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Commodities: Future Control: Manipulation under the Commodity Exchange Act

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Case Comment

Commodities: Futures Control: Manipulation Under the Commodity Exchange Act

The Department of Agriculture is charged with the enforcement of the Commodity Exchange Act,[1] and this mandate is carried out by the Department through the Commodity Exchange Authority (CEA).[2] In response to complaints charging price manipulation in the May, 1963 wheat futures market on the Chicago Board of Trade, the CEA in June, 1964 brought charges of violation of the Act against Cargill, Inc., one of the world's largest grain traders, and several of its officers. Cargill had begun to establish a "long" or buyer's position in the May futures market on April, 15, 1963. By May 21, 1963, this amounted to 1,990,000 bushels, slightly short of the maximum speculative limit. During May, Cargill also completed two profitable sales of wheat to Spain, leaving only 50,000 bushels of soft red winter wheat on the Chicago market.[3] This class is the cheapest grade, the class deliverable at par in satisfaction of futures contracts, and the ordinary trading stock of the Chicago May futures market.[4] On May 21, fifteen minutes before the trading in May futures was due to end for the day, Cargill transmitted to its broker a liquidation order on its long position requesting prices seven to eight cents above the price at which the May future was then trading.[5] This request was within a frac-

1. 49 Stat. 1491 (1936), *as amended* 7 U.S.C. § 1 *et seq.* (1970). The legislative history and purposes of the Act are discussed in detail in Campbell, *Trading in Futures Under the Commodity Exchange Act*, 26 Geo. Wash. L. Rev. 215 (1958).

2. Although the Act provides that the Commodity Exchange Commission shall exercise the regulatory powers, 7 U.S.C. § 2 (1970), the Commodity Exchange Authority performs the usual regulatory functions. 29 Fed. Reg. 16211 (1964). *See* Flavin, *The Function of the Judicial Officer, U.S. Department of Agriculture*, 26 Geo. Wash. L. Rev. 227 (1958). *See also* Wolff, *Comparative Federal Regulation of the Commodity Exchanges and the National Securities Commissions*, 38 Geo. Wash. L. Rev. 223 (1969).

3. Cargill v. Hardin, 452 F.2d 1154, 1159-60 (8th Cir. 1971).

4. *Id.* at 1157.

5. At 11:45, the future was trading at $2.20. Cargill then transmitted to its broker the following sell order:

200,000 bushels at $2.27
200,000 bushels at $2.27¼
300,000 bushels at $2.27½

tion of a cent of the high price limit for the day which, under the Board of Trade rules, is ten cents above or below the previous day's closing price. In the resulting confusion and congestion 420,000 bushels of outstanding futures contracts remained open after trading ended. This congestion was subsequently liquidated, with Cargill's co-operation, through an exchange agreement developed by officers of the Chicago Board of Trade whereby Cargill sold warehouse receipts to unresolved shorts in order to clear the May wheat future.

The CEA hearings lasted more than six years,[6] and on August 18, 1970, the Secretary of Agriculture entered an order finding that defendants had manipulated the market price of wheat futures in violation of sections 6(b) and 9 of the Commodity Exchange Act.[7] On appeal of this order,[8] the Eighth Circuit affirmed, *holding* that the CEA had acted reasonably in concluding that the evidence supported findings that defendants had intentionally created and exploited a "squeeze" condition in the May futures market and that such action was prohibited "manipulation" within the meaning of the Act. *Cargill v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 92 S.Ct. 1170 (1972).

400,000 bushels at \$2.27¾
500,000 bushels at \$2.28
390,000 bushels at \$2.28¼

452 F.2d at 1160.

6. The sanctions proposed were suspended because of the undue protraction of the proceedings and because Cargill had apparently been relying on the authority of Volkart Bros., Inc. v. Freeman, 311 F.2d 52 (5th Cir. 1962). *See* notes 23-25 *infra*; 452 F.2d at 1156.

7. Section 6(b) of the Act, 7 U.S.C. § 9, provides:

> 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 . . . he may serve upon such person a complaint stating his charges in that respect, . . . 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. . . .

Section 9 of the Act, 7 U.S.C. § 13(b), provides:

> 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 . . . .

