in my opinion, the reason that the request was made last year, and again this year, is because of the reversal of the *Volkart* case.

Mr. FOLEY. Well, as I say, you are your own best judge of what you want to say. But it seems surprising to me that if you had the opinion that the Department of Agriculture was deliberately trying to frustrate justice in supporting this rule of evidence and at the same time, you know, you have this view—at the same time you have the view you could not possibly say that there has ever been any wrongdoing in the

commodity field, it did show a rather delicate balance of judgment and discretion in the one case and a rather reckless disregard for any evidence in the other.

Mr. RHODES. I am afraid, sir, you read a lot into what I intended to say, and what I did say.

I might even make a little further statement on this: I was really quite surprised by some of the allegations made by the Department's own witnesses about the weaknesses of their own administration of this program. I spent 25 years in the Department of Agriculture, and I know most of the people down there and I have a very high regard for them. I do not think their case is nearly as black as it was painted today.

I think they have done a magnificent job, in fact, with the amount of money they have had and the personnel they have had, in administering the Commodity Exchange Authority Act. I think they have all the power they need now, and all they need to do is to continue the job they have been doing. I do not think they need a lot of additional power and authority to take further actions than they have been able to take in the past 25 years.

Mr. FOLEY. I do not want to be argumentative and I do not mean to be. It is just that I have to judge the weight of your testimony in my own mind, as I have to do with every witness. I must say if your statement to me is that you have no way of knowing that there has ever been any wrongdoing in the way of commodity trading, I must take that into consideration.

Mr. RHODES. You asked me—there are about 15 exchanges across the country, and I have no intimate knowledge of all the transactions in the other 14. I commented and gave you a specific answer with respect to the one I am familiar with.

Mr. FOLEY. Do you think that it is necessary in order to have a free market to have the freedom to manipulate, to be dishonest, to overreach, and defraud?

Mr. RHODES. What was your question?

Mr. FOLEY. Do you think that in order to have a free market, it is necessary to have the right, or the power, to defraud and to—

Mr. RHODES. Of course not.

Mr. FOLEY. Do you understand the question?

Mr. RHODES. I understand the question. I sort of resent it, too.

Mr. FOLEY. Well, I suggest to you that what you say in your testimony is:

Trading on our exchange has begun to develop, and we oppose anything that will discourage the return of a free market. What we say about the cotton exchange applies to all other exchanges. If traders are discouraged by the Government from using the futures markets, the markets are less able to perform their functions for the good of the economy.

We may have very different views of this bill. I am just trying to decide what your views are, sir. I think the thrust of this action or this legislation is to prevent defrauding, prevent manipulations on the market, prevent speculation that is in the nature of overreaching, and other offenses against commodity exchanges as we view them.

I would therefore ask you, and I do not mean to be, as I say, argumentative, if you feel that that kind of regulation and control hurt the free market?

Mr. RHODES. I think that it is to the advantage of each commodity market to be as clean as it is possible for it to be and operate. I think the CEA Act as it is written gives the Administrator of the act, the CEA Commission, and the Secretary of Agriculture, the powers and authority that they need to properly administer the various commodity exchanges. We do not have objections to a lot of the things in this bill. This bill has 28 or 30 points, and I only talked about three or four of them.

Mr. FOLEY. I suggest to you reasonably, sir, that there are people, very honest people, who feel that certain kinds of conditions, although they personally disapprove of them, should be allowed to exist rather than the Government regulate them. That is not an unusual position. It is taken by honest people.

My question was not intended to trap you into any kind of an unfavorable reference. There are people who feel that free markets should operate without any Government operation, even though there are going to be cases of violations of law, overreaching, and defrauding. It is a position taken by—

Mr. RHODES. I am not one of that group.

Mr. FOLEY. That is what I was trying to find out.

Do you object to increasing the penalties, criminal penalties, under the act from a misdemeanor to a felony?

Mr. RHODES. Yes, sir.

Mr. FOLEY. I take it from your previous answers, you are probably not aware, and I am not either—but just would like to know if you do know—have there been any convictions under the act that involved defrauding in large sums of money?

Do you know?

Mr. RHODES. Not in the case of cotton; no, sir.

Mr. FOLEY. You represent the cotton exchange?

Mr. RHODES. There are other people here representing other exchanges that have firsthand information with respect to actions that have been brought within their exchanges. I do not have access to that information.

Mr. FOLEY. Would you assume that it is possible to commit a crime of defrauding and commodity exchanging in which large sums of money are involved?

Mr. RHODES. Well, that is hypothetical. It is conceivable it could happen; yes.

Mr. FOLEY. And, if that were the case, do you think 5 years' penalty for, let us say, stealing a couple of hundred thousand dollars, would be excessive?

Mr. RHODES. No; if it were brought in a court of law and it was proved under normal evidence rules, it would not be excessive.

Mr. FOLEY. You are aware, are you not, that in the Federal jurisdiction, judges impose sentences and the law just states the maximum, does not say what the judge has to do? He has wide power to provide probation, even to those who are convicted of felony. You are aware of that?

Mr. RHODES. I am a lawyer.

Mr. FOLEY. Then you object to giving the Federal judges the right to impose as high as a 5-year penalty, regardless of how serious the offense might be?

Mr. RHODES. Our position is that the current CEA Act has ample powers and authority to administer the provisions of the act.

Mr. FOLEY. And that no conceivable case could justify as high a penalty as 5 years in prison imposed by a Federal judge after conviction in a U.S. court?

Mr. RHODES. That would depend—you would have to be more specific as to what the case was, how it was brought, and so forth.

Mr. FOLEY. That is what I am trying to ask you. You cannot conceive of a legitimate case, no matter how severe, after conviction in a U.S. court, in which it would be legitimate, in your judgment, for a U.S. judge to impose as high a penalty as 5 years in prison?

Mr. RHODES. Against a hypothetical question like that, you have to weigh the arguments on the other side. If you set up a procedure here which makes the trading public think that they are liable to be subject to a felony charge, even though they did not do anything, naturally, they are going to become very careful and cautious and probably decide that the risk they would be running to deal in the market would not justify the good they are going to get out of it.

That is the reason we feel that you have to weigh the advantages on both sides. If you make these penalties so severe that you force everybody out of the market because they are afraid of the possibility of their future being jeopardized for some unfounded accusation, why, they just will not take that chance. That is the reason I repeat that we think the penalties that are in the current act are ample to administer the act.

Mr. FOLEY. Do you think the Department has been reckless in character and number of charges that are brought criminally under this act?

Mr. RHODES. No, I just pointed out that I thought they had done a very good job and, according to their testimony last year, there has been less than one criminal case per year brought in the 30 years the act has been in being.

Mr. FOLEY. I do not understand how a man can be afraid who has been in the business that, with this kind of record, one a year, he is suddenly going to be harassed with a criminal conviction and improperly weighed and penalized for an act for which he is responsible that is legitimate, and some judge is going to impose a 5-year sentence on him as a result.

The CHAIRMAN. Before you answer that question, Mr. Rhodes, I wonder if you would let the chairman make an inquiry.

I would just like to get an idea as to how long the questioner would like to proceed. It is not to cut you off at all, but to know whether we should recess and go and answer the rollcall, or whether we should try to hold off a few minutes.

Mr. FOLEY. Was that the first bell?

The CHAIRMAN. That was the rollcall, and I want to answer it. I know others do. I am willing to come back. I do not want to cut you off. I just want to know whether you have a number of questions.

Mr. FOLEY. I have about 5 minutes more, Mr. Chairman.

The CHAIRMAN. I wonder if it would be satisfactory then—I do not want to cut you off. Neither do I want to prolong this. Would it do if you could take the chair and let us go over and answer, and adjourn when you finish? Would that be satisfactory?

Mr. FOLEY. May I ask for this point of information? Was that the first bell?

The CHAIRMAN. Yes; that was the first bell. It means 15 or 20 minutes to the rest of the Members, whether we answer the first round.

Mr. FOLEY. If it were the second bell, I would recommend that we adjourn right now.

I would be glad to do what you suggested.

The CHAIRMAN. I do not want anybody to go who does not want to.

I thank you.

Before I go, I would like to ask unanimous consent to have put into the record the statement of Frank Knell, president of the Wool Associates of the New York Cotton Exchange, Inc., and the statement of the American Farm Bureau Federation at the appropriate places in the record.

(The documents above referred to, follow:)

STATEMENT OF FRANK KNEEL, PRESIDENT OF THE WOOL ASSOCIATES OF THE NEW YORK COTTON EXCHANGE, INC.

The Wool Associates of the New York Cotton Exchange, Inc., of New York City, wishes to emphasize most emphatically its belief that world commodities or commodities that are on an import basis in this country, and which have futures markets in foreign lands as well as the United States, should not be brought under the Commodity Exchange Authority, for domestic and foreign business will be driven from our domestic markets to our foreign competitors, resulting in increased unemployment, and seriously hurting our balance of payments problem.

Our major concern is that H.R. 11930 may further reduce our small volume of business through the threatened revocation of licenses, additional fines, imprisonment, injunctions, cease and desist orders and the Secretary's right of veto over the exchanges' internal matters.

As our name implies, we are closely affiliated with the New York Cotton Exchange. President Rhodes is appearing before this Committee expressing that Exchange's objections to H.R. 11930. The Wool Associates of the New York Cotton Exchange, Inc. subscribes 100% to the objections of President Rhodes to the aforementioned subjects.

It can only be emphasized that wool is basically an import commodity, with futures markets in foreign lands in competition with ours, and we have seen business increase in these markets at our expense. An increase of power to the Commodity Exchange Authority would tend to accelerate the movement of wool futures business overseas.

AMERICAN FARM BUREAU FEDERATION,
Washington, D.C., August 16, 1967.

Hon. W. R. POAGE,
Chairman, Committee on Agriculture,
U.S. House of Representatives,
Washington, D.C.

DEAR CONGRESSMAN POAGE: The American Farm Bureau Federation has been actively interested in the Commodity Exchange Act since its adoption. This legislation which establishes the rules to be followed in the futures trading of various agricultural commodities has protected both agricultural producers as well as the public interest.

The elected voting delegates of the member State Farm Bureaus at our most recent annual meeting adopted the following policy on Futures Trading:

"Futures trading has a prominent and rightful place in our competitive market price system.

"Trading in commodity futures reflects a need of the market system for a means of transferring certain types of risk. It serves a useful purpose for a number to commodities.

"Experience has demonstrated the need for regulatory measures to prevent abuses. We favor strengthening the Act to prevent such abuse.

"We favor extension of the Commodity Exchange Act to all agricultural commodities traded on futures markets."

We believe that H.R. 11930 is a material improvement over previous proposals to amend the Act. We particularly favor the extension of the Act to cover coffee, sugar, livestock and livestock products.

While in our opinion the enactment of this legislation is generally desirable, we do have some question with regard to the provision which would give the Secretary authority to issue cease and desist orders and place the burden of proof on alleged violators of the law. The AFBF Board of Directors will be meeting on September 13 and we will be discussing this specific question. If final action has not been taken by the House Agriculture Committee by that time, we would appreciate the opportunity of submitting any additional recommendation that our Board may wish to make.

We would appreciate your making this letter a part of the hearing record.

Sincerely yours,

JOHN C. LYNN,
Legislative Director.

AMERICAN FARM BUREAU FEDERATION,
Washington, D.C., September 15, 1967.

HON. W. R. POAGE,
*Chairman, Committee on Agriculture,
U.S. House of Representatives,
Washington, D.C.*

DEAR CONGRESSMAN POAGE: On August 16, 1967 we endorsed the basic principles of H. R. 11930, which amends the Commodity Exchange Act. In our letter we raised a question about the provision of the bill which gives the Secretary of Agriculture authority to issue cease and desist orders and place the burden of proof on alleged violators of the law.

The Board of Directors of the American Farm Bureau Federation discussed this provision at their meeting yesterday and now have no further objection to this provision.

We would appreciate it if you would make this letter part of the hearing record immediately following our letter of August 16.

Sincerely yours,

JOHN C. LYNN,
Legislative Director.

Mr. FOLEY (presiding). Mr. Rhodes, again I want to ask, in other words, you are concerned not so much that the penalty might be too severe in an appropriate case—you are concerned that the general effect of having any kind of severe criminal penalty is going to be to discourage people from trading?

Mr. RHODES. Yes, sir; that, I think, is a correct statement, that if you go too far and make the penalties so severe that a legitimate merchant or mill that normally hedge their stock of raw cotton are afraid to take the chance to be in a market, why then, you of course destroy the effectiveness of the market.

Mr. FOLEY. If that happens, I agree. But do you not agree that what we are trying to do is discourage those who are dishonest?

Mr. RHODES. I have no doubt that the intentions of the Department are completely honest. But that is the effect it might have.

Mr. FOLEY. And having too weak penalties might encourage people who are dishonest to engage in dishonest practices, might it not?

Mr. RHODES. Well—

Mr. FOLEY. Is that not generally true, that if you removed or weakened the penalties for any criminal violation, it encourages the

dishonest? I would not ask you to say that as a general rule; is it not sometimes the case?

Mr. RHODES. Fortunately, I seem to have associated with people whom I have not thought of in that way. Maybe there is a point to what you say. I expect there are 500 cars parked illegally within three blocks of this building, but I do not imagine many of them will be ticketed today.

Mr. FOLEY. I think we have, to some extent, a problem here in communication. I am not suggesting that any substantial number of people in any of the exchanges—that there are any substantial number of people in any of the exchanges that are dishonest. But on the other hand, I do not accept the suggestion that I think has been made that there is no problem and that no one has any way of knowing that there is a single dishonest person engaged in commodity trading.

As much respect as I have for myself and my other colleagues, we have some bad apples in Congress. It is well known, and we have them in the bar associations, as any lawyer knows, and the medical profession. I just cannot quite imagine that your business, sir, is completely and entirely peopled with gentlemen of absolutely unimpeachable integrity. You must have some people who have been less than honest, less than upright, in their dealings. I would be most surprised if you did not.

Mr. RHODES. We have no desire whatever to protect anybody in any phase of dishonesty. We have our own conduct committees and floor committees that stand by, back of the ring all the time, watching trades made. Every effort that we can make is made to carry on a clean and honest market.

I might add that we have had very, very few occasions where we have had any difficulty getting together with the Department of Agriculture officials on changing rules or any of that type of thing. I am not saying that no one ever traded in a cotton market that was not completely honest, but I do not think you can destroy the market in order to try to find just one or two people that you might be thinking of.

Mr. FOLEY. Do you really think the market is going to be destroyed if this bill is passed?

Mr. RHODES. I think the market will be greatly weakened, and it is just barely getting back on its feet now. It has been only in the last 60 days that the New York Cotton Futures Market has started operating again. And the market is very thin today.

There are only about 100,000 bales in the open interest. If a man takes a sizable position in an open interest of that size and then was accused of manipulating the market and made subject to being charged with a felony, he might just say, "Well, in a market this size, I had better not even get in it at all."

Mr. FOLEY. The fact of the matter is that the Department is not given any additional authority under statutes in this bill except as to penalty. Is that not true?

Mr. RHODES. I believe so.

Mr. FOLEY. Therefore, what the Department could do if this bill were passed, in the way of bringing a felony charge is just what it could do in the case of a misdemeanor—make a recommendation to the Department of Justice.

Mr. RHODES. I had my lawyer down here with me yesterday but we did not get called yesterday, so he went back. I am not a practicing attorney, and I do not feel myself qualified to go into legal procedures as such.

Mr. FOLEY. Do you think the injunctive procedures are more drastic than the present criminal penalties in the bill?

Mr. RHODES. I think in one phase, as I pointed out in my testimony, it might be more damaging than the way it is; yes.

Mr. FOLEY. Do you feel it has the same character as the increased criminal penalties; that is, it might be more effective in deterring malefactors, but it has the effect in your judgment of discouraging trading itself?

Mr. RHODES. I would think that this bill, if enacted, would discourage trading; yes, sir.

Mr. FOLEY. If it did not discourage trading, would you think that the injunctive procedures would increase the effectiveness of the Department in eliminating wrongdoing?

Mr. RHODES. Well, the injunctive procedures, of course, would permit the Department to move when they suspect something. This, of course, raises the question of whether they should be authorized to act on suspicion, or whether a man has a right to proceed in a market until something has actually been done wrong.

I think in many cases, they would likely move in when there is nothing wrong, but to move in on a suspicion. In a sensitive market, they could cause untold loss, both in—

Mr. FOLEY. Would it be fair to characterize your view that injunctive procedure is, in your judgment, effective but a dangerous procedure to give the Department of Agriculture?

Mr. RHODES. Effective, but unnecessary in this case.

Mr. FOLEY. Do you have in your statement—I cannot recall at this moment—a description of your own regulatory provisions in the cotton exchange?

Mr. RHODES. No, not details of it, no.

Mr. FOLEY. Are they in print anywhere?

Mr. RHODES. Oh yes; the bylaws and rules of the exchange are a book of about 450 pages.

Mr. FOLEY. I see. You have some provisions for self-regulation in it?

Mr. RHODES. Oh, yes; we have about 20 different committees that are charged with different functions. For example, I happen, myself, to be chairman of the legislative committee.

Mr. FOLEY. You have not taken any action in a case of fraud or manipulation or dishonesty since you have been president?

Mr. RHODES. No. The *Volkart* case was started while I was still in the Department of Agriculture.

Mr. FOLEY. No cases have come to your attention, and no action has been taken by the exchange?

Mr. RHODES. Oh, there have been actions by our own committees since I have been there.

Mr. FOLEY. Action taken by your own committees?

Mr. RHODES. By our own conduct committees; oh, sure.

Mr. FOLEY. A case of misconduct?

Mr. RHODES. Yes; it was determined to be misconduct.

Mr. FOLEY. But it did not involve fraud, manipulation, or dishonesty?

Mr. RHODES. A matter of something like \$5 or \$6 was the amount of money involved, but it was violation of a trade practice, the way the trade was actually supposed to be consummated on the open floor of the exchange.

Mr. FOLEY. That is the only case that you have?

Mr. RHODES. That is the only case in the 6 or 7 years that I have been there.

I might add that that member of the exchange is no longer active on the exchange.

Mr. FOLEY. So it would be your judgment that you have effective means of self-regulation; there just did not happen to be any problems in your exchange?

Mr. RHODES. No; I think that we have very good procedures. Of course, it is an old exchange; it is nearly 100 years old. It has guarded its conduct rather carefully and has had very few real problems.

The only big problem in the last 15 or 20 years was the *Volkart* case.

Mr. FOLEY. Do you consider all commodity exchanges up to your standards? I am not asking you name to any, but do you think you are at the top, or average, or typical of the industry?

Mr. RHODES. I would not be human, I do not think, unless I said I thought ours was the best.

Mr. FOLEY. Do you see any need for this legislation at all? Your judgment is that it is just not necessary?

Mr. RHODES. We think it is unnecessary; yes, sir.

Mr. FOLEY. And there is no substantial problem of fraud or misconduct that is not presently being taken care of, either by the Department of Agriculture's present authority, or by the self-governing regulations of the various exchanges?

Mr. RHODES. I think the Commodity Exchange Authority has done a commendable job. I think they can improve on that as time goes on with some of the changes that have just recently been made to put more of their records on IBM, data processing, and so forth, and maybe they need more employees. I am not qualified to speak on that.

Mr. FOLEY. Thank you, Mr. Rhodes.

(The complete prepared statement of Mr. Rhodes, above referred to, follows:)

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

For a number of years there has been little opportunity for trading in cotton futures. The government controlled cotton prices; the free market was destroyed; hedging was unnecessary; the New Orleans Cotton Exchange ceased to function; trading on the New York Cotton Exchange diminished and finally almost disappeared.

However, thanks to the government, policies have now been changed. Cotton is again being sold at competitive prices. The free market is being restored. This will mean that prices will fluctuate and growers, merchants, processors and others in the marketing system will once again need hedge protection against changes in price. The economic function performed by the futures market when cotton was sold in a free market will again come into play.

In order for the New York Cotton Exchange to perform adequately its function of providing price insurance for those who deal in cotton, it is important for the market to be broad and active. A large volume of business is necessary for an effective market. If the volume of trading is low, the futures market cannot furnish the protection required. Producers, merchants and mills must be brought back into the market; speculators who make hedging possible by taking the other side of market risks must be encouraged to participate.

Trading on our Exchange has begun to develop and we oppose anything that will discourage the return of a free market. What we say about the Cotton Exchange applies to all other exchanges. If traders are discouraged by the government from using the futures markets, the markets are less able to perform their functions for the good of the economy.

Our concern is that some sections of H.R. 11930 could dampen interest in futures trading. The bill threatens revocations of licenses, additional fines, imprisonment, injunctions, and cease and desist orders. If there were illegal practices rampant in the futures markets which the bill would cure, the public interest would require enactment of the bill. Our concern with the bill is that we see little need for most of the provisions proposed. The Commodity Exchange Authority has sufficient power now to deal with improper practices.

An example of what I am discussing is found in the enforcement and penalty provisions of the bill dealing with manipulation. Under the present Act a person found guilty of manipulation or attempted manipulation is subject to the following penalties: (1) he can be denied the privilege of trading on any exchange for such period as the Secretary may prescribe (Sec. 6(b)); (2) his registration as a futures commission merchant or floor broker can be suspended or revoked (Sec. 6(b)) and (3) he may be prosecuted for commission of a misdemeanor and, on conviction, fined up to \$10,000 and imprisoned for up to one year; or both.

The new bill would make two changes: (1) The crime is changed from a misdemeanor to a felony and the term of imprisonment is increased from a maximum of one year to a maximum of five years (Section 25 of the bill); and (2) The Secretary may issue an order requiring the person charged to cease and desist. If he violates the Secretary's order, he can be convicted of a felony for such violation with the \$10,000 fine and five year imprisonment applicable.

I would like to ask why are these additional harsh provisions added? Is manipulation so rampant that stronger penalties are required? According to the testimony of the Administrator of the Commodity Exchange Authority at the hearings on the last bill presented to Congress by the CEA, in the 31 years since the Commodity Exchange Act was enacted, there have been complaints charging manipulation or attempted manipulation of less than an average of one per year. There were 28 administrative complaints and 3 criminal charges.

This proves, Mr. Chairman, one of two things: that members of commodity exchanges and those who use the market are generally well behaved, or that the controls enforced by the CEA and the governing boards of futures markets are exceedingly effective. I believe that both are true and that there is no need for threatening the trade with additional and more severe penalties. On the other hand, if this bill is enacted into law, I can envisage legitimate traders having genuine concern about the stress on penal provisions, which could discourage them from entering the market.