8. 7 U.S.C. § 9 provides that after "the issuance of the order by the Secretary of Agriculture, the person against whom it is issued may obtain a review of such order or such other equitable relief as to the court may seem just by filing in the United States court of appeals of the circuit in which the petitioner is doing business a written petition praying that the order of the Secretary of Agriculture be set aside."

Some knowledge of the basic mechanics of the commodity futures market is required to perceive and understand the issues litigated in this case.[9] A commodity future contract is an agreement between a buyer and a seller that the buyer will purchase from the seller a specified quantity of a commodity at a specified price, with delivery of the commodity at a designated month in the future. The clearing organization of the Board of Trade is substituted as buyer from the seller and as seller to the buyer; thereafter each is obligated only to the clearing organization. In almost all cases these contracts are closed with no intention of delivery by the seller or acceptance by the buyer. Rather, the expectation of each is that prior to the maturing of their buy-sell obligations a cancelling sale or purchase will be effected through the clearing mechanism that is the function of the Board of Trade. This situation occurs because most traders "offset" their future position by acquiring an equal and opposite position in the same future.[10] Thus a seller, who is considered to have a "short" position in the market, may acquire a buyer's or "long" position in the market in order to avoid having to make delivery of the commodity under the contract. The offsetting party will pay any loss or receive any profit on the difference in price between his original futures position and his subsequent offset. Accordingly, a long will profit if his contract is purchased at a price higher than the cost of his original long position. Similarly, a short will profit if his acquisition of a long contract is at a price lower than the original cost of his short position. Traders whose position in the market is short benefit from price declines, while traders in a long position benefit from

9. *See* B. Goss, The Theory of Futures Trading (1972); J. Baer & O. Saxon, Commodity Exchanges and Futures Trading (1949); G. Hoffman, Future Trading Upon Organized Commodity Markets in the United States (1932). *See also* Memorandum of the Board of Trade of the City of Chicago as Amicus Curiae, Cargill v. Hardin, 452 F.2d 1154 (8th Cir. 1971). Other literature on the regulation of commodity exchanges includes Huebner, *Corners*, in 4 Encyclopedia of Social Science 409 (E. Seligman ed. 1931); Irwin, *Legal Status of Trading in Futures*, 32 Ill. L. Rev. 155 (1937); Mehl, *Objectives of Federal Regulation of Commodities Exchanges*, 21 J. of Farm Econ. (1937); Vogelson, *Tightened Regulation for Commodity Exchanges*, 55 A.B.A.J. 858 (1969); Comment, 21 U. Chi. L. Rev. 94 (1953); Comment, 73 Yale L.J. 171 (1963); Comment, 60 Yale L.J. 822 (1951).

10. The "offset" is recognized as an acceptable alternative to delivery. *See* Board of Trade v. Christie Grain and Stock Co., 198 U.S. 236, 246-48 (1905). Almost 99 per cent of the futures contracts on the Chicago Board of Trade are offset rather than fulfilled by delivery. Cargill v. Hardin, 452 F.2d 1154, 1157 (8th Cir. 1971), *cert. denied*, 92 S. Ct. 1170 (1972). *See also* J. Baer & O. Saxon, *supra* note 9, at 210.

rising prices.[11]

The commodity futures market has several important functions[12] which may be disturbed by significant price fluctua-

11. Although delivery is an infrequent occurrence in futures contracts, such a requirement is essential to the maintenance of a true price relation between the commodity cash market and the futures market. Because the shorts are able to avoid offsetting purchases from the longs by purchasing and delivering wheat, the longs are prevented from demanding a price higher than the actual commodity price, sometimes called the "spot" or cash price. The delivery element in the contract acts as a safety valve against unrealistic price pressures that do not reflect actual supply and demand for the commodity. A scarcity of deliverable commodity in the delivery month may adversely affect the shorts since their inability to procure the commodity for delivery will encourage the longs to raise their asking prices for their offsetting contracts. Conversely, a glut of a deliverable commodity may threaten the longs with delivery, thus tending to lower futures prices downward to a point at which the shorts find it as economical to offset as to deliver, G. HOFFMAN, *supra* note 9, at 275.