Another provision of the bill gives the Secretary of Agriculture new power to issue cease and desist orders against persons violating the Act (Sec. 17). According to the Assistant Secretary of Agriculture who testified in favor of the last bill to amend the Act, this power is sought to deal with less serious violations of the Act which would not warrant the more drastic remedy of the denial of trading privileges or the suspension or revocation of registration which might put the offender out of business. But this bill provides that if the offender violates the cease and desist order he is guilty of a crime and on conviction may be required to pay a fine of up to \$10,000 and may be imprisoned for from one to five years, depending on the offense.

This less drastic remedy can be worse than a criminal prosecution in the first instance. If a person is charged in a criminal proceeding with a violation of the Act, he is entitled to a trial in court on the question of whether he violated the Act. Under Section 17 he could be subjected to criminal penalty without a trial on the issue of his violation of the Act, but merely on the question of whether he violated the cease and desist order. We do not feel the Department needs this remedy.

I am sure that those who trade in the commodity markets would regard this "less drastic" remedy a discouraging factor and would prefer the present law under which the CEA could bring proceedings for the denial of trading privileges, the suspension or revocation of registration or a straight-out criminal proceeding before a court. The Department does not need this additional remedy. If the offense is minor, and a less drastic remedy is indicated, a suspension for a few days could be imposed.

The bill would also authorize the Attorney General to bring an action to enjoin a violation of the Act by an exchange or any other person when notified by the Secretary of Agriculture of such violation (Sec. 26). Ordinarily there is nothing objectionable in such a provision, but here we are dealing with activities on sensitive markets where a proceeding for an injunction could have an artificial and unwarranted effect on prices.

If anyone has engaged in a practice in violation of the Act, he can be punished under present provisions. If he is currently engaging in illegal activities he can be called in by the CEA and told to stop. If he refuses, proceedings can be brought immediately by the CEA to deny trading privileges, or to suspend or revoke his license. If that is not a sufficient deterrent, and he commits the illegal act, he can be prosecuted criminally. How many cases have there been where a person warned to stop his violations has flaunted the administrative officials? What real need is there for this added power?

While most of the forceful provisions of the bill are directed against persons trading on exchanges, some of its provisions which deal with contract markets are troublesome.

Under the present Act the Secretary is empowered to issue a cease and desist order against an exchange for violation of its provisions "in lieu of revoking its designation" as a contract market. This provision for alternative exercise of power is deleted from the bill (Sec. 18). I raise the question, "What experience has the CEA had with exchanges that prompted this suggested amendment?"

Section 6(a) of the present Act authorizes the Commodity Exchange Commission to suspend or revoke the designation of a contract market for violation of law or failure to enforce its rules. This is a wholesome provision. But the bill amends this section to provide that the license of a contract market can be suspended or revoked also for a violation of the Act by any of its directors, officers, agents or employees (Sec. 15). 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. I assume that this was not intended, but the amendment is broad enough to be so applied.

The CEA seeks power under this bill to disapprove any by-law, rule or resolution of an exchange, its managing board or committee which relates to the terms of a contract of sale or other trading requirement when he finds that it violates the Act (Sec. 23). It seems to me that the power to disapprove is equivalent to absolute control for orders of disapproval can be issued until you finally write it the way the Department wanted you to write it in the first place.

If this power to disapprove were to be exercised only when the by-law, rule or resolution were clearly illegal, we have no quarrel with the amendment because exchanges must comply with the Act. However, in such case, the power to disapprove is not necessary for the same reason—if it is illegal it must be rescinded.

If the power is exercised when there is doubt as to legality, the result will be that the CEA instead of the exchanges will be writing the terms of the contracts and the trading rules and the governing boards might as well retire. Again I come back to the question of the real need for this amendment?

I understand that the exchanges licensed as contract markets make available to the CEA all of their by-laws, rules and resolutions, as well as amendments to these by-laws and rules. If there is doubt whether a proposed by-law or rule complies with the Act, it is usual for an official of the exchange to discuss it with the CEA. The New York Cotton Exchange and the CEA officials have experienced little difficulty in working out amendments to our by-laws and rules.

One of the most objectionable features of the bill is found in Sections 15 and 16b where the rule of evidence in an appeal from a decision of the Secretary of Agriculture is changed. This amendment requires the Court of Appeals to accept the findings of fact of the Secretary if supported by "substantial evidence on the record considered as a whole" instead of the "weight of evidence". In other words, if the court concludes that the decision of the Secretary in punishing a trader is wrong it must approve his erroneous decision if there is substantial evidence in the record on which he relied.

What prompted this amendment? I believe I know. It is an aftermath of the famous Volkart case.

In 1958 the CEA charged Volkart Brothers Company, one of the most respected members of the New York and New Orleans Cotton Exchanges, 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 to the commodity futures industry, and was opposed by the cotton futures exchanges, regional cotton associations and by the American Cotton Shippers Association. It was opposed because a futures 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 the position of inviting a charge of manipulation.

The Department of Agriculture held Volkart guilty of manipulation. The case was appealed to the United States 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 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.

The proposal to substitute "substantial evidence" for "weight of evidence" is an attempt to prevent a 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 the court might not have been able to overturn the erroneous decision of the Department.

The amendment proposed will 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. However, when an appeal is taken there is no justification for limiting the power of the court to correct a wrong decision.

I have some brief comments on other provisions of the bill.

The registration of a futures commission merchant or floor broker may be refused, suspended or revoked for certain specified causes such as conviction of a felony, making a false statement in his application, etc. (Sec. 20, 21). It may also be refused, suspended or revoked for other good cause. Should there be standards for the determination of such other "good cause"?

Minimum financial requirements are to be prescribed for futures commission merchants, either by the exchanges with the approval of the Secretary or by the Secretary where the commission merchant is not an exchange member (Sec. 7). Financial standing is not the test of character or integrity. If the financial standards are set too high, small but honest businessmen may be deprived of the right to do business.

Throughout the amendment wherever provision is made for compliance with the Act or of the rules and regulations promulgated by the Secretary thereunder there is added the word "orders", so that compliance is to be required with rules, regulations and orders. The nature of an order is not clear. The power of the Secretary to implement the Act is contained in Section 8(a)(5) which authorizes him "to make and promulgate such rules and regulations as, in the judgment of the Secretary of Agriculture, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of this Act."

If the Secretary is not empowered to issue "orders", penalties should not be imposed for failure to comply with them. If all directions of the Secretary to implement the Act are of general application they can be incorporated in rules and regulations available to the trade generally.

We believe the CEA has ample power under present Act to enforce the law which it administers and needs no new power or the right to impose new penalties.

The New York Cotton Exchange would like to have the record show that it does not believe foreign produced commodities which are traded abroad on organized futures markets should be subjected to CEA regulations.

(The following letters were also submitted to the committee:)

NATIONAL FARMERS ORGANIZATION,
Corning, Iowa, August 12, 1967.

Congressman W. R. POAGE,
Chairman, House Committee on Agriculture,
Washington, D.C.
(Attention: Mrs. Christine Gallagher).

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE: The National Farmers Organization, after careful study by the NFO Grain Commodity Department, respectfully requests that this statement be filed with the Committee in full support of Bill H.R. 11930 proposing amendments to the Commodity Exchange Act intended to provide means for more effectively carrying out the purpose of the act and protecting the public interest.

We have long believed that the Secretary of Agriculture needed additional authority to effectively control predatory practices in the commodity markets.

If we were to add any thought to the provisions described in the summary supplied by the Department of Agriculture it would be in Section 12, the provision requiring action to be based on the "weight of evidence" which would be changed to substitute "substantial evidence on the record considered as a whole." In our opinion, this description of a condition in the market when the Secretary of Agriculture shall take action, needs the two descriptive words added or in its entirety should read as follows: "parallel of circumstances and evidence on the record considered as a whole." We believe this would give the Secretary the authority to act when various individuals, business firms, corporations and others, always seem to buy the same commodities at the same time and sell the same commodities at the same time in a large enough volume to cause an erratic condition in the market. When this buying and selling occurs more than twice by the same people, it would seem to us to indicate an attempt by certain groups and individuals to control the market and cause extreme price fluctuations harmful to producers and the public interest.

We urge that the Committee take prompt affirmative action on this Bill to update and revise the Commodity Exchange Act.

Yours truly,

HARVEY SICKELS,
Secretary and Legislative Representative.

AMERICAN NATIONAL CATTLEMEN'S ASSOCIATION,
Denver, Colo., August 15, 1967.

Hon. W. R. POAGE,
Chairman, House Committee on Agriculture, Washington, D.C.

DEAR MR. POAGE: The American National Cattlemen's Association endorses your bill, H.R. 11930, which proposes amendments to the Commodity Exchange Act.

In recent years, live fed cattle, live feeder cattle and beef carcasses have been added to the list of commodities exchanged on a futures trading basis. Live cattle futures in particular have shown a remarkable and steady growth since they were added to the futures trading just a few years ago. We feel it necessary that the Commodity Exchange Act include these cattle and cattle products on a regulatory basis so that adequate protection may be provided the cattle producers throughout the nation.

We respectfully request that this letter be made a part of the hearing record. Thank you.

Cordially,

C. W. McMILLAN.

Mr. FOLEY. The Committee on Agriculture will stand adjourned, until Tuesday, the 29th of August, at 10 o'clock.

(Whereupon, at 4:20 p.m., the committee recessed, to reconvene on Tuesday, August 29, 1967, at 10 a.m.)

AMEND THE COMMODITY EXCHANGE ACT

MONDAY, SEPTEMBER 11, 1967

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m. in room 1301, Longworth House Office Building, Hon. W. R. Poage (chairman) presiding.

Present: Representatives Poage, Gathings Purcell, O'Neal, de la Garza, Vigorito, Montgomery, Dole, Goodling, Miller, Burke, Mathias, Mayne, Zwach, Kleppe, Price, and Myers.

Also present: Mrs. Christine S. Gallagher, clerk; Hyde H. Murray, assistant counsel; and Francis LeMay, staff consultant.

The CHAIRMAN. The committee will please come to order. We meet this morning to consider further the commodity exchange bill. We have a list of witnesses here. I don't know a thing about the reason for establishing them in the order in which they are listed, but it has just been made known to me that Mr. Graham, who is listed as last on this list, has to go to the hospital this afternoon. In view of that, I assume the other witnesses will not object if I call Mr. Graham first, and we will then start back on this list. As far as I know, we will proceed as it is written here. I don't know any particular reason why anybody is listed in any special order.

Mrs. GALLAGHER. They are in the order that they were listed, the same order as at the last meeting.

The CHAIRMAN. In the order in which they filed their requests?

Mrs. GALLAGHER. Yes.

The CHAIRMAN. That is all right.

I am sure everybody would be willing to hear Mr. Graham because he has to go to the hospital this afternoon.

STATEMENT OF HARRY GRAHAM, LEGISLATIVE REPRESENTATIVE, THE NATIONAL GRANGE

Mr. GRAHAM. Thank you, Mr. Chairman. I am sorry to have to ask this favor but this is just one of those things that I am real sorry I have to do, sorry for some of the things I have to do today.

Mr. Chairman and members of the committee, the Grange testified in favor of H.R. 11788 before the 89th Congress, and we come before this distinguished committee again today with our continued approval of the attempt to give the Commodity Exchange Authority needed assistance in maintaining orderly and useful future markets in the interest of both the producers and the trade.

Our support of H.R. 11788 was more vigorous than we can give to H.R. 11930, because we believe that the USDA has gone rather far

in trying to meet the objections of the commodity exchanges to H.R. 11788—objections which, in our judgment were not well justified.

The committee will remember that when the hearings were held on extending resale provisions to commercial elevators early last spring, the Grange objected to this arrangement for the simple reason that the futures market, in our judgment, when prices are above the support level, was the proper place and a better method of hedging against price declines than an expanded resale program. The futures market, when properly regulated and controlled, performs a highly useful function for producers, merchandisers, processors, and consumers.

However, it is a matter of record that there have been abuses and some unfortunate incidents that have arisen in the commodity exchanges which need to be prevented in the future in the interest of the general welfare. We believe H.R. 1193 will make a very useful contribution to the strengthening of these markets. The Grange supported the original law which was proposed and finally passed in 1922. We again supported the amendments of 1936 which further strengthened this law.

The record will show that there were predictions of disaster when both laws were passed. The record will also show that these exchanges have increased in their influence and those involved in them have increased their prosperity during the passing years. Therefore, we do not share in the consternation of those opposing more effective regulation, nor do we believe that this committee should give heed to this kind of prediction of doom when the record clearly shows—not only in relation to the Commodity Exchange Authority, but in relation to the regulation of the stock exchanges—that the regulations necessary to prevent fraud, deception, and manipulation have made a major contribution to the integrity of these markets, and to the economic growth of the United States—a matter of pride for all of us.

There is a vast difference between control and regulation. The Grange was the first national organization to fight for regulation of those parts of our economy which were out of control and which were a threat to the existence of our competitive individual enterprise system. We have heard these predictions of doom concerning regulatory measures since the time when the Interstate Commerce Commission Act was first proposed and passed as the first great legislative achievement of the Grange in 1887. The predictions of doom cited in our history books at that time concerning the regulation of interstate commerce were almost identical to the ones we are hearing from some persons involved in the commodity exchanges today. However, economists and historians throughout the world recognize that it was the regulation of the laissez faire economic system which brought in a modified type of capitalism, whereby the public interest was protected by law, which has made us not only the bastion of competitive capitalism throughout the world, but has made America almost completely invulnerable to the threat of communism.

We have within the membership of Potomac Grange No. 1 the last Prime Minister of free Poland, the Honorable Stanislaw Mikolajczyk. He was in the National Grange office the day after Mr. Khrushchev left Washington at the time of his famous and highly publicized visit. He was obviously agitated at the presence in this city of the man who represented to him the subjugation of his own country.

However, he told us that his grandfather many years before had been very much concerned about the U.S. movement to bring its capitalistic system under some kind of regulation, and he predicted that the United States would eventually destroy capitalism in this great country. Then he proceeded to confess how wrong they had been in their predictions and how right our action had been at a time when *laissez faire* capitalism had been so vigorously assaulted in Europe. He stated that day in very dramatic terms and quoted from our declaration of purposes a great deal more than most of the members could do when he said to Mr. Newsom, he said:

Mr. Newsom, if we could have had an organization like the Grange to get the kind of legislation that was contained in the Grange legislation, my beloved Poland today might not be under the heel of a Red dictatorship.

History shows clearly and without any controversy that it was the regulation of our capitalistic system which enabled us to attain a reasonable facsimile of justly distributed burdens and justly distributed power.

Those advising this committee and the Congress and our American public that we need to return to a *laissez faire* type of capitalism have forgotten all of the lessons of history, including the fact that every *laissez faire* economy in the world has been challenged successfully by some type of socialism or communism.

The greatest danger facing our futures markets and our exchanges of various kinds is the opportunity for them to run roughshod over the rest of the economy. This must be prevented at all cost.

The present proposals are designed to permit the USDA to continue the same general pattern of regulation which has been applied with favorable results for many years, but to do so more effectively and, particularly, more expeditiously.

The very nature of the futures markets points to the need for intelligent regulation. If they are overregulated activity can be so decreased as to destroy the necessary liquidity of the markets. On the other hand, ineffective regulation would permit reckless and unrestrained speculation resulting in erratic price movements and causing a lack of confidence in the markets, so that at times traders, including speculators, would be reluctant to participate. We have seen periods of unjustified feverish activity followed by periods of stagnation. We know that this sort of thing can never be completely eliminated in operations of this type. At the same time we know from observation that reasonable and constructive regulatory measures make these ups and downs in market activity less severe and less frequent, thus lessening the devastating cyclical fluctuations of the market upon our agricultural economy.

Any one who looks back on the old days of completely unrestrained activity will find instances where the usefulness of the market for hedgers was pretty badly impaired as the aftermath of such situations. There will never be a complete solution to this problem, but we believe that conscientious efforts by the Commodity Exchange Authority provided with the necessary authority, and cooperative action by the appropriate committees of the exchanges can go a long way toward bringing these markets even closer to the perfect economic mechanisms which their more ardent supporters claim them to be.

In recent years, we have been disturbed by the manipulation in the commodity exchange markets, especially in Maine potato futures, and the more famous "salad oil" scandal of a couple years ago. At the 100th Annual Session of the National Grange in Minneapolis in November 1966, the Delegate Body adopted the following resolution:

Resolved, That the Department of Agriculture be given authority to exercise a strict control of the futures market, and particularly in agricultural commodities of small volume and in which one or a small number of persons, may by manipulation corner the market.

The senior members of this committee will remember our appearing before this committee a number of times to support legislation to remove Maine potatoes from futures trading because of the history of manipulation of that particular market. It should be remembered also that this committee and the Congress found it necessary a few years back to remove onions from futures trading. We would also remind you that a great deal of the problems besetting agriculture a year ago, in terms of increasing prices, were the result of the speculation on pork bellies. The dramatic increase in the price of bacon was widely and vocally resented by the public.

The National Grange does not feel it necessary in our statement to analyze every technical detail of the bill. We see nothing that looks like a radical departure from the objectives which date back to the Grain Futures Act of 1922. There are some points of language which we would like to raise with the committee counsel, but we are sure they can be adjusted without impairing the intended effect of the bill. We will submit a separate memorandum on this subject to the counsel.

In conclusion, we favor the competitive marketing system, as exemplified by futures trading. We know that the protection against the effect of price movements has been extremely helpful to important segments of the industry. We, of course, hardly need to mention that these price movements are unavoidable in a competitive enterprise system. The ability to transfer these price risks to those who wish to carry them is very important, and the rights of the public to assurances against fraud, manipulation, collusion, and all other unethical practices is paramount to the selfish interests of the trade.

At the same time, we are realistic enough to know that any activity permeated with speculation is susceptible to abuse, and it seems clear to us that the purpose and effect of these proposed amendments will be to more effectively curb some of the unfavorable factors in these markets.

We earnestly and respectfully solicit the support of the committee in the enactment of this legislation.

The CHAIRMAN. We thank you very much, Mr. Graham. We will be glad to have you give your suggestions to Mr. Murray or talk with him about these language changes which you propose.

Are there any questions of Mr. Graham? If no one desires to question the statement it must be pretty good, Mr. Graham. We appreciate your statement and hope you have a speedy recovery.

Mr. GRAHAM. I have to have 10 days' traction so I am going to be looking at the ceiling, going nuts. But I do appreciate the courtesy you have given me this morning, Mr. Chairman, along with the many other courtesies in the past.

The CHAIRMAN. Thank you.

Now we will hear from Robert L. Martin, chairman of the board, Chicago Board of Trade. Mr. Martin, we are glad to have you with us.

**STATEMENT OF ROBERT L. MARTIN, CHAIRMAN OF THE BOARD,
CHICAGO BOARD OF TRADE, ACCOMPANIED BY JOHN E.
NOLAN, JR., OF STEPTOE AND JOHNSON, WASHINGTON
COUNSEL FOR THE CHICAGO BOARD OF TRADE**

Mr. MARTIN. My name is Robert L. Martin. I am chairman of the board of directors of the Chicago Board of Trade. I am accompanied here this morning by Mr. John E. Nolan, our Washington counsel.

I appear today, as I did last year, to comment on the proposed amendments to the regulatory statute under which we live.

May I say at the outset that I appreciate this opportunity. And on behalf of the board, may I say how much we appreciate the interest which this entire committee takes in the legislation at hand.

My remarks will be brief. I know there is no need to remind this committee of the signal contribution of the commodity futures markets to the American way of life—the service these markets render to producers, processors and to the public at large.

We at the Chicago Board of Trade are proud of our contribution. And we are particularly sensitive to the responsibility it involves. We regard this responsibility as a public trust and in discharging that trust we have the same objectives as the proponents of the bill you are now considering.

That does not mean, however, that we agree with the bill as proposed. On several fundamental provisions we feel that the bill is inappropriate or even dangerous. I would like to discuss first the provision relating to injunctions.

This provision, as you know, has been suggested on several earlier occasions. It has never been accepted, and we believe with good reason. In our view it is unnecessary for the regulatory functions performed by the Commodity Exchange Authority and, in the context of the commodity futures markets, a drastic remedy fraught with peril for the innocent and the unsuspecting.

We find it in no way persuasive that other regulatory agencies have similar power in other fields. The commodity futures markets have unique characteristics which make application of an injunctive power inappropriate. Because we are familiar with the trading of commodity futures, we believe we are able to make an informed judgment of the effect of the use of the injunctive power—or even its existence—would have in the futures markets.

In urging adoption of this provision the Department has pointed to its use in cases where market action is involved—alleged manipulation, for example. This is certainly of no less concern to us at the Chicago Board of Trade than it is to the Department. From within the market itself we are constantly alert to any attempt to influence it improperly. And we would without hesitation join in support of any measure we believed helpful in protecting free play of forces in the market.

At the same time, however, we recognize that the futures markets represent a degree of concentration found in no other field of endeavor. Unlike the stock markets, the billions invested in the futures markets are concentrated at any one time in a mere handful of futures. And, also unlike the stock markets, in the grain markets nearly all of these

futures are directly related, one to the other. Grains, futures and markets are interchangeable. Any major impact in the wheat market is reflected instantly in corn, oats and rye markets. A forced sale of Minneapolis wheat, for example, would have immediate market repercussions in Chicago and Kansas City.

And the delicate balance of these markets is maintained by a sensitivity to outside influences difficult for someone not familiar with it to realize. Advance suggestions of governmental attitudes or programs, crop forecasts, transportation factors, weather conditions the world over, for example, are reflected in price adjustments in the futures markets.

Because of this, use of the injunctive power as the Department has suggested it would be almost like making a surgical incision with a meat axe. Its use to affect market positions could not in any way be limited. It would necessarily affect thousands of contracts and millions of dollars of investment. Its impact could be felt the country over from the largest processor to small country elevators and individual farmers. And all of this could happen with no advance warning, no bond and no provision for compensating the losses of unsuspecting traders. Their losses would, in fact, be incalculable.

Even if the effects of an injunctive proceeding could be limited to the defendant, we feel that the power suggested here would be inappropriate. Injunctions are a summary remedy to be applied under emergency conditions to prevent a continuing injury. By their very nature, they should be applied only in clear cases. But the commodity futures markets are complex mechanisms, not readily understood by those not familiar with them. Entirely beyond that, market behavior and price changes are difficult to understand even by those in minute-to-minute contact with the market. The difficulties to be faced by a judge looking at this picture for the first time under the urgency of a summary injunctive proceeding are readily apparent.

If there were any doubt about this point it must have been dispelled by the Department's record on appeal as submitted to this committee. In appeals cases where charges of manipulation were reviewed, although the Department had the benefit or more thorough analysis and demonstration of proof than would be true in injunctive proceedings, it was reversed by the courts three out of six times. Being right just half the time doesn't demonstrate the kind of certainty required for proper use of injunctions.