12. The theoretical explanation of the functions fulfilled by the various commodity future markets is the subject of continuing investigation. *See* G. GOLD, MODERN COMMODITY FUTURES TRADING (1971); W. LABYS & C. GRANDER, SPECULATION, HEDGING, AND COMMODITY PRICE FORECASTS (1970); L. VENKATARRAMAN, THE THEORY OF FUTURES TRADING (1965). *See also* FEDERAL TRADE COMMISSION, REPORT ON THE GRAIN TRADE, *especially* vols. V (1920) & VII (1926). Articles of importance include Blau, *Some Aspects of the Theory of Futures Trading*, 12 REV. OF ECON. STUDIES 1 (1944); Irwin, *The Nature of Risk Assumption in Trading on Organized Exchanges*, 27 AM. ECON. REV. 267 (1937); Working, *New Concepts Concerning Futures Markets*, 52 AM. ECON. REV. 431 (1962); Working, *Futures Trading and Hedging*, 43 AM. ECON. REV. 314 (1953).

There is, however, a consensus among traders and economists on many of the functions which the market performs. First, the market allows producers to spread the sale of seasonal crops over many months, thus avoiding the imbalance of supply and demand which is typical of crops having seasonal harvests. Second, futures trading provides reliable pricing information for persons and firms throughout the world who buy and sell the commodity. *See* MERRILL LYNCH, PIERCE, FENNER & SMITH, THE HEDGER'S HANDBOOK 17-18 (1971). The theory that hedgers and speculators are particularly informed about the probability of price changes is attacked in Working, *New Concepts Concerning Futures Markets*, 52 AM. ECON. REV. 431, 433-35 (1962). *See also* Note, *Federal Regulation of Commodity Futures Trading*, 60 YALE L.J. 822, 829-30 (1951).

A third economic benefit of commodity futures is that futures contracts perform an insurance function by allowing the immediate fixing of the price of a transaction that will not be consummated until a future date. Through a process called "hedging," the price of the commodity can be pegged even if the market price subsequently rises or falls prior to the date of delivery, thus protecting buyers and sellers in the "spot" market from price fluctuations. If a hedger makes a December purchase of grain with the intention of processing in May of the next year, he covers his purchase with the simultaneous assumption of short or sellers position in the May future. In May, when the hedger sells his cash crop for processing, he simultaneously makes a purchase tions.[13] In order to prevent the inadvertent creation of such fluctuations[14] the Commodity Exchange Act directs the regulation of exchanges and expressly forbids intentional practices

in the May future to offset his December short position. Such simultaneous and opposite transactions in the cash and futures market allow hedgers to overcome price fluctuation by taking positions which cover both the possibilities of price declines and price rises within the market. If the hedger's December purchase position is hurt by falling prices, his position as a seller in the futures market is aided since he may deliver his lower price wheat or, as is more likely, the longs will lower their asking prices, giving the short a profit on the difference between his original contract and the offset. Conversely, if prices rise, appreciating the value of the hedger's wheat, the hedger will be required to pay a proportionate increment in order to offset his short position. *See* MERRILL LYNCH, PIERCE, FENNER & SMITH, *supra*, at 5-10; Wolff, *supra* note 2, at 223.

Of course the avoidance of this risk by hedgers necessarily means that other persons must be willing to accept it. These persons, called "speculators," invest in commodity futures for capital appreciation. Speculation supplies needed risk capital and also serves to allow sufficient liquidity in the market to permit immediate access and egress to buyers and sellers. At the same time, speculative capital serves to keep various commodity markets, dealing in the same commodity but geographically separate, from being forced out of price alignment by unusual local conditions. *See* Emery, *Speculation on the Stock and Produce Exchanges of the United States*, in COLUMBIA UNIVERSITY, STUDIES IN HISTORY, ECONOMICS AND PUBLIC LAW, vol. VII, No. 2 (1896). The literature of futures trading is heavily salted with discussion of the desirability of speculation and its effects upon the market. J. BAER & O. SAXON, *supra* note 9. *See also*, T. HIERONYMOUS, ECONOMICS OF FUTURES TRADING 136-46 (1971). The importance of these functions is recognized by the Congress and is discussed in the Act. 7 U.S.C. § 3.

13. For example, it impairs successful hedging, which depends on reasonable parallel levels of price between the cash and future market. Chicago Bd. of Trade v. Olsen, 262 U.S. 1 (1923). *See* 7 FEDERAL TRADE COMMISSION, REPORT ON THE GRAIN TRADE 243, 248, 256 (1926). In addition, the normal flow of consignments is disturbed and speculators are subjected to risks unrelated to supply and demand forces in the cash market, discouraging their investment. *See* Testimony of Arthur R. Marsh, former President of the New York Cotton Exchange, in *Cotton Prices, Hearings before a Subcomm. of the Comm. on Agriculture and Forestry Pursuant to S. Res. 142*, 70th Cong., 1st Sess. 209-211 (1928). Finally, the artificial prices created are a burden on the public since they form the basis for prices in the cash market. G. HOFFMAN, *supra* note 9, at 30.

14. Many efforts have been made to eliminate the fluctuations associated with squeezes. The rules of the exchange now allow up to 10 days for delivery of the product after the future market trading is closed. This is only effective to the extent that traders are willing to deliver at all, and the evidence indicates that mostly they are unable and unwilling to do so. Second, price change controls allow increases or decreases of no more than ten cents per day, thus preventing any great variation of prices. Since price distortions may result from the unintended effects of excessive speculation the Act provides that daily trading and net commitment limits be set. 7 U.S.C. § 6(a)(1)-(2) (1970). These limits do not prevent bona fide hedges. 7 U.S.C. § 6(a)(3) (1970).

which are known to cause such fluctuations.[15] Although many forms of trader impact on the market are forbidden by the Act,[16] its scope is not clear since the prohibition against "manipulation or attempting to manipulate" commodity prices is not specifically defined and designation of activities which are proscribed by this section has been left to administrative and judicial interpretation.[17]

Cargill v. Hardin represents the CEA's second attempt to include within the definition of the word "manipulation" the kind of market activity known as a "squeeze."[18] Senator Pope, who managed the Commodity Exchange Bill in the Senate, defined "squeeze" as follows:

> Squeeze (Congestion): These are terms used to designate a condition in maturing futures where sellers (hedgers or speculators), having waited too long to close their trades, find there are no new sellers from whom they can buy, deliverable stocks are low, and it is too late to procure the actual commodity elsewhere to settle by delivery. Under such circumstances, and though the market is not cornered in the ordinary sense, traders who are long hold out for an arbitrary price.[19]

A squeeze thus exists where a trader has a dominant position in the futures market, but does not have control over the commodity to be delivered in satisfaction of the outstanding contracts.[20] A squeeze may or may not be caused by the manipula-

15. 7 U.S.C. §§ 6 & 9 (1970).

16. 7 U.S.C. § 4 (1970); *see* T. HEIRONYMOUS, *supra* note 12, at 297-302.

17. One of the few judicial definitions of "manipulation" is found in General Foods v. Brannan, 170 F.2d 220, 231 (7th Cir. 1948), where the court said:

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

The Government's brief in this case offers a definition found in Campbell, *Trading in Futures Under the Commodity Exchange Act*, 26 GEO. WASH. L. REV. 215, 234 (1958):

> [A] . . . manipulated price is created whenever the manipulator makes the market price of a commodity, or of a futures contract, behave in some manner in which it would not behave if left to adjust itself to uncontrolled or uninspired supply and demand.

Brief for Respondent, 60. Obviously such definitions have the broadest possible application. The only safe guide to determining what is or is not "manipulation" under the Act must be rules of practical conduct. *See infra* notes 32-36.

18. *See* text accompanying note 23 *infra*.

19. 80 CONG. REC. 6089. *See also* 80 CONG. REC. 6164, 7857-7858, 8088.

20. In contrast, a corner on the market is a situation in which a long holds a dominant future position and also controls the deliverable

tive intent of traders, but in any event it is a situation which produces a temporary derangement of prices.[21] It is the position of the CEA that previous judicial determinations, the general understanding of good market practice and the legislative history of the Act demonstrate that intentional efforts to squeeze the market violate the Act.[22] But this interpretation, when litigated by the CEA for the first time in 1962, in *Volkart Bros. v. Freeman*,[23] was rejected by the Fifth Circuit.