There is an additional consideration that I feel I must raise—not because it is probable but because it is clearly relevant. The existence of injunctive power, by itself, would have a significant effect on the market. Because of the drastic nature of this power, the mere possibility of its use would always have to be a major market factor in the minds of those making market decisions. The temptation to use it in doubtful cases would be understandably great. The Department might feel that it was better to seek an injunction early in any doubtful case.

This presents the question whether it is appropriate for the Department of Agriculture—no matter how fair-minded its officials might be—to be able to seek injunctions in the commodity futures markets. As you know, the Department has responsibilities directly related to prices entirely outside the commodity futures markets.

The Department's responsibility to producers, all of the price support programs it administers and its recently exhibited concern for food prices to consumers are only a few examples.

You recall, I am sure, the Department's selling activities to depress wheat and corn prices only last year. By seeking an injunction against an outstanding long position in the futures market, the same effect could be produced in futures prices. And, conversely, futures prices could be bolstered by moving against a substantial short position. Is it fair that the Department—which may at any time be under substantial pressure to produce either one price effect or the other—be placed in this position of fundamental conflict?

There are, of course, other arguments to be made against the injunctive power. It has been approached with knowledgeable criticism by all informed segments of the futures markets. Because of the recognizable danger it poses to orderly functioning of the markets, it should be adopted only if a most compelling case can be shown for its necessity. It seems obvious to us that there is no such case.

It has not been suggested that the injunctive power would have been used or been of any assistance in circumstances like the DeAngelis case of a few years ago. It is obvious that the SEC experience with injunctions in the securities markets is no relevant example. Although the SEC brought 1,420 injunction proceedings over a 30-year period, the Department told this committee that it would have sought injunctions only 16 times in the past 15 years. This scarcely makes the case for urgency, particularly when an examination of the 16 instances discloses that a majority of them were settled with consent orders.

In our view the expanded cease and desist provisions of the present bill could be used to be substantially as the equivalent of injunctive powers. For that reason we urge that they also be deleted. Conduct which is properly actionable may be proceeded against under other sections of the Act and the present bill in addition to our own comprehensive program of self-regulatory activity.

Another provision of this bill (section 23) would empower the Secretary to disapprove trading rules or provisions of the markets relating to contracts of sale. This is a variation of a provision in last year's bill which related to margin requirements. It may have been retained in the present bill inadvertently. In our view it should be eliminated because it is inconsistent with the principle of responsible self-regulation.

Beyond that, it is superfluous and entirely unnecessary. Under the act a designated contract market is subject to a cease and desist order or to suspension or revocation of its designation for any violation of the act or rules or regulations under it. Providing for such disapproval by the Secretary (and revocation pursuant to disapproval, section 12) adds no additional penalty and serves no meaningful purpose. It does, however, inject the Secretary's power—at least indirectly—into the very heart of the board's most responsible exercise of self-regulation. We strongly urge that these provisions be eliminated.

There are two other aspects of the bill which I might treat together. In one it is our view that a phrase should be eliminated; in the other our concern could be satisfied by adding a definitive phrase.

Section 15 of the bill now provides for suspension or revocation of a board's designation as a contract market if it fails to do certain things or if it or "any director, officer, agent or employee" violates the act or rules, regulations or orders under the act. If such person acts within the scope of his office or employment, we agree that the board should be responsible. That point, however, is expressly covered in section 2 of the present act which provides just that. And if there were any doubt, it is covered again in section 1.2 of the regulations under the act where it is repeated. To include the reference to "any director, officer, agent or employee" a third time in this bill is not only repetitious but misleading as well. It might be interpreted to mean that the contract market is responsible for actions entirely outside the scope of the person's office or employment. We do not feel this would be fair or proper, and we assume that it was never intended. Such persons are made responsible for their own actions under other provisions of the bill.

For these reasons we recommend deleting the phrase " , or any director, officer, agent or employee thereof," on page 12 of the bill, line 11.

In the interest of precision we feel that the term "order" added by section 13 of the bill and added in a number of other places should be expressly defined if it is to be employed. If "order" here means one of the particular orders of the Secretary or the Commission under sections 4, 5, or 6 of the act, it should be so defined. If it has any broader meaning, we would oppose its inclusion as too indefinite a standard to support the severe sanctions of the statute.

In conclusion, there are three additional points to which I would refer:

First, we believe that the standard for review which has served well under the present act should be retained. It has proved workable and reasonable over the years to require that the Commission's findings be supported by the weight of the evidence. No significant reasons are advanced for a change at this time. From our point of view, we certainly oppose any attempt to narrow the scope of judicial review. This is particularly true where the administrative rulings have consistently favored the regulatory agency as they have under this statute.

Second, we would suggest that section 27 of the bill be revised so that the adverb "willfully" applies to all of the proscribed acts rather than just one who "aids." As written it could be interpreted as having a required element of intent for aiding but not for "abetting, et cetera." This is clearly inappropriate and the possible ambiguity is easily resolved.

Third, we feel that if the members of the Commission are to delegate their very significant authority under the act, such delegation should be only to officials of the Department concerned. This is an area of vast importance. It involves the trading of billions of dollars worth of futures contracts each month, the livelihood of thousands and the welfare of the entire Nation. To delegate the Commission's functions from Cabinet officers to departmental employees who could not accurately be described as "officials" is to deprive this important function of the stature it deserves.

With these specific suggestions my comments are concluded. Let me again express my appreciation for the courteous hearing you have afforded our views. If the members of the committee have any questions I will be glad to try to answer them now.

Thank you.

Mr. GATHINGS. Thank you so much, Mr. Martin. I wondered if Mr. Nolan has a further statement. I believe Mr. Nolan is with you.

Mr. NOLAN. No; I do not, Mr. Chairman.

Mr. GATHINGS. Are there any questions of Mr. Martin or Mr. Nolan? Mr. Dole.

Mr. DOLE. First, I want to say I am sorry to be late. I had another meeting this morning.

I read your statement very hurriedly and would ask a question or two about your objection to the injunctive provisions which are now included in the bill. I have determined from a quick reading that you oppose this provision and the reasons for the opposition. As pointed out in an earlier colloquy I had with Mr. Mehren and the counsel for USDA, it was said it should be in this act because we have it in other regulatory agencies. You make the point that this may be all right for other agencies but yours is a unique business, and therefore would not be reasonable and would not be responsive to the problems that may arise; is that correct?

Mr. MARTIN. That is right, sir. In addition to that, the danger that would exist here. I don't mean to be redundant, but again in moving against a large position I can think of no parallel in another business where a movement or action against a very large position, a commercial position which, it is decided, is not in keeping with the Government's own position or for any other reason, the impact on the market is going to be very real, incalculable, and impossible of restoration if there were to be any quarrel about the validity of the Government's position.

Mr. DOLE. Do you know of any alternative that would accomplish what the Department wishes to accomplish without the injunctive provision?

Mr. MARTIN. I would say, for the most part, we have seen consent, cooperation, and if they would move into this area I am sure they would find the people that are involved would be inclined to go with them. Also, the board of trade would be extremely cooperative. We have found in the past that they have sometimes been, and regard it as illegal to tell us of positions. We do not know of customers' positions but I am sure that cooperatively with the board of trade and with their own efforts with the parties involved that this could be reasonably satisfied.

Mr. DOLE. So then, in your judgment, this provision just is not necessary?

Mr. MARTIN. Well, not only is it not necessary but it is dangerous.

Mr. DOLE. Thank you.

Mr. GATHINGS. Further questions?

Mr. MAYNE. Yes, Mr. Chairman.

Mr. GATHINGS. Mr. Mayne.

Mr. MAYNE. Of course, this whole injunctive procedure is a judicial procedure, is it not?

Mr. MARTIN. Yes, Mr. Mayne, but I think at the last meeting, albeit a little reluctantly, there was an admission that an injunction

could be obtained without the presence of the respondent, if that is the proper term.

Mr. MAYNE. But there would be judicial supervision?

Mr. MARTIN. That is right.

Mr. MAYNE. And the usual protections available from a court who is asked for an injunction?

Mr. MARTIN. True. But currently the Department has a case before it that has gone on since, I believe, 1963. They made reference to it in passing in the testimony. In their passing reference they referred to this as one case, one of the cases in which the injunctive powers might have been resorted to. Now, to this day this is still unresolved. I think this is about 4 years and 5,000 pages of testimony later. Now, this is an extremely intricate business, and had the Department gone with the degree of urgency as would have existed in seeking an injunction, a judge is going to be impressed by the appearance of the Department and this is, as I say, an extremely intricate business. Now, without meaning to demean the judge's intelligence at all, I think that he is going to be not fully aware of all of the possible consequences of his action. This was a case that involved manipulation. This is where we are very concerned, not to defend the manipulation, we are opposed to manipulation, but the manipulation has not yet been proven. Yet the Department says that this is one that they would have sought an injunction against. I think we put an awful burden on a judge to try to decide this in short order because there is a degree of urgency when one seeks an injunction.

Mr. MAYNE. You seem to be pretty well satisfied with the ability of the judges to handle the situations in three out of six cases which you referred to on page 4—

Mr. MARTIN. Yes.

Mr. MAYNE (continuing). Where they reversed the Department in those proceedings, three out of six times, as you stated.

Mr. MARTIN. Our point there was not satisfaction or dissatisfaction, but rather that the findings came after a period of intensive investigations and not the very brief time that would be possible in applying for an injunction. This is obviously under some degree of pressure.

Mr. MAYNE. I don't want to be unfair, but it does seem to me that you stress very much the departmental administrative part of this proposed legislation and existing legislation, indicating that the administrative rulings are frequently arbitrary and not supported by any real evidence; but I think we must recognize that it is accompanied by judicial supervision. It seems to me by your own admission, on page 4, that judicial supervision has been adequate, has been vigilant and has, in cases of abuse, corrected injustices. They did reverse administrative decisions three times upon appeal, three times out of six. It seems to me that is a pretty good record of judicial vigilance and supervision. So that at least in the manipulation proceedings that you cite there has been a good record of enforcement, in the final analysis, after appeal.

Mr. MARTIN. This I would agree with; this is what we are concerned about, that the correction would come after the fact, after the market has been subject to the impact of the injunction, and the possibility of one. In fact, even the publicity attendant to obtaining an injunction

or seeking one, even if it were not obtained, would very possibly have quite an impact on the market.

If, for example, it were known that a large firm were to be moved against and that they were long a substantial amount of wheat, this would drive down the wheat market to some extent because other participants in the market, commercial, speculative, and all, are going to not want to buy or are going to liquidate a long position, hold off purchases until they see how this comes out. They are also aware of a possible governmental attitude in this area.

Now, when we speak of the correction, we are quite satisfied that there will be ultimate justice prevailing but we are concerned in a case of an injunction being sought in a hurry, having its effect on the market and then some time later, 2 or 3 days later, or 2 or 3 years later, saying "No, that was wrong." We don't think that a .500 batting average is enough in this area. It has to be a good deal higher to warrant this power because this is going to affect the farmers' prices, the consumers—could, I should not say would—but could very well affect the price to the farmer, the consumer, and all concerned in between.

Mr. MAYNE. Of course, your members aren't going to be unique in feeling that the filing of an injunctive proceeding against them is unfair. I doubt if there has ever been a defendant in the history of legislation who thought that there should be an injunction started against him.

Mr. MARTIN. I agree, but I don't confine myself to just the member who is being enjoined. In fact, it might not be any of our members that we are concerned about, but the public itself.

Mr. MAYNE. Thank you.

Mr. GATHINGS. Any further questions?

Mr. ZWACH. Mr. Chairman.

Mr. GATHINGS. Mr. Zwach.

Mr. ZWACH. I have a question. Your board of trade and your president police all of those who practice in your pits?

Mr. MARTIN. All of our members, that is right. We have 1,402 members, sir.

Mr. ZWACH. What kind of a police force, what kind of a licensing committee do you have?

Mr. MARTIN. First, we have a membership committee which approves applicants for membership. Then once in, they must abide by our rules. We have a business conduct committee, we have a rules committee, a floor practices committee. We have several, not disciplinary but policing committees. In matters of disciplinary action, this comes before the directors and we can suspend, expel, or reprimand, as we deem necessary.

Mr. ZWACH. As I recall there was testimony here that a Las Vegas character—and that doesn't necessarily make him bad—but a Las Vegas character with a long history of disrepute apparently was able to get right in and practice in your group. Were you president of the board at that time?

Mr. MARTIN. No, I wasn't. I am not president; I am chairman.

Mr. ZWACH. Were you chairman at that time?

Mr. MARTIN. No, I was not, but I will tell you that he was able to get into the board through misrepresentation. He got his license as a commission futures merchant through the Government, through

misrepresentation. He was out in a very short time. He was out almost immediately—I shouldn't say almost immediately. He did do damage. This is not to say that one can never get in because we are, like any other organization, composed of human beings. We have all kinds. That is why we do try so hard to police ourselves. But he was able to get in. He came in—I happen to have that—he became a member in October of 1962 and in May and June of 1963 the board investigated accusations against him. In July of 1963 he was ordered to appear before the business conduct committee. He failed to appear at this time and I suspect he was already out of the country at the time, and in trouble. On July 18, 1963, the U.S. attorney in Nevada filed a criminal information against him. October 22, 1963, he was expelled from the board so he lasted about a year. Now, this is a year too long. He fooled us, he fooled the Government. We try to minimize these. We are not infallible, but I think in this case we were cooperative with the Government. It is one of these things that a bad apple will show up. We try to minimize it.

Mr. ZWACH. Your policing is active, it isn't only a paper structure?

Mr. MARTIN. No; it is active. We have spot checks. We respond to every complaint that comes in. Naturally, we prefer none but when one comes in it is pursued. Many of these just happen to be somebody that the market did not satisfy, but we pursue everything; plus our own vigilance and surveillance of the activities on the floor and the customer-firm relations.

Mr. ZWACH. That is all, Mr. Chairman.

Mr. GATHINGS. Thank you so much, Mr. Martin.

The next witness listed is Mr. Reed Clark, president of the New York Coffee & Sugar Exchange. Mr. Clark, will you introduce the gentlemen with you at the table.

STATEMENT OF REED CLARK, PRESIDENT, NEW YORK COFFEE & SUGAR EXCHANGE, INC.; ACCOMPANIED BY EARL MacHARDY, PAST PRESIDENT; HERBERT J. COYNE, MEMBER, BOARD OF TOBACCO; AND JOHN J. HEIMBURGER, WASHINGTON ADVISER

Mr. CLARK. My name is Reed Clark. I am president of the New York Coffee & Sugar Exchange, Inc., located at 79 Pine Street, New York. In private business I am president of the Czarnikow-Rionda Co. of 120 Wall Street, also in New York City. To answer any questions or provide additional information that may result from this testimony, I have taken the liberty of inviting certain associates to join me on this occasion. They are Mr. Earl MacHardy, past president of the exchange, Mr. Herbert J. Coyne, member from the coffee section of the industry, and our Washington adviser, Mr. John Heimbürger.

Mr. GATHINGS. Thank you. We are glad to have all of you gentlemen here. You may go right ahead.

Mr. CLARK. Our exchange is a nonprofit membership corporation which provides facilities for the trading in future delivery contracts of coffee and sugar. These facilities are used extensively by the sugar and coffee trades for hedging purposes, which is a time-proven means of protecting the producer, importer, or processor of these commodities against fluctuation in prices.

The New York Coffee & Sugar Exchange is managed by a board of managers consisting of 15 elected members. Our bylaws and rules

empower the board to deal promptly and effectively with any situation affecting just and equitable principles of the trade, or any conduct detrimental to the best interests of the exchange and the public.

We are proud of the fine record we have achieved in self-regulation of this exchange and of the contribution which this exchange has made to the coffee and sugar industries over a span of 85 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 of any contract. We feel that this record of responsible self-regulation speaks for itself.

This record has been achieved through the exercise over these years of responsible, prudent management and strict adherence to disciplinary procedures as provided within the rules and bylaws of the exchange and enforced as a result of the actions of its investigative and disciplinary committees.

Any member accused of willful violation of bylaws or rules, or of a 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 this committee, the board of managers may censure, fine, or suspend the accused member. Should circumstances warrant, the accused member may be expelled from the exchange.

If the board of managers believes a trade situation exists which may jeopardize the normal functioning of the exchange, the board can appoint a control committee which reviews information submitted by exchange members with respect to their own and their client's positions and accounts. If an examination of this information indicates that a market situation exists which is prejudicial either to the exchange or to the public interest, the control committee is empowered to summon the affected member or members to appear before it. The control committee then endeavors to bring about a voluntary correction of the situation, failing which the committee reports its findings directly to the board of managers. The board itself may require liquidation, within a specified time, of any portion of any members' open contracts. If any member fails to comply with the requirements of the board, he is subject to sanction, fine, suspension, or expulsion.

The proof that self-regulation as practiced by the exchange is completely effective is demonstrated, as indicated previously, by our record of 85 years of responsible management in our own and the public interest.

In support of our belief that there is no need for this legislation as regards coffee and sugar, it should be borne in mind that the sugar section of the U.S. economy is completely and totally controlled by the Sugar Act of the United States, a child of this committee. This is a well-conceived and time-tested piece of commodity legislation. It insulates the U.S. sugar economy from the world sugar market. So long as it continues in effect, unusual events in the world market, including violent price fluctuations, will not cause a ripple in the United States.

Our domestic contract (No. 10) is completely dominated by the Sugar Act. It is a captive of the act. Unacceptable or uncontrolled performance of the No. 10 contract could only come from unacceptable or uncontrolled performance of the Sugar Act.

"World" sugar (No. 8 contract) plays no part in the U.S. economy. (In the interest of simplicity we are ignoring a minimal amount of nonquota sugar which enters this country, and which is about 1½ percent of our annual usage. This is permitted under the Sugar Act for nonhuman consumption and is used mainly for livestock feeding and alcohol distillation.) "World" sugar is produced in foreign countries only and delivered to foreign countries only. As a physical commodity it is of no concern to the United States. We therefore ask what valid interest the U.S. Government can have in a commodity which is obviously beyond its purview.

Coffee also is produced entirely in foreign countries, excluding Hawaii. Coffee and coffee futures trading are now under the influence of the International Coffee Agreement to which the United States is a signatory. Coffee futures trading is negligible in this country under these circumstances. It is inappropriate to consider further burdening coffee futures contracts with new controls and regulations.

Moreover—and this is the key point in the matter—the Secretary of Agriculture has no jurisdiction in the producing country.

While many of the powers and obligations of the basic Commodity Exchange Act and H.R. 11930 are appropriate to domestic commodities passing in interstate commerce, they are not appropriate for commodities produced in foreign countries. We cannot see the Secretary of Agriculture realistically exercising his regulative or investigative powers in Fiji, South Africa, or Brazil.

In short, we believe this proposed legislation is not necessary legislation. It serves no really useful purpose in the field of coffee and sugar.

Furthermore, we believe that H.R. 11930 represents a major threat to the healthy life of our exchange and that it will tend to drive our business abroad.

There are well-organized futures markets in foreign financial centers for trading in both coffee and sugar. If trading here is subjected to increased costs and hampering regulations, then trading, in our opinion, will dry up. Our business would quickly move to the more favorable trading climate of the European exchanges.

If margin controls were later added to this proposed legislation, then the point is no longer debatable. Business would move abroad, particularly to London, where cash margin requirements are virtually non-existent.

If the probability of trading moving abroad is valid, as controls and restrictions increase, then it follows that a drain on the U.S. balance of payments will be created. Trading costs and losses will result in an outflow of dollars.

Our exchange lives on its "world" sugar contract (No. 8). The coffee and domestic sugar contracts cannot support us. If the "world" contract were damaged, our facilities and services would dwindle away. The "world" sugar contract is the most vulnerable to foreign competition by its very nature.

To put this in perspective, let me say that our open position at last week-end is approximately this:

	Contracts
"World" sugar (No. 8)-----	20,901
Domestic sugar (No. 10)-----	597
Coffee-----	15

Trading in coffee contracts is virtually nil in the United States. This business has already gone to London.

Trading in domestic sugar contracts (No. 10) has also been drying up. Sugars covered by this contract are entirely controlled by the Sugar Act. The administration of this act by the U.S. Department of Agriculture has been most effective. It has been so effective in maintaining a stable market that the need for hedging to eliminate market risk has been virtually eliminated.

In summary, we believe that (1) not only is this legislation unnecessary for coffee and sugar but also that, (2) it could reduce this exchange to a skeleton of its former self if not ultimately destroy it.

To advocate that the New York Coffee & Sugar exchange should be brought within the control of the Commodity Exchange Authority on grounds that its existence outside that body is atypical, independent of the monolithic regulation of all commodity trading, nonconforming and therefore prejudicial to the national interest seems to us, on the face of it, specious reasoning.

At the same time, we recognize that the climate of these times renders almost anachronistic our claim for perpetuation as a self-regulated, self-governing membership corporation. The possibility, however, that our claim for continued independence may fall on deaf ears in certain quarters makes us no less convinced of the essential rightness of our cause nor of our determination to champion its validity at every opportunity.

Mr. Chairman, with your permission after having heard the testimony of the Assistant Secretary of Agriculture Mehrens, I would like to make a comment or two on his remarks concerning coffee and sugar.

On the question of coffee, the Assistant Secretary referred to the Federal Trade Commission Report of 1954 and to investigations by the chairman of Subcommittee on Consumers Affairs of the House Committee on Banking and Currency. He clearly inferred that these investigations revealed sufficient justification to bring coffee under Government regulation. This inference is not supported by fact and is misleading. Various Federal agencies have investigated coffee futures market and none of them has ever reached the conclusion that futures trading in coffee had any measurable effect on coffee prices nor have they concluded that Federal regulation was warranted.

Further, the simple fact that the Assistant Secretary had to go back to 1954 to find something to criticize seems proof positive that this exchange has done a pretty fine job in the self-regulation of coffee futures trading.

On the sugar question, the Assistant Secretary stated that:

The Department of Agriculture reported after study that excessive and totally unregulated speculation in sugar futures stimulated price explosions in 1963.

The Assistant Secretary also quoted Mrs. Leonor K. Sullivan, Consumer Affairs Subcommittee chairman, that:

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 (coffee and sugar)—resulting in wild swings in prices which were reflected in quick order in much higher consumer prices.

Mr. Chairman, these statements cannot be allowed to stand unchallenged. Against the background of a sharp reduction in world production as a result of bad weather in Europe and communism in Cuba, if there was one single overriding factor which brought about the 1963 price rise in sugar, it was the temporary existence of the so-called global quota. (This is the same temporary global quota which this committee opposed to the bitter end. The Sugar Act in the United States has operated since 1934 with great success for the U.S. economy with one exception, and that was during the short period of the existence of the global quota.) There is solid evidence for the truth of the above statement and it is this: On that day in 1963 when the global quota was finally filled, the sharp rise in sugar ended for good and the market plummeted downwards. Prices fell the permissible daily limit for nine consecutive days. The pounding, concentrated demand for physical supplies by the United States from a thin world supply was over for the year.