The fact pattern of *Volkart* is similar to that of *Cargill*. Volkart Bros. was an experienced cotton brokerage firm which traded in the cash and future markets for cotton. In October, 1957, Volkart held a large block of October cotton futures on the New York Exchange. While other longs were liquidating their interests, Volkart not only retained its New York holdings but simultaneously made a large purchase of futures on the New Orleans Cotton Exchange. By October 11, Volkart was aware that the available deliverable supply of cotton amounted to less than one-half of Volkart's combined New York-New Orleans interest. Volkart retained its long holdings throughout October by offering to sell only at prices slightly above market. On the final day of trading, Volkart was able to raise its prices to even higher levels and the shorts, unable to make delivery of the commodity itself, were forced to offset their contracts at prices which yielded Volkart a last day profit of over $20,000.[24] The court

commodity. In such a situation, the long has the shorts in a double bind since the short must apply to the long for either the offsetting contract or for the commodity which their contracts require them to deliver. The long is in possession of both supply (the commodity) and demand (the outstanding long contracts) and he may therefore require a price which is unrelated to the normal forces of the market. One of the most spectacular reported cases illustrating such a corner is Peto v. Howell, 101 F.2d 353 (7th Cir. 1938). The court found that the defendant acquired 8,500,000 bushels in long corn futures for delivery in Chicago. After 7,000,000 bushels of wheat had been delivered, constituting 97 per cent of the deliverable supply in Chicago and 90 per cent of the deliverable supply in the entire nation, there remained 1,500,000 outstanding interests which could not be satisfied by delivery. The settlement price of the contracts was found to be artificially high. Recent litigation involving corners as prohibited by the Act includes Great W. Food Distribut., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); G.H. Miller & Co. v. United States, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 359 U.S. 907 (1959). Frank Norris' *The Pit* is perhaps the most famous literary example of a corner that failed.

21. G. HOFFMAN, *supra* note 9, at 309-18.

22. Brief for Respondent at 60-65, Cargill v. Hardin, 452 F.2d 1154 (8th Cir. 1972).

23. 311 F.2d 52 (5th Cir. 1962).

24. *Id.* at 58.

found that Volkart had not engaged in manipulation. It seemed to fear that the difficulty of distinguishing squeezes from permissible trading activity would threaten the operation of the futures market by generating uncertainty and reducing the flow of speculative capital. Fundamentally, the court based its ruling on a conviction that the difficulty of articulating a clear standard of forbidden activity made it impracticable to define market squeezes as illegal manipulation.[25]

The *Cargill* court, however, agreed with the CEA's view that intentional market squeezes constitute illegal manipulation. The court adopted the Government's conceptual framework for reviewing the evidence. That framework basically distinguished the conditions necessary to a squeeze from the intention to squeeze. The court accepted the Government's suggestion that three principle conditions are prerequisite to a squeeze: 1) a dominant or controlling position in the futures market; 2) an insufficient supply of wheat available for delivery and 3) the exaction of an artificial or abnormally high price in the liquidation of contracts.[26] For the scienter requirement, the court adopted judicially developed methods of proving intent.

First, with respect to dominance in the market, unless a long trader has sufficient control of the outstanding future contracts to force the shorts to accept his prices, a squeeze is impossible. The court found that Cargill's long position of 2,000,000 bushels, which represented sixty-two per cent of the market by the time Cargill announced its prices, was in fact a dominant position. To Cargill's argument that the last long out of the market is always in a dominant position, the court replied that Cargill's position was of such magnitude that it represented "a sufficiently controlling position to warrant consideration of the question whether Cargill actually manipulated prices."[27]

Second, proof of an insufficient supply of the deliverable commodity is necessary to demonstrate that the short's option of delivery in place of offsetting long contracts by purchase was eliminated and that they were at the mercy of the controlling long interest. The court determined that there existed sufficient evidence to support the CEA's finding that there was an insufficient supply of wheat available from sources other than Cargill for delivery on the May future.[28]

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25. *Id.* at 59.
26. 452 F.2d at 1164, 1167.
27. *Id.* at 1164.
28. The subsidiary question of what constitutes deliverable supplies also was resolved against Cargill, who contended the shorts had

Third, the Cargill court found that an abnormally high or artificial price was exacted by Cargill upon liquidation of the outstanding contracts.[29] The concept of artificial price, however, does not promote reasoned analysis and it is unclear why the court or the government elected to rely on it. Evidence offered by the government that prices are out of alignment with their historical pattern, or with other markets, does not explain why those distortions occurred. Abnormal price activity may reflect the result of natural as well as intentional squeezes;[30] prices are "artificially" high only where they are manipulated. Similarly, the alleged variance between the closing prices of the future and the spot market prices, although evidence of market disturbance, should not be treated as prima facie evidence of manipu-

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available supplies which they refused to ship from other markets. The court found that hard wheat, which could also be delivered on the contract, was available for shipment to Chicago in time for the deadline but that the CEA had acted properly in excluding it from the available deliverable supply. The court found this to be consistent with the decision in Great W. Food Distrib., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953). In that case, which involved egg futures, the court found that more expensive fresh eggs could not be considered as part of the supply available for delivery under future contracts when cheaper local refrigerator eggs were the standard deliverable grade on the future. Great W. Food Distribut., Inc. v. Brannan, *supra* at 480-81. By contrast, *Volkart* had held that cotton stocks which would not have been considered the ordinary stock in trade of the futures market had to be considered as part of the commodity available for delivery. 311 F.2d 52, 59 (5th Cir. 1962). *Cargill* rejected the *Volkart* holding on the ground that the decision in that case was reached without consideration of the economic realities involved. 452 F.2d at 1166.

29. The government proposed four tests to determine whether the price of the future was artificial and asserted that the price which Cargill demanded conformed to none of the tests. First, the Government contended that the sharp price rise in the last two days of trading was not comparable to any movement in the nine other years studied. Second, the Government demonstrated that the spread between the price of the May future and the July future was similarly distorted, a distortion which likewise had no historical analogue in the years studied. Third, the Government contended that the Chicago future price was considerably out of line with the Kansas City future price as compared with prior years and as compared with the same year. Cargill did not sharply dispute any of these statements. Finally, the Government sharply debated with Cargill the question whether the price of the future was substantially different from that of the cash commodity. In theory, the price of the future should be approximately 2¼ cents to 3 cents less than the price of the cash wheat, the discount reflecting warehouse loading charges. The court determined that the preponderance of this final argument was in the Government's favor. The court concluded that the "tests proposed by the Government very clearly support the ultimate conclusion that the futures price was artificially high." 452 F.2d at 1169.

30. G. HOFFMAN, *supra* note 9, at 309-18.

lation. Certain inefficiencies of the market may force prices out of their historical alignment in a manner which defeats the expectation of traders, but such prices are not per se artificial. Unusual stresses or demands on the available supply can create such distortions absent any form of manipulation. Moreover, the concept of artificial price does not reach the situation where a trader attempts to manipulate the price but is unsuccessful. Certainly such activity is equally prohibited.[31] While the complaints of traders may be heard only in cases where the market price pattern defeats their expectation, the trier of fact ought to confine itself to the practical test of whether certain market activity was engaged in by the trader with the intention of forcing price moves which would not otherwise have occurred. The success or failure of the effort should not be dispositive of the question whether manipulation was attempted.

Finally, having demonstrated Cargill's capacity to squeeze the May future market, the court sought to discover what intentional market activity was employed by Cargill to in fact squeeze the market. It appears that neither the court nor the CEA contended that the Act prohibited Cargill from acquiring a large outstanding long future position, or from making its Spanish sales which created the shortage of deliverable supply.[32] Rather these actions, while perfectly legitimate in themselves, created the capacity to squeeze the market. It is, however, the leverage of intentional market activity operating on such capacity, whether gained fortuitously or intentionally, that arguably constitutes the complex of activities which the Act's prohibition against manipulation proscribes.

As the standard for the kind of activity forbidden by the Act, the court adopted the practical test of ordinary market behavior. This objective test makes it unnecessary for traders to engage in speculation about whether the prices they seek for their contracts are "artificial." Rather, they need only avoid a course of conduct which is unusual. Cargill's decision to wait until the last fifteen minutes of trading to liquidate its large outstanding interest was demonstrably unusual. First, a broker, called by Cargill as a witness, testified that he "would not be inclined to show any broker, just for the sake of his nerves, a 2,000,000 [bushel] sell order for the last 15 minutes, just for the sake of his nerves."[33] Second, the court examined the liqui-

31. *See* Comment, 73 YALE L.J. 171, 175.
32. 452 F.2d at 1170.
33. *Id.* at 1170.

dation procedures of two major grain traders who were long in the May futures market to determine the method by which they took their profits. Both had liquidated their holdings over the entire last day of trading so as "to get an average for the day."[34] Cargill's unusual market technique therefore signaled an artificial or manipulated market force.