I would like to quote a few lines from the introduction of the Department of Agriculture report to which the Undersecretary referred. "Futures market traditionally attracts speculation. Speculative excesses are common in such markets. The sugar futures market in the first 6 months of 1963 was an example of this pattern. The extreme pressure of the rise in world raw sugar prices as reflected in the world futures contract at New York caused domestic futures prices to rise in the late spring of 1963 as the speculative fever increased in both the world and domestic futures contracts. The results of the investigation which was made by the Commodity Exchange Authority of the Department, are submitted in this report." The report is a long one and goes on in this vein. The message is, in brief, that speculation caused the rise first in the world futures contract and that this then influenced the domestic futures contract. This report, therefore, completely ignores the fact that the world futures contract and the domestic contract were one and the same during the life of the global quota demand. This is the heart of the matter. I do not know whether this was done deliberately by the CEA or not. If it is not misrepresenting it is, at the very least, misleading. It does not fit the facts.

Let me now compare this with testimony submitted by the U.S. Department of Agriculture officials under knowledgeable questioning during hearings by the Committee on Finance of the U.S. Senate on May 29 and June 6, 1963. This testimony was given by Mr. Charles S. Murphy, Under Secretary of Agriculture, Mr. John C. Bagwell, General Counsel, and Mr. Lawrence Myers, Director, sugar policy staff. These gentlemen are well known to this committee. If anyone in the Department understood the sugar situation in 1963, these men did. The report of these hearings cover 122 pages and, obviously, I can only attempt to give you a summary of this testimony. The weight and thrust of their testimony was simply this—the basic reason for the advance in sugar prices has been the reduction in world production as a result of bad weather in Europe and communism in Cuba. This resulted in a shift from a surplus to a shortage situation in the world market. Stockpiling by sugar users in this country through the global quota was a most significant fact in contributing to the price rises. A complete report of these hearings is, of course, available to this committee.

The posture of the Department officials testifying in the Senate is completely and totally in contradiction to the CEA report. One can only guess that this difference was created by motive. The sugar people of the Department were responding to the informed and penetrating questions of the Senators and consequently were sincerely attempting to explain what had happened. The CEA, on the other hand, wants control of this exchange and has created a document to support their position.

Conditions today are entirely different. The short-lived global quota is a thing of the past. This committee has wisely brought out legislation which goes back to the historic time-tested country quota now in effect. The present Sugar Act is good legislation. The 1963 situation, to which the Under Secretary referred, cannot reoccur as long as the Sugar Act lasts.

(Supplementary statement filed by Mr. Clark follows:)

STATEMENT OF NEW YORK COFFEE AND SUGAR EXCHANGE, INC.

My name is Reed Clark. I am President of the New York Coffee and Sugar Exchange, Incorporated, located at 79 Pine Street, New York. In private business, I am President of Czarnikow-Rionda Company of 120 Wall Street, New York. Here with me are my associates, two past presidents and active members of the Exchange. They are Mr. James M. Clark, Vice President of Anderson, Clayton and Company and Mr. Leon Israel, Jr., partner of Leon Israel and Brothers. Also with me today are Mr. Johann J. Scheu, a member of the Board of Managers of the New York Coffee and Sugar Exchange and Director, Purchasing, The Nestle Company, Inc., and Edwin B. Dexter, Real Admiral, U.S.N., retired, who is Executive Director of the New York Coffee and Sugar Exchange.

I have been directed by the Board of Managers of our Exchange to make the following statement with regard to H.R. 11930—a Bill to amend the Commodity Exchange Act.

BACKGROUND

The New York Coffee and Sugar Exchange, Inc., is a non-profit membership corporation. It exists to provide facilities for the trading in future 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 the trading. The Exchange neither buys nor sells any contracts for its own account. The Exchange does not make or fix prices for coffee or sugar contracts. It merely provides a market place and makes public the prices resulting from transactions there.

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.

In the best traditions of the American legislative process, we believe that no case has been presented to warrant further government control of the New York Coffee and Sugar Exchange—as is implied by H.R. 11930. Therefore, there can be no blame without fault.

Our Exchange has been operating for more than 85 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. Therefore, we find it difficult to understand why at this time the government proposes to impose restrictive measures on our exchange—a measure which could ultimately cripple the New York Coffee and Sugar Exchange and the hedging operations of American businessmen.

CONTRACT

The New York Coffee and Sugar Exchange provides facilities for trading in two sugar futures contracts and two coffee futures contracts—each of which is designed to serve a particular marketing function of 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 and Sugar Clearing Association.

TRADING ACTIVITY IS IN FOREIGN 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 subjected to cost increasing hampering regulations, in our opinion, trading in the United States will dry up.

Our business would quietly move to the more favorable trading climate of the European exchanges. If margin controls were later added to this proposed legislation, then the point is no longer debatable. Business would move abroad, particularly to London, where cash margin requirements are virtually non-existent.

If the probability of trading moving abroad is valid, as controls and restrictions in the United States increase, then it obviously follows that a drain on the United States balance of payments will be created. Trading costs and losses will result in an outflow of dollars.

The present Commodity Exchange Authority bill to control the New York Coffee and Sugar Exchange is really an effort to control trading in so-called "world" sugar under present circumstances. Not one pound of "world" sugar is produced in the U.S.A., nor may "world" sugar be used to fill U.S. quotas under the Sugar Act. "World" sugar is largely unrelated to the U.S. sugar economy.

At the present time, trading activity in our Exchange is largely in the #8 world sugar contract. All raw sugar deliverable under the #8 contract is produced in foreign countries. Delivery is made F.O.B. and stowed in ocean-going vessels at a loading port in a foreign producing area.

Delivery under #8 contracts cannot be made in a United States port. With the exception of approximately 150,000 long tons which are imported annually into the United States for ex-quota purposes, namely, re-exportation, livestock feed and distillation and production of alcohol, none of this raw sugar involved in #8 contract trading enters commercial channels in the United States.

Our Exchange lives on its "world" sugar contract. Business in coffee and in the domestic (#10) contract could not support us. If the "world" contract were damaged, our facilities and services would dwindle away.

Trading in coffee contracts in New York is negligible. The current coffee futures business has gone to London. In 1964 some 32,883 coffee contracts were traded on our Exchange; in 1965 this level dropped to 15,123; in 1966 to 3,204; and in 1967 to date to 430.

Trading in the #10 (domestic) contract has also been drying up. Sugars covered by this contract are entirely controlled by a well-conceived piece of legislation, the Sugar Act of the United States, which is a child of this Committee. The administration of this Act by the U.S. Dept. of Agriculture has been most effective. It has been so effective in maintaining a stable market during recent years that the need for hedging to eliminate market risk has been virtually eliminated.

In 1965 some 42,704 domestic (#10) contracts were traded; in 1966 some 38,126; in 1967, to date, there were only 13,388. More importantly, after liquidation of the current month, there will be only about 337 contracts open in the entire domestic position.

In perspective, then, we have open positions in "world" sugar of 22,397 contracts; in domestic (#10) sugar we have 337, and in coffee we have 21.

SELF-REGULATION EFFECTIVE

No case against self-regulation has been presented to warrant further government controls of the New York Coffee and Sugar Exchange. In short, we feel that our record of performance is proof of the effectiveness and adequacy of our own regulatory and disciplinary machine.

Our Board of Managers consists of fifteen elected members. Our By-Laws 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 has the power to adjust margins to meet market conditions.

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 By-Laws 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 and Sugar Clearing Association information submitted by members with respect to their own and their clients' position 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 of 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 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, needed rules governing commissions and the employment of agents and representatives, and all other matters necessary to good management.

OPPOSE FURTHER GOVERNMENT CONTROL

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 85 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. 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 nor 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.

The repeated efforts of the Commodities Exchange Authority to put controls on the New York Coffee and Sugar Exchange in 1963 and again in 1965 have failed to show any justification for their recommendations.

We do not believe that there is any need for further controls over the "world" contract. Price fluctuations in the "world" contract cannot affect the domestic price of sugar in the United States. The Sugar Act controls domestic sugar and is a good piece of legislation. It insulates domestic sugar from the world sugar market. In addition, the job of supervising and policing sugar produced in a foreign area and delivered to a foreign destination is virtually impossible. It is possible

on domestic commodity production. It is not within the realm of practicability for the Secretary of Agriculture to exercise his powers and obligations as set forth in H.R. 11930 on foreign products destined for foreign delivery.

ADDITIONAL POWER FOR SECRETARY OF AGRICULTURE UNNECESSARY

Other sections of H.R. 11930, 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. 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.

There are many points why we oppose the CEA bill. If this bill becomes law, however, a new concept would be introduced in American legislation. Under Section 16(a), the Secretary of Agriculture sets the legal stage where he plays three parts: plaintiff, jury and judge. He or his subordinates could serve a complaint, conduct a hearing and then sentence the defendant. Then to ensure the Secretary's overriding power, Section 15(a) reads in part, "No such order of the commission 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 . . .". There is a sharp distinction in the meaning of the words "evidence" and "proof". In short CEA proposes to shift most of the burden of proof in court cases from the government to the alleged violators. This would reverse the traditional American justice concept of a man being considered innocent until proved guilty.

CONCLUSION

Virtually all marketing situations are self-correcting through the discipline of a competitive market. We believe the management of a commodity exchange, in touch daily with every detail of the trading situation is in the best position to take appropriate action—if any and when needed. The management of the New York Coffee and Sugar Exchange accepts this responsibility and is accountable for it.

An impartial examination of the operation of the New York Coffee and Sugar Exchange, we believe, 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 its regulation of trading in coffee and sugar futures, but we stand ready to cooperate to the fullest extent at all times with Congressional committees and government agencies to the fullest extent, as we have done many times in the past.

We are proud of our record of responsible Exchange management for 85 years. However, if any member of this committee feels 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 a bill of particulars and our day in court before the Congress of the United States, as now guaranteed in existing legislation.

The CHAIRMAN. Thank you very much, Mr. Clark. We appreciate your statement.

Are there any questions of Mr. Clark? If there are no questions, everybody either agrees with you or refuses to argue with you. We are very much obliged to you and appreciate your appearance.

Mr. CLARK. Thank you very much for this opportunity, Mr. Chairman.

The CHAIRMAN. Now we have our old friend, my colleague here, Mr. Heimbürger, attorney at law in Washington, D.C., and who represents the interests that are before us, and we will be glad to hear from you, Mr. Heimbürger, on any side you want to talk on.

STATEMENT OF JOHN J. HEIMBURGER, ATTORNEY, ON BEHALF OF
THE NEW YORK COFFEE AND SUGAR EXCHANGE

Mr. HEIMBURGER. Thank you very much, Mr. Chairman.

My name is John J. Heimbürger. I am an attorney here in Washington with offices at 1030 15th Street NW., I am appearing on behalf of the New York Coffee and Sugar Exchange in opposition to H.R. 11930, if coffee and sugar are included. My testimony will not be repetitive of that which has been given by Mr. Reed Clark, president of the exchange. My purpose is to point out some of the legal and technical problems which I believe will be encountered if the scope of the Commodity Exchange Act is broadened to include coffee and sugar.

I believe that the most convenient way for me to present my comments is to follow the structure of the act, which I understand the committee members have before them in the form of a "Ramseyer" prepared by the Department of Agriculture, and my references will be to page and paragraph of that "Ramseyer" which I believe you do have in front of you.

I would first call your attention, Mr. Chairman, to page 1 of this document, section 2(a), the first five words of the second sentence, which read: "The word 'commodity' shall mean . . ." The sentence then goes on to list various commodities—"wheat, cotton, rice, corn, oats, etc." The significance of this is that wherever the word "commodity" appears hereafter in this act, it does not refer to commodities in general, but only to those which are named in this sentence. Unless a commodity is named here, it is not a "commodity" for the purposes of this act.

It is interstate commerce in these named commodities, not interstate commerce in futures contracts, upon which the jurisdiction of the act is established. The stated purpose of the act is to protect producers and consumers of these listed commodities, not to protect those who are buying and selling futures contracts.

The bill before you would add coffee and sugar to the list of "commodities" for purposes of this act. (sec. 2(a), line 9).

These two words describe not two, but three, commodities when related to trading in futures contracts. The only market on which future contracts for these commodities are traded in the United States is the New York Coffee and Sugar Exchange. It makes available contracts in coffee, world sugar, and domestic sugar.

Coffee is raw coffee produced outside the United States (the contract does not include coffee produced in Puerto Rico or Hawaii) deliverable to any nation in the world, including the United States, but the contract for which is satisfied when delivery is made to the first buyer in any such country.

Domestic sugar is all that sugar which can be marketed in the United States under quotas established by the Secretary of Agriculture, whether produced in the United States or another country.

World sugar (for which there is a completely separate futures contract) is both produced and delivered outside the United States. Its entry into the United States (except for an insignificant quantity used for animal feed or alcohol) is prohibited by law. Therefore, it never enters the stream of interstate commerce in the United States.

The assumption of Federal jurisdiction over trading in commodity futures is based on the interstate commerce clause of the Constitution by reason of the effect which futures trading in such commodities has on the cash price of these commodities in interstate commerce.

The definition of interstate commerce, for purposes of this act is found about the middle of page 1 of this document and reads: "The words 'interstate commerce' shall be construed to mean commerce between any State, territory, or possession, or the District of Columbia, and any place outside thereof; or between points within the same State, territory, or possession, or the District of Columbia, but through any place outside thereof, or within any territory or possession, or the District of Columbia."

The rationale for bringing futures trading in these commodities under the interstate commerce clause (and, therefore, under the authority of the Federal Government) is found in section 3 of the act * * * the lower half of page 2 of your document. This is a long, complicated sentence which asserts that futures are affected with a public interest, that there is a "large volume" of futures trading (and let's remember these words), that futures prices are quoted generally throughout the United States and the world and used by producers and consumers, and that futures contracts are used by shippers, millers, and others for hedging purposes. But the real guts of the sentence—the assertion which is supposed to tie all this argumentation to the interstate commerce clause—is in the last part of the sentence, which says that the prices of commodities on the futures market are susceptible to "speculation, manipulation, and control" and "sudden or unreasonable fluctuations in the prices thereof" and that "such fluctuation in prices are an obstruction to and a burden on interstate commerce in commodities * * * and render regulation imperative."

In other words, the jurisdiction asserted under the CEA Act is based upon the effect which "speculation," "manipulation" and resulting "unreasonable fluctuations in prices" have on the cash price of "commodities" named in section 2(a) in their movement in interstate commerce in the United States.

Now, Mr. Chairman, let us consider the three commodities to which H.R. 11930 would extend Federal jurisdiction over futures trading under the constitutional justification that futures prices established on contract markets in the United States are "an obstruction to and a burden upon interstate commerce in (these specific) commodities."

The coffee for which futures contracts are offered by the New York Coffee and Sugar Exchange is produced entirely outside the United States. It enters the United States only for delivery to a purchaser. It never enters the stream of interstate commerce in the United States, because the futures contract is satisfied upon its delivery to a port of entry.

Since at least 1950, various Federal agencies have investigated the coffee futures market every time the retail price has advanced, and none of them have ever reached the conclusion that futures trading in coffee had any measurable effect on the price at which coffee moves in commerce in the United States.

In 1954, after adverse weather in Brazil had resulted in a sharp rise in coffee prices, this committee held 3 days of hearings on a bill (H.R. 7735, 83d Cong.) which would have brought trading in coffee

futures under the jurisdiction of the Commodity Exchange Authority. The committee concluded that there was not a sufficient showing that futures trading had affected coffee prices in the United States to warrant Federal regulation of futures trading in coffee, and the bill was tabled.

Since that time, bills to bring coffee within the scope of the Commodity Exchange Act have been introduced in almost every session of Congress and referred to this committee, but the committee has not considered these bills meritorious enough to schedule formal hearings on them.

At the present time, I am informed, only about 1½ percent of the world trading in coffee futures takes place in the United States. A coffee futures price established in London or in Santos has as much effect on the price of coffee in the United States as does a price which might be established in New York.

It seems apparent, therefore, Mr. Chairman, that the jurisdiction over coffee futures which would be asserted by H.R. 11930 under the interstate commerce clause has no basis in fact and would be completely ineffective were it put into operation.

The second commodity which would be regulated by the Commodity Exchange Authority under the provisions of H.R. 11930 is domestic sugar. This is sugar, of whatever origin—foreign or domestic—which can be marketed in the United States under the provisions of the Sugar Act of 1948, as amended.

The price of sugar which moves in interstate commerce in the United States is regulated by the Secretary of Agriculture under the statutory guidelines laid down in section 201 of the Sugar Act. Such price is completely under the control of the Secretary by virtue of his authority to increase or decrease the consumption estimate, and he has historically exercised this authority numerous times during each year. Futures prices in domestic sugar cannot possibly affect the price of this commodity substantially, because of the Secretary's authority and responsibility under the Sugar Act, and only a fool would try to take a futures position in the hope of influencing the cash price of domestic sugar.

In view of this controlled price situation, Mr. Chairman, I think there is a very serious question as to whether trading in domestic sugar futures is properly within the constitutional justification set out in the Commodities Exchange Act.

As to futures trading in world sugar, it seems to me that there is no such question. World sugar is clearly outside the constitutional jurisdiction established in the Commodities Exchange Act.

The general rule is that the courts will not reverse a determination by Congress that an article is in interstate commerce.

However, there are several exceptions to this general rule. One of these is:

Only such commodities as may lawfully become the subjects of purchase, sale, or exchange are articles of commerce which, on their movement from State to State, become subjects of interstate commerce, within the protection of the commerce clause of the Constitution.

World sugar is both produced and delivered outside of the United States. Its entry into the United States is prohibited by the Sugar

Act and illegal entry is a Federal crime. It never enters the stream of interstate commerce in the United States. Because of the Sugar Act, the price of sugar in the United States is completely insulated from world sugar prices and is not affected, one way or the other, by price levels in the world sugar market.

This is clearly demonstrated by the price activity of these two commodities during this year 1967. Thus far in this calendar year the price of world sugar (both on the futures market and the spot market) has gyrated at low levels. Meanwhile, the price of domestic sugar has been extremely constant, several cents a pound above world sugar, with a slow but steady upward trend as the Secretary of Agriculture adjusted the quota to keep the price in line with what he considers to be the price objective of section 201 of the Sugar Act. I do not agree completely with the Secretary as to the meaning of section 201—but that is another story. He has done a remarkable job of keeping the U.S. sugar price in line with what he considers to be the objective of that section.

I think it is quite clear: (1) that world sugar never legally enters the stream of interstate commerce in the United States; (2) that the price of world sugar does not affect the price at which sugar moves in interstate commerce in the United States and therefore cannot possibly be "an obstruction to and a burden upon interstate commerce in commodities" as postulated by section 3 of the Commodity Exchange Act; and (3) that, therefore, there is no constitutional basis established in the Commodities Exchange Act for Federal regulation of futures trading in world sugar.

There are a great many more things I would like to say, Mr. Chairman, with regard to the inapplicability of the Commodity Exchange Act to futures trading in coffee and sugar, but I will confine myself to three points.

1. Section 3 of the act, beginning on the third line of section 3 on page 2 of your "Ramseyer," bases part of the justification for Federal jurisdiction on the assertion that "such transactions are carried on in large volume by the public generally . . ." Mr. Clark, the President of the exchange has given you the figures on participation in the coffee and the domestic sugar futures markets and you know that there is no "large volume" of such transactions.

2. Even if the CEA were to establish jurisdiction over futures trading in coffee and sugar, its efforts at regulation would be an exercise in futility: (a) There is virtually no trading in domestic sugar futures because the price is fixed by the Secretary of Agriculture; (b) only about 1.5 percent of the trading in coffee futures is done in the United States, and as I stated before, a futures price for coffee established in London or Santos has as much effect on coffee prices in the United States (if any) as a futures price set in New York; (c) the same principle applies to world sugar. There is an active and very large futures market for world sugar in London. Such trading is encouraged by the British Government and as a result the exchange has a minimum of regulation and redtape and, I am informed, does not even require margin deposits on its futures contracts. The net result of Federal regulation and supervision of futures trading in world sugar in the United States is certain to be the diversion of such trading to London and, as I have observed before, a price established on the London market (which I presume

even the CEA will admit is completely outside its jurisdiction) will have just as much effect on sugar prices as a price established in New York; and (d) further regulation would reduce participation in these markets and thereby actually increase the risk of manipulation or price rigging, since it is obvious that a market on which only 100 people are trading will be easier to rig than a market on which there are 1,000 active participants.

3. The whole theory of the Commodities Exchange Act is related to commodities which are both produced and delivered in the United States. I could give you numerous examples of this in the text of the act, Mr. Chairman, but I will confine myself to two or three.

One of the most obvious of these examples occurs in section 4(a) of the act, which begins on page 3 of your document. This recites the evils of excessive speculation and authorizes the CEA to do various things to prevent such speculation, but then it says—on page 4, subsection 3—that none of these orders relating to speculation shall apply to “bona fide hedging transactions or positions.” Down in the last sentence of this paragraph it begins to define a “bona fide hedging transaction” and says:

There shall be included in the amount of a commodity which may be hedged by any person—

(A) the amount of such commodity the person is raising, or in good faith intends or expects to raise, within the next twelve months, on land (in the United States or its territories) which such person owns or leases;

This limitation of a hedging position to an amount of commodities produced within the United States means that the producer of coffee or world sugar, and 40 percent of the domestic sugar, would have a hedging position of zero. This is obviously absurd and is a clear indication that the Congress which enacted this legislation had no intention that it should ever be applied to foreign-produced commodities.

Just one more example, Mr. Chairman, of the inapplicability of this act to foreign producers. In section 5(a), beginning on page 10 of your document, it says:

Each contract market shall—

Then over on page 11, subsection 3, it says:

require the operators of warehouses in which or out of which any commodity is deliverable on any contract for future delivery made or subject to the rules of such contract market, to make such reports, keep such record and permit such warehouse visitation as the Secretary of Agriculture may prescribe.

Further down in the subsection it says that—

such . . . warehouses shall be open at all times to inspection by any representative of the United States Department of Agriculture or United States Department of Justice.

Can you visualize the Secretary of Agriculture or the Attorney General inspecting coffee and sugar warehouses throughout the world to determine whether the amount of coffee or sugar therein complies with CEA regulations?

A precisely similar example of the domestic orientation of this act could be given in connection with section 4(h), back on page 8 of your document, which relates to “persons,” rather than markets. The impossible tasks assigned the Secretary are the same.

In conclusion, Mr. Chairman, when Mr. Joseph M. Mehl, for many years Administrator of the Commodity Exchange Authority, appeared before this committee on February 17, 1954, to testify on the bill H.R. 7735 to bring coffee under CEA regulation he recognized the difficulty of effective CEA supervision.

In spite of a favorable Department report on the bill, he said:

Mr. Chairman, in my testimony you may sense *some lack of enthusiasm* for this particular amendment to the Commodity Exchange Act . . . I would *much prefer* to see the housewives and the restaurants take care of the coffee situation . . .

In 1961, the domestic marketing subcommittee of this committee had an informal hearing on a similar bill. At this hearing spokesmen for the CEA said that they would prefer not to be charged with responsibility for regulating coffee futures trading because so many of the principals reside outside the United States, therefore outside their jurisdiction, that they would be assuming a responsibility without full authority to discharge it. The same situation applies, of course, to sugar.

The New York Coffee and Sugar Exchange has members in 21 countries outside the United States. The Commodity Exchange Authority has no jurisdiction over these individuals and can obtain information and statements from them only on a voluntary basis or by the devious route of trying to compel the exchange to obtain the information for it.

The Department of Justice recognized this in 1954 in a letter to the Senate Banking and Currency Committee which says in relevant part:

* * * in 1951 and 1952 the New York office of the Antitrust Division conducted a grand jury investigation on the basis of a recommendation by the Gillette committee that the Attorney General act to prevent the continued use of restrictive contracts for trading in coffee futures on the New York Coffee and Sugar Exchange * * * Since the United States courts *lacked jurisdiction over the foreign principals*, the Antitrust Division was unable to recommend effective measures to obtain relief under the Federal antitrust laws.

To sum up, Mr. Chairman:

(1) The Commodity Exchange Act was clearly intended by Congress to apply to commodities which are both produced and consumed within the United States.

(2) Application of the act to coffee and domestic sugar is probably without constitutional justification because there is no showing that futures trading in either of these commodities obstructs or burdens interstate commerce, or that it is "carried on in large volume by the public generally."

(3) There is no Constitutional basis whatever in the act for regulation of futures trading in world sugar because this commodity is prohibited by law from entering the stream of interstate commerce in the United States and, as long as the Sugar Act is in effect, cannot influence the price of sugar in interstate commerce in this country.

(4) To confer jurisdiction on the CEA over futures trading in these commodities would be an exercise in futility, for it would (a) serve to drive futures trading in the commodities to foreign exchanges and a futures price established in a foreign exchange would have as great an influence (if any) over cash commodity prices in the United States as would a futures price established in New York; (b) present the CEA

with the impossible task of supervising a market over which it does not have jurisdiction of all the principals; and (c) divert the attention, the funds, and the personnel of CEA from supervision of markets of great importance to U.S. producers and consumers to markets which are of little or no importance to them.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Heimbürger.

I take it that your purpose of appearing here is to urge us to eliminate certain sections of this bill or certain provisions in the bill as it relates to these named commodities.

Mr. HEIMBURGER. My only purpose, Mr. Chairman, is to ask the committee to delete the words "coffee and sugar" in the first section of the bill.

The CHAIRMAN. I know it is not your business directly, but do you feel that the same objections would apply to livestock and livestock products?

Mr. HEIMBURGER. Not the objections that I have raised to coffee and sugar certainly, and while I do not speak for these people at all and have not even talked to them, I understand they do not have substantial objections to inclusion of those features in this bill.

The CHAIRMAN. Do you find the other provisions of the bill objectionable as relating to the commodities that are presently regulated?

Mr. HEIMBURGER. Mr. Chairman, I would say that—this has to be a personal expression since I believe the Coffee and Sugar Exchange is taking merely the position we should not be in. But I must say I do personally and as an attorney agree with the statement that was made by the gentleman who represented the Chicago Board of Trade.

The CHAIRMAN. That is to the injunction?

Mr. HEIMBURGER. Yes.

The CHAIRMAN. It seems to me up to this point it has been rather clear that the objections raised to this bill fall basically in two categories: one to the injunctive procedures and one to the inclusion of new and what some people think are improper commodities.

I do not think there have been other basic objections, have there?

Mr. HEIMBURGER. I have not heard all of the testimony, Mr. Chairman, but I believe that this is substantially it. I think there are some objections to some other wording in the bill. But I might say again, Mr. Chairman, that I have had long exposure to efforts to amend the Commodity Exchange Act and it seems to me this is the least objectionable bill from the standpoint of the trade and the committee that the Department has ever come up with.

It would seem to me that if certain of these features to which there is substantial objection could be eliminated or modified, that it might be a good time to finally get a bill and update the act.

The CHAIRMAN. Are there questions?

Mr. DE LA GARZA. Pardon me for showing my ignorance, but will you give me your definition of trading in the futures? Is not the trading in the specific item for delivery at a later date?

Mr. HEIMBURGER. I am sorry, Mr. de la Garza, I am not an expert on the question you just asked. I have one sitting next to me here in Mr. Clark, the president of the exchange. I will say certainly there is a clear distinction between what is called a futures contract and a contract for future delivery. In the latter case I buy from your firm

six carloads of grapefruit, let's say, for delivery at a specified time or time to be specified, but this is a contract for future delivery substantially on a cash basis. I know what that is, pretty well. How you distinguish a futures contract from that gets a little bit involved as far as I am concerned, and I would like for Mr. Clark to answer your question, if you would permit him. It is a good question.

Mr. DE LA GARZA. Good.

Mr. CLARK. Mr. Congressman, you make a sharp distinction between a physical commodity and the so-called futures contract as traded on the exchanges. The main purpose of the futures contracts on the exchanges is to provide a hedging medium and therefore you try to simplify it down to one generic contract that covers as many situations as possible as opposed to being tailored to a specific need by a seller or buyer of the physical commodity itself in order to be able to bring a greater volume to a central trading place.

Most futures contracts—I am not an expert on other changes, but certainly in coffee and sugar most futures contracts never result in the future delivery of the commodity itself called for under the futures contract. The buyer or the seller does take the obligation to do so, but in only a very small percentage, much less than 1 percent in our case, does a physical delivery ever take place.

This then permits, say in the world sugar field, a man in London to buy physical sugar from a geographically favorable place, say the Caribbean, for delivery to France as opposed to going a long distance away to Formosa or something like that.

At the same time, he can then turn to the hedging facilities of the so-called future contract which would be the same essentially in price, and if he buys a hundred tons of Dominican sugar which he intends to deliver to France, this is a specific situation where he wants a certain type of sugar and the Frenchman wants to receive a certain type of sugar, he can immediately obtain a price hedge, obtain insurance against price fluctuation by going to the No. 8 contract or the London contract, hedge it then, and then as the purchase is finally sold on to France he will buy back the futures.

I do not know whether I have helped you or confused you.

Mr. DE LA GARZA. I think you have, sir, and it has cleared up a couple of points. Both of you gentlemen seem to insist that the product never comes into the United States and that we should not mess with it, but under your definition it is immaterial.

Then you say that we should not deal with it because it is not in interstate commerce, and under the definition the generic commerce is in the futures contracts, not in the sugar. So then you are in interstate commerce if you use the telephone across State lines, if a fellow sends you the money from Houston or if you buy it in Houston.

I do not know if you have that kind of exchange or not. But you are in interstate commerce, you are not dealing with the sugar, you are dealing with the futures contracts.

Mr. HEIMBURGER. Now you are back in my territory again, Mr. de la Garza.

I will not make the flat statement that Congress has no constitutional authority to regulate trading in world sugar futures. I do make the flat statement that the constitutional authority which is set up in this act is based on the delivery of the commodity itself across

State lines and on the effect which the futures trading might have on the cash price of that commodity.

The Commodities Exchange Act is not set up on the constitutional ground of regulating interstate commerce in the contracts themselves or in the physical commodity. And since world sugar cannot enter the United States legally and does not enter the United States, obviously there is no interstate trading in world sugar.

The CHAIRMAN. Are there any further questions? If not, Mr Heimbürger, it seems that you still influence the thinking of the committee.

Mr. HEIMBURGER. Mr. Chairman, it was a privilege to be before the committee and I appreciate it very much.

The CHAIRMAN. We are delighted to have you back.

Our next witness will be Mr. E. B. Harris, president, Chicago Mercantile Exchange. Mr. Harris, we are glad to have you with us.

STATEMENT OF E. B. HARRIS, PRESIDENT, CHICAGO MERCANTILE EXCHANGE

Mr. HARRIS. Thank you, Mr. Chairman. I certainly welcome the opportunity to be here again. We have been through this a number of times, as Mr. Heimbürger said. I do not know whether I am more or less nervous from having appeared so many times. I do feel that the hearings serve one great purpose. They give us an opportunity to all understand this very important marketing mechanism which we call futures trading, which is very important to the world economy and of very great importance to the domestic economy, and unfortunately is not too well understood, in my opinion.

Mr. Chairman, 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've maintained an intense interest in farm problems. Because agricultural price determination is so much a part of our economic function on the exchange, I've 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 DePaul 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'd like to begin my testimony today by saying that I appreciate the opportunity to be here and discuss the pending bill, H.R. 11930. We of the Chicago Mercantile Exchange have always enjoyed ex-

cellent 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, even when it was voluntary.

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 they will work well in the years ahead.

Let me detail some of the recent history of the Chicago Mercantile Exchange for you. We've come a long way since Will Rogers dedicated our building just after it was built in 1928. 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. It virtually disappeared in the place of butter. Price was kept stable by a purchase and resale program. There is an example of how it automatically disappears. When it serves an economic purpose it grows and flourishes as in the case of our pork belly markets, live beef cattle, live hogs, and our other new markets. 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 strictly fresh eggs (a new contract); frozen eggs; butter, a slight amount this year when the price tended to break out of the floor; frozen pork bellies; live hogs; live beef cattle (deliverable in Chicago, Kansas City, 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, not only to find out what the best possible contracts would be, but also to have the industry feel before we opened a contract that they were a part of it. I think it was excellent public relations. We will certainly follow that pattern in the future as we intend to open additional contracts.

Prior to the opening of contracts I listed four advantages which I believe would accrue to producers and processors due to their initiation.

Back in 1962, 1963, many cattle feeders got caught in the price valley and never came back to the industry. Many family size operations disappeared forever, which I think is unfortunate, of course.

While I talked about research in promotion, we were pretty lucky to pick the right time when price was probably below the cost of production. I predicted, two, it would give farmers and others an indication of the trend of prices which would help producers in their

planning; three, it would provide price insurance as hedging; and fourth, be a great incentive toward standardization and quality control.

If a woman goes to a grocery store today she does not have to have a romance with the butcher to get good meat. She picks up a choice prime good steak, and if they can grade it that way in the stores I say you can grade it that way in the yards where the cattle are inspected. It was predicted you could not do it with the Government inspectors that come out of the agricultural colleges, and we found they can do a very, very good job. The results of these contracts exceeded my highest expectations. In discussing H.R. 11390, 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. Although we have worked successfully with the CEA on controlling commodities on our exchange which are covered by the act, we would see some opposition to our new and exciting meat markets being placed under supervision.

When I testified a year ago, I said as policy we had no objections. Our objections are with mixed feelings. If the old act prevailed, I do not feel any large segment of our membership or board would object. But we are a little bearish, if I may use a trade term, on this injunctive thing that has been talked about a good deal. I want to say this about it. We are afraid that if you have people sitting here in this town—and I spent 11 years in the Government, most of them down here—if you depend on people to say this market is wrong, we will have to get an injunction, this market has gone too high, too low, it is putting too much responsibility on an individual. Markets know more than men, I think. In foreign countries where you have a czar putting arbitrary prices—and I am not going to beat Russia to death, but there are other countries the same way—they have not had the success we had in efficiently producing and distributing food. I do not have to labor that point as it is so very, very well known. If these people, one man, two men, or three men can judge a market from Washington or any other point in the country, I submit that they would not have to work at all. If I could do it, I would not work. Now two or three little specific things. Section 4a(1), pages 2-3, dealing with trading and position limits charges to a single person any trade or position which is “directly or indirectly controlled” or where two or more persons act pursuant to “an express or implied agreement or understanding.” What constitutes indirect control or implied understanding are very indefinite concepts which the CEA can employ arbitrarily and at will to destroy trading. For example, two customers’ men at a brokerage firm might very well have a discussion of the market and agree that the buying or selling side was warranted. But by reason of such discussion they would be subject to the interpretation of having all of their trades and their customers’ trades lumped together. The potential violation of the statute would subject the parties to criminal penalties.

Section 4d, pages 5-6, the new paragraph to be added at the end of the section would require that segregated funds be held as belonging to the customer rather than the depositing commission merchant. Obviously, then, interest earned on such deposited money would

have to be turned over to the customer. Traditionally, margin deposits have been made and brokerage firms have employed those deposited funds to realize part of earnings. The fact that in this instance such deposited funds must be specifically segregated should not result in a complete reversal of practice.

Many brokers rely upon such earnings as the difference between profit and loss.

Section 4f, pages 6-7. The amendment would grant the Secretary the power to determine whether or not minimum financial requirements of the contract market are adequate. This is done by requiring the Secretary of Agriculture's approval of the rules and regulations setting forth financial requirements. There are no standards in the statute which would control the grant or refusal of such approval. The need for minimum financial standards of members' responsibility, of course, is evident. We now require financial responsibility of clearing members where the need to meet financial commitments exists. Is there a necessity to go beyond those requirements?

Section 8a, page 20. A new paragraph 7 is added giving the Secretary the power to disapprove any rule, regulation, or resolution issued by the contract market relating to the terms and conditions in contracts of sale if it violates any provision of the act or rules and orders of the Secretary.

I have always felt that there might be a need to have some Government supervision of our rulemaking functions in order to secure a semblance of immunity from the antitrust laws.

The SEC has made some progress in that direction and they are trying to make more. If provision is going to be made for disapproving rules of the exchange, I believe the Government's function should be broadened so that the disapproval could be based upon a finding that the rule is not in the best interests of the investors and traders in cash and futures commodities. It is my strong opinion that exchanges must retain authority to write their own rules to meet special and technical situations.

Section 9(a), page 23, grants the Secretary the power to enjoin any person who is engaging in an act constituting a violation of the provisions of the statute or rules of the Secretary. Since one of the specified violations of the act is attempting to manipulate the market, we would have a situation where the Secretary could at any time claim that some person is engaged in attempting to manipulate the market and therefore should be enjoined although no concrete facts are available.

In conclusion, may I respectfully suggest that free futures markets have proven their economic value for many decades. But in the past few years as we go from great, expensive, and burdensome surpluses to potential food shortages, they are needed more and more. Free futures markets mean higher prices to producers and lower prices to consumers by reducing the marketing spread through more intense competition. There have been many studies that indicated where there are futures markets for agricultural commodities, the share that goes to the farmer is greater than where there are not, because it brings intense competition into the public hall and cuts down on what we call the marketing spread.

They tend to stabilize prices. They bring supply and demand together fairly in a public arena. They force needed present and future

price information into public view, helping all producers in their planning. Any additional restrictions or regulations should be reviewed carefully lest they do more harm than good.

Mr. Chairman, I want to take 1 minute, if I may. I listened to Dr. Mehrens' testimony and I thought it was quite good in many ways, but there were a couple of what I think little inadequacies in it that I want to comment on. He spoke of hedging on pork bellies as being very nominal as opposed to the amount of speculation. I asked where the information came from. I learned it came from a study of the packers and stockyards people very early in the game. A year or two ago, after the market reached maturity, we made a study and found 45 percent of the trading in all of our livestock and livestock products was done by people in the trade, producers and packers.

I would like to read a letter from Karl Heimke, head of the investigative unit.

(The letter follows:)

CHICAGO MERCANTILE EXCHANGE,
Chicago, September 8, 1967.

Mr. EVERETTE B. HARRIS,
*President, Chicago Mercantile Exchange,
Chicago, Ill.*

DEAR MR. HARRIS: The Board of Governors of the Chicago Mercantile Exchange has authorized participation in a research project in cooperation with the University of Illinois, Cooperative Extension Service, to determine the percentage of the live cattle open interest which consists of hedging. To accomplish this project, a survey of all open contracts was made as of the close of business, July 28, 1967.

In view of your pending testimony, Dr. M. Brice Kirtley of the Cooperative Extension Service has agreed that a preliminary report should be made so that the latest information is available to the Congressional Committee.

As of September 8, 1967, 48 of our 70 Clearing Firms have responded. This represents approximately 70 per cent response. The large back office administrative load of many of our firms has delayed more prompt reply. This response, however, represents 81% of the total long open commitment and 87% of the total short open commitment, which is sufficient to form a reliable basis on which to report.

The reporting long position disclosed 53% to be speculative; 20% to be hedged. The reporting short position disclosed 16% speculative; 64% hedged. The apparent discrepancy in percentages in totalling 100% arises from the fact that the total reporting long was not equal to the total contracts cleared. The explanation is similar for the short percentage total also. The variance, however, bears a relationship to the total percent reported long and the total percent reported short.

Very truly yours,

KARL F. HEIMKE,
Vice President.

Mr. HARRIS. With regard to submitting full copies of our minutes, by saying one of our minutes simply said the President's report was presented and filed, the President's report in our exchange could be a report on personnel problems and administrative problems and things of that sort, and if any action were taken by our board on any matter brought up it would call for a motion to be seconded and voted on, and would be in the minutes.

The final thing, there was a great deal of discussion of violations of the act, how many cases had been brought and so forth. I asked the CEA to provide me with a list of all the charges that have been brought against people in our exchange since its inception and I found

there were 23 going back 50 years, roughly. The last such charge was brought on January 24, 1964. That means they brought no charge in 3½ years, and I am proud of that record, and I am proud of the CEA and glad to work with all of them and other branches of our Government. Thank you.

The CHAIRMAN. Thank you very much, Mr. Harris. I do want to make a statement to the members.

I hope you will all stay here until we have completed with Mr. Harris because the Chair does want to bring my report to the membership.

Are there any questions of Mr. Harris?

Mr. ZWACH. Mr. Chairman, I have a question.

Mr. Harris, I am impressed by your statement showing the importance of your group with regard to farm prices and stability of prices and your farm background. I have before me the parity ratios for August of 1967. It shows wheat at 54 percent of parity, corn at 69, butter fat at 77, barley at 77, flax at 76, oats at 71, soybeans at 78, beef at 82, chicken at 59, eggs at 60, turkeys at 65.

I am looking for something bright in this whole picture. It is your conviction that prices would be worse if it were not for your groups, is that correct?

Mr. HARRIS. I think that prices are made by supply and demand. But to be specific to your question, I say this: I say that if we did not have futures trading we would have less stability in prices and there would be more extremes. On average they would be the same. I am sure Dr. Mehrens would agree on that if he were here, or any other economist. I am glad to see that beef was higher, the 82 percent you mentioned, than the others. It will be noticed that commodities where the Government has not had support programs and storage programs, as in the case of livestock, have fared better year in and year out than of our poor friends in cotton and wheat and some other commodities where they have grain storage.

Mr. ZWACH. You would say producers are going to have to look beyond commodity exchange groups to get a return for their products.

Mr. HARRIS. Supply and demand is going to have to come into that delicate balance which will bring a fair price. If it brings a realistic price it may not be fair to the farmer in terms of the prices he pays for things he buys. You will notice it in the farm prices in the last few years. You will notice in my testimony I said we are going from a period of surpluses to situations of potential shortages. That did not occur this year because God blessed us with a good rain. But there will come a time.

Mr. ZWACH. We do not have a big crop yet.

Mr. HARRIS. There was frost this morning.

Mr. ZWACH. But we already have the low prices.

Mr. HARRIS. That is right.

Mr. ZWACH. But we do not have the crop?

Mr. HARRIS. That is right, sir.

Mr. ZWACH. I have nothing further, Mr. Chairman.

The CHAIRMAN. If there are no further questions, we are very much obliged to you, Mr. Harris.

Mr. HARRIS. Thank you very much, Mr. Chairman.

The CHAIRMAN. We have four more witnesses, and we will have to have an afternoon session, as I see it.

Mr. Gathings will be here. I will try to be here part of the time. I think we should meet, and would 2 o'clock be satisfactory? We will meet at 2 o'clock.

We will excuse our visitors.

The committee will stand adjourned.

(Whereupon, at 11:50 a.m., the committee was recessed to reconvene at 2 p.m., the same day.)

AFTERNOON SESSION

Mr. GATHINGS. We had a roll call vote in the House a very few moments ago and no doubt the other members will be coming over shortly.

Mr. William F. Brooks, National Grain Trade Council, Washington, D.C.

STATEMENT OF WILLIAM F. BROOKS, NATIONAL GRAIN TRADE COUNCIL, WASHINGTON, D.C.

Mr. BROOKS. Yes, sir.

Mr. GATHINGS. Mr. Brooks, we would be glad if you would come forward to the table and proceed with your testimony.

Mr. BROOKS. Thank you, Mr. Chairman.

The National Grain Trade Council appreciates this chance to submit our views on some of the proposals contained in H.R. 11930, a bill to amend the Commodity Exchange Act.

My name is William F. Brooks. I am the president and general counsel of the National Grain Trade Council.

We will submit views on a limited number of sections in the proposal, leaving to others an open record to present their views in areas of particular concern to them. Facts and information developed during these hearings may require that we submit views on other sections of the pending proposal and on other proposals to amend the Commodity Exchange Act if they are to be considered by this committee on the basis of recommendations or representations made at these hearings.

We would oppose any proposal that the Secretary of Agriculture or any other Government official or group of Government officials be given authority to establish or control margins in futures commodity transactions. We recommend that this committee, if it approves certain sections of the pending legislation which gives the Secretary of Agriculture or the Commission authority to disapprove of contract market bylaws, rules, regulations, and resolutions, should make it crystal clear that the exercise of this veto power shall not be used to influence the governing boards or clearinghouses of contract markets in their decisions establishing margins. We would oppose too, any proposals that Congress make it illegal to engage in futures transactions in any of the commodities now regulated.

We request an opportunity to be heard before this committee on any proposals which the committee may consider which are not now contained in H.R. 11930.

We would hope, too, if any attempts are made, assuming a bill is reported, in the House to add or detract to the reported bill, that this

request for an opportunity to be heard be brought to the attention of the House so that the House might not take premature action.

Organized contract markets are recognized commercial institutions. Most of the commodities for which futures trading is available, are subject to the Commodity Exchange Act. Additional commodities would become subject to the Commodity Exchange Act. Additional commodities would become subject to this act under the pending proposal.

These recognized commercial institutions make possible an orderly movement of agricultural commodities from production to consumption. Their operations assure a rough equality on buying and selling sides of the market. The availability of futures contracts makes substantial contributions to the financing of crops as they are planted, harvested, and start thereafter through the marketing channels to ultimate end users. Speculation within the commodity markets makes hedging possible and permits the operation of the Nation's low-cost efficient grain marketing system.

The grain marketing system, because of the availability of futures markets where many people trade in futures contracts covering grain, is a highly competitive, low-cost marketing system. The function performed by futures markets is to register the forces of supply and demand by open public trading.

In doing this through the medium of futures transactions, producers, processors, exporters, and others are offered an opportunity to obtain price insurance that today they may agree to deliver in the future something they may not now own or that today they may agree to take delivery in the future of goods they may now anticipate they will need, or that today they may obtain a price certain for commodities they are buying or have bought and intend to carry awaiting sales for use for processing. Through trading on exchanges, a steady flow of commodities moves from production into consumption. To this trading speculators, large and small, make a substantial and economic contribution.

During the fiscal year just ended, according to the Commodity Exchange Authority, the volume of futures trading in regulated commodities increased for the fifth successive year and was the largest on record. H.R. 11930 would classify soybean meal, coffee, sugar, livestock, and livestock products as regulated commodities. With this volume of futures trading added to the volume of trade in commodities already regulated, one must wonder why the pending proposal in section 1(c) would permit "an official or employee of each of the executive departments concerned, designated by the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General respectively" to serve as members of the Commodity Exchange Commission.

In our judgment, the responsibilities of a member of a regulatory commission should not be delegable with the possibility that the responsibility might be indiscriminately rotated between officials and between officials and employees or between employees. The nature of this broad, indiscriminate delegation is hardly conducive to the sort of sound regulatory action which can be expected from individuals whose Presidential appointment is subject to Senate confirmation.

Whatever the reason for the result which section (c) would bring, it seems to us that this committee should not approve this proposal. If a change in the personnel of the Commission appears warranted, then this committee may wish to look at two alternatives.

Perhaps Congress should study the possibility of establishing a completely new independent regulatory agency, along the lines of the Securities and Exchange Commission, to regulate, as does now the Commodity Exchange Commission, the Secretary and the Commodity Exchange Authority, futures trading in all commodities. This of course would remove from within the Department of Agriculture authority to regulate futures trading in agricultural commodities and the Commodity Exchange Authority over the years has developed substantial experience and expertise in the field.

If this is neither the time nor place to initiate such a study, and in your judgment some latitude in Commission membership is desirable, we suggest that section 1(c) provide that if for any reason the Secretary of Agriculture, the Secretary of Commerce, or the Attorney General cannot serve, their places can be taken by the Under Secretary of Agriculture, the Under Secretary of Commerce or the Deputy Attorney General, respectively.

We recommend approval of section 6 of the proposal. If this section is approved, "investment securities" and negotiable warehouse receipts would no longer be classed as satisfactory investments for funds belonging to customers of futures commission merchants.

Our members, perhaps the majority of them, are concerned with the present language of section 12 in the pending proposal which, as it now reads, appears to require minute and detailed recordkeeping of all matters discussed, within the governing boards or committees of contract markets or their affiliates. We would suggest that this language be limited by requiring that the enumerated records "clearly describe matters which relate to terms and conditions in contracts of sale to be executed on or subject to the rules of such contract market and relate to other trading requirements."

We oppose the enactment of sections 15 and 16 of H.R. 11930 as they attempt to reduce the quality of the evidence on which the Commission or the Secretary of Agriculture can base a finding suspending a board of trade's designation as a contract market, or suspending and denying an individual trading privileges in a contract market.

The pending proposal would amend sections 6(a) and 6(b) which now in effect require that revocation or suspension rulings be supported by the weight of the evidence.

The pending proposal would substitute for this "substantial evidence on the record considered as a whole." This new standard or quality of evidence would be made applicable by the pending proposal in one or two other instances, including section 17 of H.R. 11930.

We recommend that if any change is to be made in this quality of evidence the change be in the direction of stating that the findings of the Commission or the Secretary would be conclusive only if they are supported by clear, unequivocal and convincing evidence.

The "substantial evidence on the record considered as a whole" criteria is customarily used in regulatory statutes which govern proceedings to determine rates charged by public utilities or methods used by them in their bookkeeping and depreciation operations.

Proceedings under the Commodity Exchange Act are disciplinary in nature, can lead to depriving individuals of a chance to earn a living, can result in the disestablishment of contract markets, and might, under some sections of the pending proposal, set the stage for indictments and trials for felonies.

If the committee believes that the quality of evidence necessary to sustain a Secretary's finding or a Commission finding, in view of these grave, serious consequences, should be changed, we recommend that it be changed in the direction of requiring a higher quality than is now apparently the case.

Our recommendation is that these findings would be conclusive only if they are supported by clear, unequivocal, and convincing evidence.

This is a standard short of the standard imposed in criminal cases. This can be described as a standard of a higher quality than is now imposed by the present act. This is the standard now in effect in denaturalization cases, deportation cases, expatriation cases and others. In our judgment, it is the standard which the Commission and the Secretary of Agriculture's findings should meet when pressing a complaint under the Commodity Exchange Act.

We find section 16 and section 17 to be further objectionable in that they would authorize the Secretary to take steps against individuals who he has reason to believe are manipulating or attempting to manipulate.

In our judgment, the fact of manipulation cannot be determined prospectively. These are conclusions which can be reached only in retrospect after an evaluation of all the facts surrounding changes in price.

There have been a number of complaints charging that individuals or firms have manipulated prices in violation of the Commodity Exchange Act. Some of these have resulted in what, in effect, are consent judgments. Others have resulted in decisions by the Secretary adverse to the respondent, and some of these have been the subject of court decisions. In our opinion, before the committee considers the effect of sections 16, 17 and 27 of H.R. 11930, the Department should be required to specify those instances when and where cease-and-desist orders would have been issued or injunctions including temporary restraining orders would have been requested had the provisions of the pending proposal been in effect.

They should be required to state also what irreparable or great damage has been occasioned to the marketing system because of their inability to obtain injunctions in the cases which they have handled and sent the injunctive authority. That observation is prompted, Mr. Chairman, by the fact that the letter transmitting this pending legislation stated the injunctive authority was necessary to prevent great damage. At the hearings 2 weeks ago, the Assistant Secretary, having the advice of counsel, advised the committee that under the Federal rules, and this is correct advice, a temporary restraining order would be granted only if irreparable damage would be caused in the absence of a temporary restraining order.

The question is directed to having them elicit information as to how they would have used this injunctive proceeding earlier had they

possessed the authority, and what in fact damages occurred because they did not have it.

To understand the drastic results of the use by the Secretary of the denial of trading privileges in section 16, of the use of cease-and-desist orders of section 17, and the use of the injunctive authority of section 26, particularly as this last authority would involve the use of a preliminary injunction or mandamus pending final determination of the action brought by the Attorney General, one must keep in mind that persons who trade in futures contracts do not know the person or persons who may be sharing the opposite side of trades. Futures trading accounts are maintained by clearing houses. All a trader in a futures contract knows or cares to know, is that the clearing house of the designated contract market and the designated contract market have enforceable rules and regulations which make his contract or contracts valid and enforceable.

If, during the period when a contract is being traded prior to that day in a delivery month when, by regulation of the Secretary trading must cease, the Secretary were to issue a cease-and-desist order or, on the Secretary's recommendation, the Attorney General were to obtain a temporary restraining order, the trader against whom these orders issued would not be the only person adversely and perhaps erroneously affected. Those persons who had made opposite trades properly registered with the clearing house, would be the unfortunate victims of the Secretary's intervention into the marketplace. We believe that to grant the Secretary the authorities contained in sections 16, 17 and 26, will at least tend to, and probably will, discourage the volume of trading in futures contracts necessary to preserve the Nation's low-cost, efficient grain marketing system.

On August 15, the Commodity Exchange Authority issued a press release describing a report on record corn futures trading. A copy of this is attached. According to the release, the CEA administrator stated that the year 1966-67 was a year of unprecedented trading in the corn market; that the tremendous increase reflected a buildup of commitments that had been in progress during most of 1966 as a result of the large increase in free supplies of corn carried in the market; and that the speculative public held the largest part of the long side of the market and the corn industry's merchants dominated the short side.

During the first 6 months of the 1965-66 corn crop year (October 1, 1965 to September 30, 1966) the Commodity Corporation sold more than 400 million bushels of corn. During this period the grain markets, due to the availability of a fluid futures market in which the public were substantial participators and investors, the hedging requirements of merchants and processors who had purchased this corn were met without any evidence of wide price fluctuations. This constituted an assumption of risk in large measure by speculators in order to aid the Government to dispose of their stocks to carry the cost of carrying these stocks from the Government to the public generally.

It is not without significance, in this connection, that late in December 1965, the Department of Agriculture stated that supplies of corn from the 1965-66 (October 1, 1965 to September 30, 1966) would be adequate to fill all needs, and that shortly thereafter, in early January,

to fill what must have been unexpected needs, the Department embarked on a broad and expanding program of daily sales of corn.

No Secretary of Agriculture, no Commodity Exchange Administrator, no Commodity Exchange Commission can, in advance, form an estimate on price behavior in the market, whether in fact anyone or any group is manipulating or attempting to manipulate the market price. Price is based on estimates of supply, production, consumption, and carryover.

Within the past 12 months, in the brief period between November 1966 and May 1967, the Department's estimates as to these factors regarding corn show palpable miscalculations, particularly as to carryover stocks of corn as of October 1, 1967.

The November 1966 feed situation report estimated the carryover as of October 1, 1967, at 500 million bushels.

In February 1967, based on January indications, the feed situation report estimated the October 1, 1967, carryover to be 450 million bushels, a reduction of 50 million bushels from the November estimate.

In May 1967, a short 90 days later, the feed situation report estimated the carryover of corn on October 1, 1967, to be 700 million bushels. This is 200 million bushels above the Department's November estimate, and 250 million bushels above the Department's February estimate.

Estimates within the trade now indicate an October 1, 1967 carryover of corn between 800 and 850 million bushels.

It seems at least reasonable to suggest that estimates available to the Department on production, utilization, and carryover do not afford an opportunity for the Secretary of Agriculture to have valid reason to believe or determine that anyone is manipulating or attempting to manipulate a market price, that on August 9, in order that the Department might improve its statistical information, a meeting was held to explore ways and means by which this might be done.

In passing, it should be noted that according to news reports based on the report described in the attached enclosure from the Commodity Exchange Authority, the speculating public, who participated so generously in assuming the risks inherent in ownership of corn bought from the Government, appear to have suffered losses, and not the Government, whose estimates of carryover stocks contributed in part, at least, to the Government's initial decision to make substantial sales of its stocks.

It is our judgment that speculators, merchants, and processors would tend to shy away from the use of futures markets if at any time during the period for trading in any commodity for any contract month the Secretary of Agriculture might attempt to obtain an injunction to prevent trading, or attempt to have issued a cease-and-desist order when certain facts "appeared" to the Secretary to exist, or when, in the Secretary's judgment, any person was manipulating or attempting to manipulate market prices.

We feel certain that the unanticipated liquidation of Government corn, commencing in January 1966 and continuing for some months thereafter, would have resulted in precipitous price changes had there not been a fluid futures market to absorb the hedging requirements of these sales. The sales were unanticipated in view of the fact that on December 17, 1965, the Department had stated that the 1965-66 corn requirement could be met largely out of the 1965 crop, with only

limited amounts expected to be made available out of CCC-owned stocks. Less than a month later corn sales were expanded in a limited way and within 2 weeks thereafter were expanded to sales in almost unlimited amounts.

These decision changes, at least to a degree, point up the dangers of granting to the Secretary of Agriculture authority to initiate drastic action when he has reason to believe that something may occur, or whenever it appears to him that something is happening to available supplies, to probable demand, or to prices.

We recommend against the enactment of sections 15, 16, 17, and 26 as they appear in H.R. 11930.

We endorse the recommendation of the Kansas City Board of Trade that section 27, providing for a new section 13(a) of the Commodity Exchange Act, if it is to become part of the act, should be changed to read:

Any person who willfully commits, aids, abets, counsels, commands, induces, or procures the commission of a violation of any of the provisions of this Act. * * *

We wish to express the concern of some of our exchange members and other members with section 19 of H.R. 11930. This section would amend section 8 of the Commodity Exchange Act having to do with the investigatory authority of the Secretary and his discretion to make information available.

As originally drafted and enacted, section 8 precluded the publication of information which would disclose business transactions of any persons and trade secrets and names of customers. As originally enacted, the Secretary might publish results of investigations and statistical information, such as is done periodically, and was done last month in connection with the volume of futures trading in corn.

In 1947, under circumstances which often lead to unfortunate legislative results the Secretary, as a result of an amendment to the act, was authorized to disclose names and addresses of traders and to furnish these when requested to any committee of either House of Congress. No hearings were ever held on this proposal and, fortunately, this authority has seldom been used.

Section 19 would grant discretionary authority to the Secretary to furnish, at his discretion, any information in the Department's possession which had been obtained in connection with the administration of the Commodity Exchange Act, to other departments of the Government. Thus would appear to be, and possibly is, a substantial invasion of privacy, and obviously is a substantial amendment to section 8 as it was originally enacted.

We recommend that, before this is approved by this committee, the need for this substantial amendment be completely justified. In our judgment, as of now this justification is lacking.

We hope that the committee, in considering the many proposed amendments to the Commodity Exchange Act as they are contained in H.R. 11930, will keep in mind the necessity for the justification of their enactment by proponents of these amendments.

To justify their enactment the proponents, in our judgment, have the burden of demonstrating that futures trading in regulated commodities will not be hampered; that futures trading in these commodities will be encouraged; that the proposed amendments will close gaps or holes in the regulatory scheme which need to be elim-

inated. This, Mr. Chairman, we know is the framework within which this committee has operated in the past. We believe that it is the framework within which the many proposals of H.R. 11930 will be considered.

(The attachment to Mr. Brooks' statement follows:)

UNITED STATES DEPARTMENT OF AGRICULTURE,
Washington, August 15, 1967.

CEA REPORTS ON RECORD CORN FUTURES MARKET

The U.S. Department of Agriculture today issued a report by the Commodity Exchange Authority on the largest corn futures market on record in the winter of 1966-67.

The report focuses on developments in the corn futures market on the Chicago Board of Trade in 1966 and the early part of 1967. Open contracts expanded to an alltime record level of 423.5 million bushels at the end of November 1966, and marked the peak of a steadily growing corn futures market over a period of several years.

Alex C. Caldwell, CEA Administrator, said it was a year of unprecedented trading in the corn market, and the tremendous increase reflected a buildup of commitments that had been in progress during most of 1966. This was the result of the large increase in "free" supplies of corn that were carried in the market. The speculative public held the largest part of the long side of the market, and the corn industry hedgers dominated the short side.

The report includes the results of a marketwide survey of the corn market at the end of January, when open contracts were still at high levels. The survey showed 13,224 accounts in the corn futures market on January 27, 1967—more than in any previous CEA survey in any commodity. The 89 percent of the accounts classified as speculative held 66 percent of the long and 38 percent of the short open contracts. The balance of the open positions, 34 percent of the long and 62 percent of the short, were held by the 11 percent of the accounts that were classified as hedging.

Requests for single copies of the report, "Trading in Corn Futures, September 1966—March 1967" should be addressed to the Commodity Exchange Authority, U.S. Department of Agriculture, Washington, D.C. 20250. Please include your zipcode.

Mr. GATHINGS. Thank you so much, Mr. Brooks.

Mr. BROOKS. Thank you, Mr. Chairman.

Mr. ZWACH. Mr. Chairman, I should just say that there are a number of things in here that, in a way, I would like to question but I think we ought to be going to vote.

Mr. GATHINGS. Will you be available, Mr. Brooks, in 15 to 20 minutes? There is a roll call in the House.

Mr. BROOKS. Yes, sir.

Mr. GATHINGS. It will take us just about 15 to 20 minutes before we get back.

(Recess.)

Mr. GATHINGS. Mr. Brooks, Mr. Zwach wanted to ask you some questions.

Mr. ZWACH. Mr. Brooks, I am convinced that you are very knowledgeable in this field. I am a producer of grains and livestock, so I am interested. I have heard of your association a number of times, the National Grain Trade Council. Could you tell us exactly who is represented in this council?

Mr. BROOKS. This is a trade association of other organizations, the other organizations being organized grain exchanges and other national associations interested—in handling grain, whose members handle grain; exporters, terminal elevator operators, cash markets,

and the Minneapolis Grain Exchange, New York Barterers' Exchange Memphis Board of Trade, which are futures markets.

Mr. ZWACH. This does not include any cooperatives?

Mr. BROOKS. Not directly. Our policymaking members are organizations. Cooperatives are members of the Export Association, Terminal Elevator Association, and various markets, cash markets, and futures markets.

Mr. ZWACH. According to your best judgment, how have the wrong estimates of supplies affected the producer, and your group, too? I read what you said concerning your group. Our producers are very concerned about these wrong estimates. How could they be corrected?

Mr. BROOKS. Well, that was the point of this statement.

Mr. ZWACH. Or would it be best to eliminate them completely?

Mr. BROOKS. I don't think you can eliminate them, nor do I think it would be wise to eliminate them. Your Department of Agriculture over the years has built up a good record on these estimates. They are regarded as quite accurate. They differ, the results differ with the estimates made by individuals who use techniques not unlike the Department of Agriculture, attempting to get some idea of potential production, consumption, and an estimate of the carry-over. The hope is, on the basis of this August 9 meeting, or whenever it was, some techniques can be developed so that perhaps they would reflect changed technologies and other things which will give you a better crop outlook, better production outlook.

Mr. ZWACH. Does the trade sort of balance off its own estimates with the Department in arriving at decisions, your groups have their own estimates?

Mr. BROOKS. Companies have their own people who make estimates, yes. They use techniques not unlike the Department uses, as I understand them.

Mr. ZWACH. Our people feel very strongly—you spoke of the 400 million bushels of corn that were thrown onto the market in 1965, and the early fall and the whole spring of 1965—and they felt that this was disastrous. How did that affect your business?

Mr. BROOKS. This corn was bought by people in the grain marketing system, some was bought, I suppose, by feeders like yourself, maybe directly from the Government, and some was bought by perhaps people who had use for it at a local level. Most of it was bought by processors, elevator operators, and others who were able to hedge it in the futures markets. They took a position because the futures market afforded them an opportunity for an immediate sale or purchase, depending on what their forward commitments were or what they hoped them to be. These are the free supplies that the CEA reported as unusually large to explain the large volume of futures trading in corn during the year they reported on.

Mr. ZWACH. What is your exact reaction to the injunction? I was not here for all of your testimony.

Mr. BROOKS. We are opposed to the grant of authority to give the Secretary injunctive authority, cease and desist orders, and to grant him authority to request the Attorney General to obtain injunctions, including, as it does necessarily, restraining orders.

Now, during the hearings a week or 10 days ago, on advice of counsel the Assistant Secretary, referring to the Federal Rules of Civil Pro-

cedure, suggested that only when irreparable damage would be done would they get a temporary restraining order absent the notice to the other side. In the letter of transmittal they said they needed this authority to prevent great injury. I noted in the statement which is filed for the record by the gentleman for the Securities and Exchange Commission, that he talks about their authority to get this, but they don't go to the Attorney General; they do it directly. They can get one, as I read his statement, in spite of the Federal rules or maybe because the Federal rules have changed and they would have a different criterion, on not too substantial a showing. But to compare the authority to intervene in a securities transaction with the authority to intervene in a futures transaction on the commodity markets is an error. Mr. Martin pointed this out in one way this morning and I pointed it out in a little different way in my statement because in a securities transaction you definitely own something or you are trying to own something, you are trying to dump something. In the futures transaction you have an agreement, you don't care who is on the other side, you have an agreement which is going to be enforced by the rules of the contract market and its clearinghouse.

To intervene in this market place at any time is to upset not only the fellow against whom you are intervening but upset the people who have a similar position to him, unknown to him and unknown to them, and people on the other side of the transaction whose obligations are going to be enforced, they know, by the contract market and its clearinghouse.

Mr. ZWACH. Nothing further, Mr. Chairman.

Mr. GATHINGS. Mr. Dole.

Mr. DOLE. No questions. I was intrigued this morning by the statement of Mr. Martin, talking about the Department's selling activities. He did not suggest it but perhaps we should provide injunctive relief against a Secretary who manipulates the market.

I do not expect the witness to comment on that. Thank you.

Mr. BROOKS. Thank you.

Mr. GATHINGS. Thank you so much, Mr. Brooks.

Mr. George Wilkens, executive vice president of the Minneapolis Grain Exchange, is next. We are glad to have you, Mr. Wilkens.

Mr. ZWACH. Mr. Chairman, I would just like to say that this gentleman is a Minnesotan and is well known in this whole area of marketing.

Mr. GATHINGS. Thank you.

STATEMENT OF GEORGE WILKENS, EXECUTIVE VICE PRESIDENT, MINNEAPOLIS GRAIN EXCHANGE

Mr. WILKENS. Mr. Chairman, Congressman Zwach, Congressman Dole, in the interest of time it is my suggestion that this statement of mine be made a part of the record and that I be permitted for emphasis to comment extemporaneously on five issues.

Mr. GATHINGS. Mighty fine. Without objection, your statement will be made a part of the record at this point.

(Mr. Wilkens' statement follows.)

STATEMENT OF GEORGE WILKENS, EXECUTIVE VICE PRESIDENT, MINNEAPOLIS GRAIN EXCHANGE

My name is George Wilkens. I serve as Executive Vice President at the Minneapolis Grain Exchange.

The Minneapolis Grain Exchange, incorporated under Minnesota law, has operated a public grain market in the City of Minneapolis since October, 1881. There are 409 members and the affairs of the Association are governed by a fifteen-man Board of Directors, including representation from all phases of the industry.

Over a period of years, the Minneapolis Grain Exchange has considered with other Exchanges, and with the Commodity Exchange Authority, certain changes in the Commodity Exchange Act.

At a meeting with Commodity Exchange Authority officials in April, 1967, it was thought certain amendments proposed by them could be accepted by some of the Exchanges.

This new Bill, H.R. 11930, represents most of the issues discussed and includes as well, other amendments desired by Commodity Exchange Authority.

Section by Section, I would like to comment on H.R. 11930.

Page 1, line 8: It is our recommendation the words COFFEE and SUGAR be stricken from the Bill. These markets are world markets and both of these commodities are produced in large volume outside the United States. It is our judgment any trading restrictions proposed by Commodity Exchange Authority, now or in the future, for these commodities, would encourage traders to go to the London market. New York markets, in all probability, would be eliminated by adoption of this amendment. Therefore, it would be a serious mistake to extend the Act to include coffee and sugar.

Page 2, lines 6 to 8 should be stricken. It is anticipated the staff in the Attorney General's office, in the Secretary of Agriculture's office and in the Secretary of Commerce's office will conduct the investigation, but when the final issue is put to vote, these three Cabinet Officers should be called upon to render the decision. It is so ordered in the present Act and we believe it should not be amended.

Page 7 of the proposed Bill (Section 4f of the Act) more clearly defines financial requirements of futures commission merchants. We agree changes are necessary, but lines 7, 8 and 9 on page 7 should be stricken from H.R. 11930. It is not necessary to have financial standards written into the rules and regulations of Exchanges. Existing arrangements give control to the Finance Committee at each Exchange, and has functioned satisfactorily for more than 100 years. Their operating policy in all these years has not been in writing.

Small businesses require a lesser amount of capital. A very large business requires a very large amount of capital.

If the Department's proposal remains in the Act, it will be yet another obstacle for the "little businessman." Trading privileges have been granted to small firms with less than \$100,000 of operating capital. If the Minneapolis Exchange was forced to write a rule, a minimum figure of \$100,000, or perhaps more, might be written into the official regulations of the Association. It would serve no useful purpose, but would hurt the little man.

Page 11, lines 8 and 9: In line 8, place a period after the word "market." Strike out the balance of the sentence.

On page 13, line 17, strike the words, "by substantial evidence" and substitute the words, "weight of evidence."

On page 14, lines 2 and 3: The words are repeated, "or attempting to manipulate." Eliminate both phrases, one on line 2, and one on line 3.

It should be adequate and serve the Secretary's purpose when the Act reads, "If the Secretary has reason to believe that any person is manipulating or has manipulated the market price of any commodity." The addition of the words, "or attempting to manipulate" can be considered superfluous.

On page 15, lines 9 through 12: Here again, the Department proposes to substitute "substantial evidence" for "weight of evidence." It is important to the Exchanges that "weight of evidence" be retained.

Page 15, lines 17 and 18: Again, included the words, "or attempting to manipulate." This phrase should be removed on both lines 17 and 18.

On page 22, line 6: We again find the words, "or attempt to manipulate." They should be stricken. On line 9, page 22, strike the words, "or attempt to corner."

On page 23, it is our suggestion to insert the phrase, "and after hearing," immediately after the word "showing" on line 14.

It is our hope the Committee and the Department of Agriculture can accept these changes offered by the Minneapolis Grain Exchange.

On behalf of the Board of Directors of the Minneapolis Grain Exchange, may I express appreciation for the opportunity to be heard on these important matters.

Mr. GATHINGS. You may proceed as you like.

Mr. WILKENS. I would like to endorse the remarks made by the Coffee and Sugar Exchange representatives this morning when they proposed that two words in line 8 be stricken, the two words being "coffee" and "sugar."

In a world where trade and commerce is going to be expanded and where more sophisticated communications equipment is available, I think that the arguments these men have put forth are valid and I think it would be a mistake to put any hindrances into the continuation of trading of these commodities in their exchanges in New York City. I think it would require very little to encourage trading to be placed in the London markets rather than in these markets. Therefore, I think it would be a mistake to include them in the act.

The second issue I want to remark on briefly for emphasis is to retain the present Commission that is now used to make final review of cases and complaints that may be filed.

I think it would be a mistake to place this as a responsibility of employees in the Department rather than the Commission.

Mr. GATHINGS. Just at this point, Mr. Wilkens, did I understand you to say that you favored striking all of the commodities that are set out on page 1, line 8?

Mr. WILKENS. Just two words: "coffee" and "sugar."

Mr. GATHINGS. Very well.

Mr. WILKENS. The third point I would like to mention for emphasis is financial requirements. Certainly, the exchanges have many more reasons to be interested in the financial responsibility of people who may be applying as commission futures brokers. I think it is proper that the exchange shoulder this responsibility and I think we have done it in our market and the other markets have done it, as well. If an individual makes application and is not a member of a contract market I think it perfectly proper that the Department write such requirements as it thinks are necessary. I would hesitate to have these requirements written into the rules of the market because I think it might work to the advantage of the small firm seeking to start business. Therefore, I would prefer to see these financial requirements be handled by the individual markets and, if CEA believes they are not satisfactory, I wish they would come to the exchanges and cite the reasons why they think they should be raised or why they think we are currently not requiring enough financial backing of a particular member registered as a contract market.

The fourth point, the weight of the evidence, we think should be retained in the act as it is written. You have heard lots of debate about this. I will not enlarge further.

I am not impressed by the long list of other departments which were cited in a statement presented to this committee earlier. There are important differences between commodity exchanges and other departments of government, and this ought to be recognized.

The last and final point I want to mention for emphasis is the power of injunction. We cannot overemphasize the important differences between commodity contracts and contracts in the securities exchanges. It isn't just the accused that might be damaged, it might be a whole group of industry people, innocent people who could be damaged if the injunction were in error.

There must be an opportunity offered for the accused to defend and argue his case before this proceeding is taken. That is why we feel the power of injunction authority should not be granted. Instead, this should be left with the organized exchanges, and I think a liaison

can be established between CEA and the markets to bring about the necessary surveying in this area to prevent market manipulation.

All of the evidence and all of the remarks about market manipulation and cornering would suggest that the exchanges condone this sort of thing, and yet I think you will find every board of directors of these institutions is opposed to this. It is written in their rules, and we are just as concerned about preventing manipulation and cornering of markets as is CEA, perhaps more so.

So if there is any time when the CEA feels that there is a corner or manipulation taking place, we think they ought to come to the organized markets and I think these organized markets will be responsive to the CEA's request. I think this is a much better way to handle this situation.

I feel very strongly these organized exchanges, which are legal institutions operated by responsible people, are more likely to serve and protect the public's interest, and that is the way I would like to see it remain: put the responsibility of the men responsible for running the organized markets and let it rest there. If the Department feels that these organized exchanges and boards of directors are not meeting their responsibilities I think they can come and reason with them and get them to change their ways to the point so that the public interest will be protected. We are interested, in Minneapolis, in protecting the public interest, and if CEA at any time feels they have ways we could improve our procedures we would be pleased to hear from them.

In general, at Minneapolis we support adoption of this bill with the changes that have been noted here and has have been voiced by the other organized exchanges, particularly as to financial requirements. We think the present situation of registering anyone who comes, regardless of financial responsibility, is not a good situation and there ought to be minimum rules written to govern these things.

Unless there are questions, Mr. Chairman, that is the extent of my remarks to your committee.

Mr. GATHINGS. Thank you, Mr. Wilkens. Are there any questions of Mr. Wilkens?

Thank you very much for your statement.

Mr. GATHINGS. Mr. Roy F. Hendrickson, National Federation of Grain Cooperatives, it's a pleasure to have you with us.

**STATEMENT OF ROY F. HENDRICKSON, EXECUTIVE SECRETARY,
NATIONAL FEDERATION OF GRAIN COOPERATIVES, WASH-
INGTON, D.C.**

Mr. HENDRICKSON. My name, Mr. Chairman, is Roy F. Hendrickson, executive secretary of the National Federation of Grain Cooperatives, Washington, D.C.

I am appearing here in connection with H.R. 11930, a bill introduced by the chairman to amend the Commodity Exchange Act.

The association I represent consists of 26 regional grain marketing cooperative associations owned by more than 2,700 local grain marketing cooperative associations. These serve their farmer-owners in all of the principal grain and oilseed-producing areas of the Nation.

These regional or federated marketing associations hedge commodities to reduce inventory risks and to facilitate the sale of grain and oilseeds for their farmer members. In areas where hedging facilities are not available, risks are larger and marketing costs higher.

Cooperatives and their farmer members need liquid markets where grain can be bought and sold in large or small volume quickly and efficiently at the lowest possible risk and at low cost.

Cooperative associations do not solicit the business of the general public, such as persons engaged in speculative buying or selling. We have no interest whatever in earning commissions from the business of speculators.

Grain cooperatives were active in urging passage of the Commodity Exchange Act in 1936 and of the Grain Futures Act of 1922.

We value greatly this act which finally ended many decades of antiooperative discrimination under which farm cooperatives were denied seats on grain exchanges.

We respect the excellent and responsible work carried on in administering the act by the Commodity Exchange Authority of the U.S. Department of Agriculture. There has been a large and growing volume of futures trade. There are some 17 million transactions yearly involving \$75 billion.

I am informed that the volume of complaints is small. The number of administrative cases, 146 since 1936, where action was taken by CEA is evidence that the volume of offenses is not large. The number of cases since 1936 which have gone to the courts is only 15. In all but three cases, CEA's position was sustained, which is an excellent record.

I have appeared on a number of occasions before this and other committees in opposition to amendments that proposed to vest in the Secretary of Agriculture authority to fix margins. Here is a clear instance where the responsibility should rest with the exchanges.

We are glad to see that the amendments here proposed do not request this authority for the Secretary of Agriculture. We urge that the legislative record be clear that Congress is not conferring authority to fix margins directly or indirectly on any agency of Government.

In the operation of the exchanges, wherever it is possible we believe in the exercise of self-regulation by the exchanges. Their record in this respect is good, has improved steadily over the years. CEA deserves some of the credit for that good record.

From time to time there are abuses which are beyond the control of the exchanges. This is an area that is separate and distinct from the province of the exchanges best dealt with by them. In these cases there should be sound, responsible regulatory work to protect that small portion of the public which is bamboozled or cheated or short of sales resistance when subjected to the wiles of confidence men. I do not believe it is a very large problem.

To make CEA action possible in this nonexchange area, amendments to the act appear to be needed to deal with abuses by so-called bucket shops and markets churners.

The proposed injunctive power, if it is conferred, should be limited to cases of this kind which cannot be dealt with by the exchanges or members subject to their discipline.

Extension of the act to all farm commodities traded on futures markets was requested by USDA. In my view this would not destroy

the capacity or incentive for self-regulation on the part of the exchanges. I see no reason to view CEA as an ogre. In the case of coffee and sugar, I am unaware of any demand on the part of producers anywhere for legislation, including very large numbers of sugar producers in this country who are organized cooperatively, and I have heard no case made here to the effect that the exchanges are lax.

When regulatory officials—sober, sincere, and dedicated to their work as I have always found those of the Commodity Exchange Authority to be—urge and justify the need for changes sought in this bill to deal with matters beyond the control of the organized markets, their proposals deserve serious consideration, and I congratulate this committee for giving very careful consideration to the whole matter. I have heard no testimony here which leads me to believe that any of the proposed amendments is urgently needed so far as the markets are concerned.

What should be the role of the Commodity Exchange Commission? A year ago the USDA proposed that this Commission, consisting of the Secretaries of Agriculture and Commerce and the Attorney General, be abolished.

It was unclear then as to whether the principal reason was because there had been only one or two occasions for a meeting of the Commission in 30 years or if the chief reason for eliminating the Commission was the difficulty of getting the busy members into a meeting at one place at one time. The reasons given were not impressive. The main thought appeared to be to vest all authority in the Secretary of Agriculture.

We objected then, believing rather that the role of the three-member Commission should be enlarged. I am glad to see that the proposed legislation would retain this Commission.

However, it is proposed that each member be authorized to designate "an official or employee" of his Department to act in his stead. This could result in the designation of nonpolicymaking officials. This would prove to be a mistake, as I have noticed it always becomes a mistake.

I urge that delegation be authorized but limited to the designation of Department officials appointed by the President with the advice and consent of the Senate. This would mean, in the case of the Departments of Agriculture and Commerce, officials with the rank of Under Secretary or Assistant Secretary, or the equivalent in the Department of Justice.

I further urge that any new powers of consequence approved by this committee and Congress be vested in the Commission. This would be in the tradition of vesting authority in Commissions as in the case of the Securities and Exchange Commission, the Federal Trade Commission, and others. This would provide protection from individual officials who might in some future days have overshot fuses.

The Commodity Exchange Act at present vests in 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 con-

tract market, and notice that in view of this type of responsibility it is noteworthy in a period of some 30 years there have been only one or two meetings of the Commission.

A year ago the bill presented for discussion proposed authority for the Secretary of Agriculture to prescribe trading rules for contract markets. This has been eliminated from the bill before you.

It proposed that the Secretary of Agriculture be given authority to disapprove trading rules when he finds such rules violate or will violate provisions of the act or the rules, regulations, or orders of the Secretary or of the Commission.

Here is an instance where, should the need for such an amendment be found to exist, which I doubt, it would be desirable to vest the authority in the Commission.

Finally, I recommend that the amendments proposing changes that would include terms such as "attempting to manipulate" and "substantial evidence" be rejected until a far clearer case supporting the need for such changes be made here.

Thank you very much, Mr. Chairman.

Mr. GATHINGS. Thank you, Mr. Hendrickson.

We have one more witness, Mr. Harold Bryant.

Mr. ZWACH. Mr. Chairman, I would just like to commend Mr. Hendrickson for I think a clear and concise and knowledgeable statement on these matters. He really represents down here a great many of my constituents.

Thank you.

Mr. HENDRICKSON. They are very fine constituents.

Mr. ZWACH. Thank you.

Mr. GATHINGS. Our next witness is Mr. Harold Bryant of the Maine Potato Council.

You may proceed as you wish, Mr. Bryant.

**STATEMENT OF HAROLD BRYANT, VICE PRESIDENT, MAINE
POTATO COUNCIL, PRESQUE ISLE, MAINE, ACCOMPANIED BY
STUART SMITH, PRESIDENT, MAINE POTATO COUNCIL, EXETER,
MAINE**

Mr. BRYANT. My name is Harold E. Bryant. I am executive vice president of the Maine Potato Council, with headquarters in Presque Isle, Maine. The Maine Potato Council is a trade association having as members all 2,000 potato growers in the State of Maine.

Maine potatoes have been traded on the New York Mercantile Exchange for many years. The volume of trading on Maine potatoes alone has now reached some very outstanding figures. In recent years futures trading on Maine potatoes alone has amounted to between 600,000 to 700,000 cars annually, with a dollar volume of over \$1.5 billion. Futures trading of Maine potatoes, therefore, becomes an extremely important and significant development in the marketing of our potato crop.

From observation we know that there have been cases in the past when undesirable and possibly unethical activities were being carried on but which might take months and even years for correction under the present authority and regulations of CEA.

As we understand it, at present CEA does not have injunctive powers that are enjoyed by other regulatory bodies such as the Security

Exchange Commission. With the tremendous volume of futures trading, not only on Maine potatoes but on all commodities, we believe that the Commodity Exchange Authority should have the same strength and regulatory powers that is enjoyed by other commissions.

We further understand that no significant changes have been made in the Commodity Exchange Act in the last 30 years. Certainly with changes that take place over a period of 30 years and with the tremendous increase in volume, it is time for this Act to be reviewed and strengthened.

Those of us connected with the potato industry have the highest regard for the personnel in the Commodity Exchange Authority and believe they will give proper protection and representation to producers and receivers alike if they have the proper administrative authority.

In behalf of the Maine potato industry, we urge this committee to vigorously support H.R. 11930. We particularly emphasize the need for injunctive authority so that when improper action is observed, the Commodity Exchange Authority will be able to present facts to the Department of Justice and the courts to obtain injunctive relief.

We thank the committee for this opportunity to appear before you.

Mr. Chairman, the president of our organization was here 2 weeks ago to present testimony and, with your permission, I have his written statement and I would like to submit it for the record.

Mr. GATHINGS. It will go in the record as part of your statement, Mr. Bryant. Without objection.

Mr. BRYANT. Thank you.

(The statement follows:)

STATEMENT OF STEWART SMITH, POTATO GROWER, EXETER, MAINE

My name is Stewart Smith. I am a potato grower raising 200 acres of potatoes in Exeter, Maine. In addition to my growing operations I am currently the president of the Maine Potato Council, which is a trade association having as members all 2,000 potato growers in the State of Maine.

Futures trading in potatoes has been the subject of a great deal of interest and concern on the part of the Maine potato producers. While the legislation being considered here today relates to trading in all agricultural commodities, the Maine Potato Council feels that its effect on potatoes will be to make that market more useful in the hedging and marketing of our product.

We believe that the history of the potato futures market, and I assume other markets, will show instances where it could have been made more useful by more effective control of episodes which at least for certain periods of time seriously impaired the value to the legitimate users who were attempting to hedge their product.

Particularly, it seems that the inability to bring prompt action when abuses become evident has on a number of occasions seriously weakened the effectiveness of regulation.

As we understand it, the conclusion of administrative action against violators of the law frequently takes long periods of time, always running into months, and sometimes into a number of years. In the case of an activity which moves as fast as a futures market, this means that the abusive action has long since been completed before the procedure which is now available under the Commodity Exchange Act can become effective.

The proposal to give authority for the issuance of injunctions in cases of apparent manipulation would seem to be highly desirable, particularly as it has been used effectively by other regulatory agencies.

Our observation of the history of the enforcement of the Commodity Exchange Act and our understanding of the legal procedure necessary in order to obtain an injunction convinces us that there is no danger of this authority being used in a manner which would in any way handicap legitimate operations.

We have not attempted to evaluate precisely all the provisions in the proposed amendments. However, it would seem that requiring adequate financial resources, imposing severe penalties on those committing serious violations, and permitting the issuance of cease and desist orders in lieu of more drastic penalties would all tend toward making the markets more orderly and more dependable in facilitating the handling of potatoes, as well as the other products in which there is futures trading.

We are hopeful that this legislation will be enacted and believe that it may well result in a broader acceptance of the markets and less criticisms arising from occasional abuses, some of which have obviously been most serious.

We wish to thank the committee for this opportunity to appear before you.

Mr. GATHINGS. What year was it that potatoes were brought under the authority of the CEA? It has not been too many years ago, has it?

Mr. BRYANT. Yes. I believe but I am not sure, I think it has been under the authority of CEA ever since they started trading. I may be wrong.

Mr. GATHINGS. I was under the opinion that authority was granted just a few years ago.

Mr. BRYANT. I may be wrong, but I think they have always been under CEA.

Mr. GATHINGS. Thank you so much, Mr. Bryant.

Without objection, the statement of Philip A. Loomis, Jr., General Counsel for the Securities and Exchange Commission, will be made a part of the record at this point.

(The statement referred to above and in addition a statement from the National Livestock Feeders Association and letters from the National Cotton Council of America and the Secretary of Agriculture follow:)

STATEMENT OF PHILIP A. LOOMIS, JR., GENERAL COUNSEL OF THE SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman, I am Philip A. Loomis, Jr., General Counsel of the Securities and Exchange Commission.

I am here to testify with respect to certain aspects of H.R. 11930, 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 the enforcement powers of the Department of Agriculture with respect to commodity markets and commodity brokers and dealers.

I should like to explain at the outset why I am here. The Securities and Exchange Commission has no jurisdiction or responsibility with respect to the Commodity Exchange Act or the commodities market and our understanding of those markets is limited. On the other hand, we do have an interest in this legislation. This arises from the fact that many firms registered with us as securities brokers or dealers also act as commodities brokers or dealers. If such firms get into difficulties, particularly financial difficulties, as a result of their commodities activities, this may well have an adverse impact on their securities business and could result in injury or loss to their securities customers. Furthermore, a number of the amendments to the Commodity Exchange Act proposed to be made by the bill closely parallel provisions of the Securities Exchange Act, and we felt that perhaps testimony concerning our experience with such provisions might be of some assistance to the Committee in its consideration of the bill.

Before turning to these provisions, I have one more preliminary observation. We, of course, do not claim any particular experience or familiarity with the commodities market and we know that these markets operate in a way which is in many respects quite different from the securities market. For these and other reasons, regulation in the commodities market may call for different provisions and for somewhat different objectives than those of securities regulation. There is, however, one aspect in which it seems to me the regulatory purposes may be quite parallel. The Securities Exchange Act, among other things, seeks to prevent manipulation and fraud in the securities markets and to regulate brokers and dealers in those markets for the purpose of protecting their public customers. I would think that regulation in the commodities market may well share these objectives.

It has been suggested that I confine this statement largely to three provisions of the bill. These are Section 7, which would amend Section 4(f) of the Commodity Exchange Act to authorize the Secretary of Agriculture to prescribe minimum financial requirements for commission merchants, subject to an exemption for members of contract markets having adequate financial standards. The second is Section 26 of the bill which would add to Section 9 of the Commodity Exchange Act a provision authorizing the Secretary of Agriculture to notify the Attorney General of violations of the Act or the rules thereof and authorizing the Attorney General to bring an action in the proper United States court seeking an injunction or other appropriate relief. The third is Section 27 of the bill which would add a new Section 13(a), making a person who willfully aids, abets, induces, or procures the commission of a violation responsible as a principal in administrative proceedings under the Act. All of these provisions very closely resemble certain provisions of the Securities Exchange Act of 1934.

Section 15(c)(3) of the Securities Exchange Act, which was added by amendment in 1938, authorizes the Commission to prescribe rules in order to provide safeguards with respect to the financial responsibility of brokers and dealers. Unlike Section 7 of the bill, this statute does not expressly exempt members of exchanges having adequate rules with respect to financial responsibility but the Commission has provided such exemptions in its rules. The Commission has exercised that authority by requiring that the current assets of a securities broker or dealer exceed his current liabilities by a specified percentage, and that in most instances he maintain a minimum net capital of not less than \$5,000. The rule goes on to define the terms utilized and to prescribe methods for calculating assets, liabilities, and net worth.

We believe that this rule provides 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, who must rely on their financial responsibilities to fulfill their contracts. It has been our experience that the financial community in general supports and welcomes these rules. Indeed, the National Association of Securities Dealers provides us with valuable assistance in enforcing them. The United States 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 21(e) of the Securities Exchange Act, as well as comparable sections in the other securities laws, authorizes the Commission to seek injunctions or other appropriate relief against violations. Proposed Section 9(a) of the Commodity Exchange Act very closely follows Section 21(e) of the Exchange Act, except that, since the Commission is an independent agency, it brings civil actions itself instead of referring the matter to the Attorney General.

We have found this provision to be an important—indeed, I believe it is an essential—means of enforcement. There are two principal reasons: In the first place, it enables us to move rapidly when speed is necessary for the protection of the public. An administrative proceeding or a criminal prosecution necessarily takes considerable time before the final order can be issued or a conviction obtained. Particularly, in the fast-moving marketplaces a good deal of damage can be done before such proceedings can be completed. This is particularly true if a manipulation or a fraud is in the process of being perpetrated or if a broker-dealer is in financial difficulties or is insolvent. A federal court, on the other hand, has power, if a satisfactory showing both as to the merits of the case and the need for immediate relief is made to it, to enter a temporary restraining order or a preliminary injunction which puts an immediate stop to the violation. Law enforcement agencies, not excluding our Commission, are on occasion accused of locking the barn door after the horse has been stolen. The power to seek injunctions in appropriate cases may well be necessary to avoid this.

Another advantage of the injunctive remedy is that it is available in situations when neither a broker-dealer nor an exchange, who are subject to administrative proceedings, is involved and where either the necessary proof of criminal intent is not available or criminal prosecution is for any other reason inappropriate. Without the power to seek an injunction, the law enforcement agency may have no other remedy. Since 1934, when the Securities and Exchange Commission was created, we have brought 1487 actions to enjoin violations and have obtained 1332 in-

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

junctions. 5097 defendants were involved and injunctions against 3940 were issued. The number of cases per year has averaged in the neighborhood of 40, and excluding 1934, has ranged from a high of 99 in 1962 and 1960 to a low of 18 in 1944.

Section 27 of the bill with respect to aiders and abettors in, in effect, almost the same as a major portion of Section 15(b)(5)(E) of the Securities Exchange Act, which was added by Congress at our request in 1964. Neither the securities exchanges nor the securities industry opposed this provision at that time.

The Criminal Code expressly provides that an aider and abettor may be prosecuted as a principal. We believe that the same principle should apply with respect to disciplinary proceedings before an administrative agency and, as I mentioned, at least with respect to the securities laws Congress has agreed with us.

This concludes my prepared statement. I would be glad to answer any questions which the members of the Committee may have.

STATEMENT OF DON F. MAGDANZ, EXECUTIVE SECRETARY-TREASURER, NATIONAL LIVESTOCK FEEDERS ASSOCIATION

It is considered a privilege for the National Livestock Feeders Association to present views and comments pertaining to the legislation under consideration, which legislation would make some necessary amendments to the Commodity Exchange Act. As a voluntary organization this association consists of members engaged in the business of feeding and finishing livestock (cattle, hogs, and lambs) for the slaughter market, which members have organized themselves in a non-profit and non-political trade association through which they can be represented in their policy determinations.

Livestock feeders have a prominent interest in future's trading on various commodities and the operation of Commodity Exchanges. In particular, these products would include live beef cattle, live hogs, and pork bellies, as well as any other meat animal products. Among the several advantages believed to accrue to producers and processors through future's trading is the opportunity to hedge the cash purchases of live animals thus providing, for those who want to use it, some measure of price insurance.

Though it would be impossible to furnish a firm number, we do know that many of the members of this association are now hedging their purchases when the market on future contracts is at a level permitting them to do so advantageously.

The National Livestock Feeders Association generally supports and endorses the provisions for amending the Commodity Exchange Act as contained in H.R. 11930. It encourages the addition of new commodities to those now covered by the Act; namely, coffee, sugar, livestock and livestock products. The increasing of safeguards for customer funds, the authority to seek injunctions through district courts, and the various other enforcement authority necessary to prevent and discourage violations of the Act are important considerations.

In 1966, we presented comments and arguments relative to H.R. 11788, a bill introduced in the 89th Congress for the same purpose. It was necessary, though, to voice certain disagreements with provisions contained in H.R. 11788 which went beyond what this association felt was necessary to provide additional authority to regulate today's future markets effectively. For the most part, the present legislation has been revised sufficiently to overcome the principal objections we raised at that time. There follows, now, brief comments relative to the several principal changes in the Act which would be accomplished by the amendments contained in H.R. 11930:

Extended Coverage to Other Commodities and Products.

In the official policy adopted by the members early in 1965, this association took the position that necessary legislative changes should be made to extend the coverage of the Commodity Exchange Act to include livestock and meat, as well as the products and by-products derived therefrom. The specific language of "livestock, and livestock products" contained in the bill would seem to completely satisfy this particular recommendation.

Safeguarding Customers Funds

We viewed it as being necessary and highly desirable to provide additional protection for the funds which brokerage firms have as custodial responsibilities. We fully support those provisions which disallow these funds to be treated as the property of any person other than the customer. Also, it is felt there is considerable merit to prohibiting investment of customer funds in "Investment Securities" while still permitting investment in federal, state, or other governmental securities.

Cease and Desist Orders

This Association agrees with the use of cease and desist orders where violations are less serious, and the invoking of more severe penalties if said person is found at some later date to have violated the order, or commits a serious offense such as embezzlement, manipulation or willful dissemination of false information. It appears as though this is a much more desirable method for handling relatively minor violations in the first instance, but the use of such orders should be confined to violations that are of a less serious nature.

Injunctive Procedure and Authority

The members of this Association concur in the fact that the present Act is definitely lacking in authority for the regulatory agency to seek action through a District Court to enjoin certain acts and practices that are in violation of the law. It is known that this authority has been given by law to some other regulatory agencies, although there are still others, such as the Packers and Stockyards Administration, which do not have this much needed authority.

Without authority to seek restraining orders, long delays may occur between the time when violations are discovered and they can be stopped. Under the injunctive procedure provided for, which requires satisfying a District Court that a restraining order is necessary, there would seem to be ample protection for the individual against unwarranted action by the agency.

However, in our opinion such procedure should be used and limited to those 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, rules and regulations. It may be that this recommendation is amply considered in paragraph (b) of the new Section 13 which states in effect that the Secretary of Agriculture or the Commission shall not be required to report minor violations for prosecution or institution of proceedings toward a restraining order if it appears that the public interest does not require such action.

Establishment of Financial Responsibility

There is every reason that persons, who are doing business with the public and handling large sums of customers' funds as well as margin money, be required to meet certain reasonable standards of financial responsibility. This can in no way be considered burdensome, and is a reasonable provision in contrast to the privilege in the existing law of being able to do business as a futures commission merchant regardless of financial status.

Application of Penalties

In order to overcome some of the deficiencies and inadequacies in the present law, and to afford the market users and the public the kind of protection to which they are entitled, broader coverage against fraudulent acts and the more effective application of penalties is necessary and appropriate. Also, there is every reason to treat such offenses as embezzlement, manipulation and willful dissemination of false information as felonies.

Those who may frown on the extension of regulatory activities, and the broadening and increasing of certain penalties, need only be reminded that such apply only to those who knowingly or unknowingly operate outside of the law. They in no way affect those persons who are highly ethical and honest in the conduct of their business.

Approval of By-Laws and Rules of Contract Markets

In order that there can be effective regulation, it is meaningful for the Secretary of Agriculture to have authority to disapprove market rules relating to terms of contracts of sale or other trading requirements when he finds that such by-laws or rules violate, or will violate, any provisions of the Act, regulations or orders.

Additional Association Policy

For the information of the Committee, we relate here some further policy of the National Livestock Feeders Association with respect to 'contract markets'. Our membership has declared that,

"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 position:

"(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."

It is not our thought, nor are we suggesting, that the above positions be written into legislation. On the contrary, to do so would, in our opinion, be undue and unjustifiable extension of regulatory authority. We mention them because we feel they warrant careful consideration by not only the commodity exchange officials and commodity brokers, but also by the members of the Congress perhaps in developing legislative history in connection with the pending legislation.

We appreciate the opportunity to make these views and comments available to the Committee as it deliberates on H.R. 11930, and we trust that favorable action will be taken to amend the Commodity Exchange Act.

NATIONAL COTTON COUNCIL OF AMERICA,
Washington, D.C., September 19, 1967.

Representative W. R. POAGE,
Chairman, House Agriculture Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: The National Cotton Council, the overall organization of the raw cotton industry, is vitally interested in making the production, marketing, and processing of cotton as efficient as possible. Under certain market conditions, an active cotton futures exchange is absolutely necessary for the efficient marketing and processing of the cotton crop. If handlers and processors had to assume the price risk under conditions where there could be wide fluctuations in the price of cotton, the margins for marketing the crop as well as processing it would necessarily have to be increased. This could add appreciably to the cost of cotton textiles with competitive losses to synthetic fibers as the result.

If a cotton futures market is to be active and offer the opportunity for merchants and processors to hedge, it must be the kind of market in which traders are being encouraged rather than being discouraged to enter. In our judgment some of the proposed amendments to the Commodity Exchange Act embodied in H.R. 11930 would almost certainly have the effect of discouraging trading in the cotton futures market.

This would not have been too important in the last eight or ten years since the operation of the cotton program virtually eliminated all elements of price risk. The price-support program afforded to the farmer set the price floor and the Commodity Credit Corporation's offer to sell its surplus stocks set the price ceiling at a level only slightly above the price floor.

With the elimination of the surplus in sight and the developing shortage of cotton stapling $1\frac{1}{16}$ inch and longer, we now have a rather active cotton futures market on the number two contract at the New York Cotton Exchange. The reason for this is that the price of these longer staple cottons is well above the floor (the loan) and CCC has virtually no supply so there is no ceiling on the price.

The amendments which we feel would tend to discourage futures trading and seriously impair or even eliminate the usefulness of the futures market are discussed below. We would hope that the Committee would not include them in any bill which it approved.

The first trade discouraging feature is the change in penalty from a misdemeanor to a felony for certain offenses including manipulating the futures market. The current penalty of a \$10,000 fine and imprisonment up to a year or both for manipulating the futures market is a pretty tough penalty. We can see no reason why the penalty should be increased to a felony with imprisonment up to five

years. We were not aware that instances of manipulation were such as to warrant such an increase in the penalty in order to discourage it.

Another change which concerns us in H.R. 11930 deals with the rule of evidence in an appeal from a decision of the Secretary of Agriculture. Under the proposed change the Court of Appeals would be required to accept the findings of fact of the Secretary if supported by "substantial evidence on the record considered as a whole" instead of "the weight of the evidence." We can see no reason for changing this part of the law. It certainly is reasonable to require that the findings of fact be supported by the weight of evidence.

Finally, we believe that the authority which is sought to obtain injunctive power as a means of preventing a violation under the act is stronger than is needed to enforce the act. We feel that the remedies now contained in the bill including criminal prosecution for the commission of illegal acts is certainly a sufficient deterrent.

We would appreciate it very much if you would place a copy of this letter in the record of the hearings on H.R. 11930.

Sincerely,

J. BANKS YOUNG,
Washington Representative.

DEPARTMENT OF AGRICULTURE,
Washington, D.C., September 18, 1967.

Hon. W. R. POAGE,
*Chairman, Committee on Agriculture,
House of Representatives,
Washington, D.C.*

DEAR MR. CHAIRMAN: In the recent testimony of witnesses appearing before your Committee in opposition to H.R. 11930 we found numerous instances of misunderstanding about this important legislation. This bill would amend the Commodity Exchange Act to enable us to cope more adequately with futures markets which have grown tremendously in size and activity since this legislation was enacted in 1936.

In the attachment we comment on some of the statements of witnesses, and cover:

1. The requested authority to disapprove trading rules of contract markets.
2. The change in the standard of evidence on appeal.
3. Recording contracts in writing; and a mistake concerning cease and desist orders against contract markets.
4. Self-regulation by contract markets.
5. Injunctive authority and price manipulation.
6. The record of the CEA on manipulation cases.
7. Margin requirements.
8. Speculative limits.
9. Customers' funds.
10. Financial requirements for commission merchants.
11. Injunctions; and cease and desist orders against persons other than contract markets.
12. Coffee and sugar.

I believe these comments would be a valuable addition to the record.

With every good wish, I remain

Sincerely yours,

ORVILLE L. FREEMAN.

The following comments have been prepared in order to correct some of the erroneous statements and misunderstandings that were expressed in testimony before the Committee.

1. There are objections to the authority sought by the Secretary to disapprove certain trading rules of contract markets, and statements which give the impression that the Secretary would have authority to disapprove any exchange rule. The amendment would only give the Secretary the authority to disapprove rules of an exchange which violate or would violate the Commodity Exchange Act.

2. Some of the strongest objections have been to the proposal to change the standard of evidence on appeal from one of "weight of evidence" to "substantial evidence on the record considered as a whole." It was said that this change would permit an order to be supported by "a bare minimum of evidence." It is difficult to believe that a circuit court of appeals would uphold an order which was based

upon "a bare minimum of evidence", and the language "substantial evidence on the record considered as a whole" would itself certainly dispute such a contention. It has also been said that this is an attempt to prevent a court from righting a wrong which may be committed by Department officials. This could not be possible in a circuit court of appeals when the standard required was "substantial evidence on the record considered as a whole." It was also said, both in a formal statement and in answer to Committee questioning, that this provision came about because the Department lost a case in 1962 in which Volkart Brothers Company was charged with price manipulation. As to that statement, it is sufficient to point out that this proposal was introduced as early as 1949 in S. 1751 (81st Congress) and again in January 1960 in S. 2807 (86th Congress) and in H.R. 9865 (86th Congress). The Volkart decision was not rendered until December 1962.

3. One witness, in referring to proposed section 9(c) of the Act, said "Now specific money and imprisonment penalty are to be imposed if any one of our members fails to evidence any contract by a record in writing as required in section 4." This provision is currently in the Act and there is no change whatsoever. It was also said that at present a cease and desist order can be issued against an exchange "in lieu of revoking its designation as a contract market," but that the proposed amendments eliminate this provision for an alternative exercise of power. The bill makes no change in this alternative. It remains in the legislation, but the new language which is proposed just does not use these same words.

4. Section 5(d) of the Commodity Exchange Act, presently in effect, requires that governing boards of contract markets provide for the prevention of manipulation of prices by the dealers or operators upon such boards. The witness for the New York Cotton Exchange said that he believes the controls against manipulation enforced by the governing boards of futures markets are exceedingly effective. Other witnesses testified in similar vein. Although the Commodity Exchange Authority has successfully prosecuted a number of cases of price manipulation in regulated commodities on contract markets, we know of no instance in which the governing board of an exchange has done so despite the requirements of section 5(d).

5. Although the witness for the Chicago Board of Trade did not intend this, in opposing the injunctive power sought in the bill he made a fine case for adopting this provision. He said that an injunction "would necessarily affect thousands of contracts and millions of dollars of investment. Its impact could be felt the country over from the largest processor to small country elevators and individual farmers. And all of this could happen with no advance warning, no bond and no provision for compensating the losses of unsuspecting traders. Their losses would, in fact, be incalculable." This is also an excellent description of the unwholesome effects of price manipulation in futures on producers, consumers and others, whether or not they themselves are engaged in such trading. He says further that "Injunctions are a summary remedy to be applied under emergency conditions to prevent a continuing injury." This is exactly why the Department of Agriculture wants injunctive authority; i.e., "to prevent a continuing injury", whether it be manipulation, fraud or cheating.

The witness also says that most of the 16 cases in the past 15 years (which the Department has cited as a partial list of situations in which injunctions might have been sought) were eventually settled through consent orders. "This", he says, "scarcely makes the case for urgency." The settlement of these cases by consent orders has nothing to do with the urgency surrounding them at the time since the settlements were made long after the violations occurred. If injunctive authority had been available, it might have been possible to prevent, or at least diminish, the damage caused by these violations.

6. He comments further that the Department was "right just half the time" in that it was reversed by the courts in three out of the six times that manipulation cases were appealed to the courts. In stating it this way, he ignores the 20 additional manipulation cases successfully prosecuted at the administrative level which the respondents failed to appeal, presumably because they felt that they had little chance of success. Three reversals out of 26 is not a poor record.

7. He says that the provision to empower the Secretary to disapprove trading rules relates to margin requirements. *There is nothing in this present bill which relates to margin requirements.* The margin provision in last year's bill was specifically omitted from the present one. The Secretary seeks the authority to disapprove trading rules that violate or would violate provisions of the Commodity Exchange Act—that, and nothing more.

8. The Chicago Mercantile Exchange witness objects to the amendment of section 4a(1) in which trading or position limits are applied to trades or posi-

tions "directly or indirectly controlled", or those entered into by two or more persons acting pursuant to "an express or implied agreement or understanding." These are indefinite concepts, he says, which the CEA can employ arbitrarily. The first of these, "directly or indirectly controlled", is merely language intended to affirmatively incorporate a longstanding administrative interpretation. Over the years we have had no difficulty with this concept. The second provision, "two or more persons acting pursuant to an express or implied agreement or understanding", is currently included in each of the orders of the Commission setting limits on speculative positions. The Commission apparently anticipated no difficulty with this language and we have found none. There is nothing indefinite about the language in either situation. The problem is proving the existence of the situations which they cover. This need for proof prevents any arbitrary employment of these concepts.

9. He also takes exception to that language in section 4d which "would require that segregated funds be held as belonging to the customer rather than the depositing commission merchant." The entire philosophy of the parts of the Act dealing with customers' funds is that these funds *do* belong to the customer and not to the commission merchant. This has been the fact ever since the enactment of the legislation.

10. This witness agrees that there is a need for minimum financial standards, but feels that so long as clearing members of an exchange have the necessary financial responsibility, nothing more should be necessary. The exchange's interest is only in the financial responsibility of clearing members to the clearing house. It is their responsibility to their customers with which the Secretary is concerned. Whether the futures commission merchant is a member of a contract market or not, responsibility to his customer is apparent and should be guaranteed to some extent by his meeting certain minimum financial standards.

11. This witness makes the surprising statement that section 9a would grant the Secretary power to enjoin. This it would not and could not do. The power to enjoin is reserved to the courts, and H.R. 11930 provides for such court action. It was also said that in the use of an injunction, the Secretary could claim that a person should be enjoined "although no concrete facts are available." We find it hard to believe that the Attorney General would request, or a court would issue an injunction when no facts were available. To believe otherwise would require a complete lack of confidence in our established judicial procedures.

Another witness objects to the provisions of the bill which would give the Secretary the authority to issue cease and desist orders. He infers that action by the Secretary would be a summary action which could be hastily and arbitrarily employed. The proposed legislation would, of course, provide for full hearing on the issues with subsequent right of appeal to the circuit court. Others make this same error regarding cease and desist orders. A cease and desist order could be issued only after:

1. Development by CEA of evidence of a violation;
2. Preparation of a complaint by the General Counsel;
3. Issuance of a complaint;
4. Hearing before a referee on the issues;
5. Preparation and issuance of the referee's report;
6. Possible oral argument before the Judicial Officer;
7. Issuance of the cease and desist order.

After this, the proposed legislation provides the right of appeal to a circuit court, and finally, appeal to the U.S. Supreme Court.

Misstatements are also made regarding the imposition of penalties for violating a cease and desist order. These claim that penalties may be assessed merely for violating the order, and not for any substantive violation. Conviction of violating a cease and desist order would require proof in court that a new violation of the same kind had occurred, or that the old violation had continued. Further, because violation of the order would be a misdemeanor or a felony, a stricter standard of proof would be necessary.

It was also said that "the fact of manipulation cannot be determined prospectively. These are conclusions which can be reached only in retrospect after an evaluation of all the facts surrounding changes in price." This means that manipulation of the market price with all of its damaging effects upon the economy, upon producers, consumers, dealers, and processors must be permitted to proceed to its conclusion. After that, the manipulators may be tried and punished. It is our view that there should be authority to act before such activities damage the economy. This is much more in the public interest than is the prosecution and punishment of the manipulators.

12. A witness for the New York Coffee and Sugar Exchange testified "world" sugar plays no part in the United States economy and that as a physical commodity it is of no concern to the United States. This also appears to be almost equally true of coffee. It might well follow that futures markets in these commodities are inappropriately located in the United States. We do not suggest that such futures markets be eliminated, but we do believe that so long as they are present and are used by United States citizens, it is entirely appropriate that the operation of the markets be subject to reasonable regulation.

He needlessly fears that futures trading in "world" sugar would move to other parts of the world if regulation is imposed upon it by the United States. This has not been true of wool or of cotton, both of which are produced abroad. Futures markets for these two commodities have continued to be used by foreign interests as well as American, despite coverage under the Commodity Exchange Act. Futures markets rise and decline because of factors other than regulation of the kind authorized by the Commodity Exchange Act, and the witness confirms this by saying that trading in coffee contracts has already gone to London.

Another witness for the New York Coffee and Sugar Exchange says "The stated purpose of the Act is to protect *producers and consumers* of these *listed commodities*, not to protect those who are buying and selling futures contracts." This is an error. The Act is designed to protect producers and consumers, but also throughout the Act are important provisions for the protection of the users of the markets, those who are buying and selling futures contracts. Sections 4b, 4c, and 4d are concerned almost completely with such user protection.

A major thrust of this statement is that world sugar and coffee, being produced and delivered almost exclusively outside of the United States, have no effect upon the prices of those commodities in the United States or upon interstate commerce in these commodities inside the United States. Studies of past situations by the Congress, the Federal Trade Commission, and the Department of Agriculture have developed evidence to the contrary. However, even if the statement were correct, the fact remains that futures trading is conducted in these commodities in the United States and is participated in by United States citizens. The users of these markets should have the protections afforded by the Commodity Exchange Act.

The claim was made that the whole theory of the Commodity Exchange Act is related to commodities which are both produced and delivered in the United States. The provision of section 4a(A) relating to hedging was quoted as meaning "that the producer of coffee or world sugar, and 40 percent of the domestic sugar, would have a hedging position of *zero*." The section quoted is merely one of several relating to hedging. In this particular situation, the producers of coffee, world sugar, and 40 percent of the domestic sugar would not be included, but in other situations they would be amply protected by the hedging definition. Stocks of sugar which they owned and sales of sugar which they had made (and the same applies to coffee) would both qualify as hedgeable positions.

He considers absurd the provision now in the Act that contract markets must require that operators of warehouses regular for delivery make reports, keep records, and permit visitation. He finds it difficult to visualize the Secretary of the Attorney General inspecting coffee and sugar warehouses throughout the world. Deliveries of coffee on New York Coffee and Sugar Exchange contracts must be made in warehouses located in the *Port of New York*. It would not seem difficult for the Secretary or the Attorney General to inspect these warehouses. Furthermore although it might not be usual to call for reports from, or make visits to foreign warehouses (and it isn't usual with regard to domestic warehouses), there could be situations in which it might be necessary to make such visitation or to call for reports. Foreign businessmen who wish to have their facilities used for the purpose of delivery on contracts traded in the United States must be willing to abide by United States rules. We would expect no difficulty with these provisions.

The Coffee and Sugar Exchange has members in 21 countries outside the United States, and, the Commodity Exchange Authority having no jurisdiction over them can obtain information from them, it was said, only on a voluntary basis or by the devious route of trying to compel the exchange to obtain the information. The Chicago Board of Trade, the New York Cotton Exchange, and others have members in numerous countries outside the United States. There are also foreign users of these futures exchanges who are not members. The Commodity Exchange Authority has not had difficulty in obtaining information from these people and would not expect to have any difficulty from the foreign members or traders on the New York Coffee and Sugar Exchange.

Mr. GATHINGS. Does anyone present want to submit a statement with respect to this legislation?

Does anyone present have anything to say?

The chairman is not here and I assume the record will be left open. This is the last day of hearings. Anyone who may want to present a statement will be given a reasonable time to file it.

We stand in recess.

(Whereupon the committee adjourned.)



Mr. Chairman, I am pleased to have the opportunity to discuss the importance of the community exchange act. This act is a landmark legislation that will provide a framework for the development of a national system of community exchange. It is a significant step towards the creation of a more equitable and efficient system of community exchange. The act will provide a framework for the development of a national system of community exchange. It is a significant step towards the creation of a more equitable and efficient system of community exchange. The act will provide a framework for the development of a national system of community exchange. It is a significant step towards the creation of a more equitable and efficient system of community exchange.

(The committee adjourned.)