The practical test of normal course of dealing or ordinary market behavior involves a comparison which is difficult to establish and which may be difficult to apply. However, it has the advantage of looking to the market itself for good trading practice rather than to current theories of commodity price prediction which constitute an inexact science at best.[35] Traders have long been aware that the holding of a large open interest until late in the life of the future may give a trader a dominant position and consequent profits by taking advantage of the shorts' unwillingness and inability to deliver.[36] The normal expectation of traders includes the possibility of natural squeezes wherein prices fluctuate from their expected levels. Although such fluctuations may not represent actual price forces of supply and demand for the commodity itself, they must be understood as one of the inefficiencies of the futures market, one of the costs of such an insurance operation.[37]

However, intentional efforts to aggravate such situations need not be tolerated. The loadout of the deliverable wheat from the Chicago area through the Spanish sales probably created a condition of natural squeeze as evidenced by the price rise of almost ten cents the day before trading in the May future closed.[38] Assuming that the second Spanish sale at a price of $2.09 was a true reflection of price force realities, the price rise to $2.18⅝ for the May future must be considered as some sort of squeeze phenomenon caused by the unexpected loadout of such

34. *Id.*

35. *See* note 12 *supra*. *See also* Working, *New Concepts Concerning Futures Markets*, 52 AM. ECON. REV. 431 (1962), which details the various stages of development of economic understanding of the futures market.

36. G. HOFFMAN, *supra* note 9, at 214-318.

37. *See* note 12 *supra*.

38. "[T]he prices and price movements of No. 2 soft red winter wheat in Chicago on May 20 and 21, 1963 were *artificial* in that they did not reflect basic supply and demand factors and that this artificiality was brought about by the movement of wheat out of Chicago at a time when there was an insufficient supply of deliverable grade wheat in Chicago to satisfy the open interest, and that this situation produced an over reaction and caused a temporary price surge." Brief for Respondent at 80, Cargill v. Hardin, 452 F.2d 1154 (8th Cir. 1972).

a large quantity of the commodity. Cargill's unusual method of liquidating its long holdings constituted an additional and "manipulative" squeeze which forced the price to a high of \$2.28¼. The shorts were properly responsible for their contracts under the pressure of the first type of squeeze but not the second squeeze caused by Cargill's delaying action, which cannot be considered to be ordinary market activity.[39] The court's treatment of the problem of intent appears to be squarely in line with the best judicial interpretation of the Act. The line of decisions in the Seventh Circuit is instructive. In *General Foods Corporation v. Brannan,*[40] the court reversed an administrative finding of manipulation of rye prices, devoting its analysis to the difficulty of finding direct evidence of the trader's intention. Five years later, in *Great Western Foods Distributors, Inc. v. Brannan,*[41] the Seventh Circuit changed its emphasis. Rather than requiring direct evidence of intent to manipulate, the court examined commercial practice and other explanations of petitioner's conduct which might tend to suggest legitimate intention. Finding none, the court approved the administrative finding of a corner on the egg futures market.[42]

In the present case, Cargill insisted that the decision to wait until the last fifteen minutes to liquidate was an honest judgment that the future price was unusually low, and that the delay was intended only to procure a reasonable price. This contention failed to consider either the market impact of Cargill's actions or Cargill's ability to understand the impact of its action on the price of the future.[43] Since Cargill as an experienced trader must have been aware of the inflationary effect of holding such a large open interest until the last moment of

39. 452 F.2d at 1171-72.
40. 170 F.2d 476 (7th Cir. 1948).
41. 201 F.2d 476 (7th Cir.), *cert. denied,* 345 U.S. 997 (1953).
42. *Id.* at 483-84.
43. Other possible explanations for Cargill's decision which would accord with accepted trading practice likewise fail, since Cargill's long position was admittedly speculative. Had Cargill's holding been a hedge against a cash market sale, its action in failing to liquidate could have been explained by its failure to find a buyer in the cash market. *See* Comment, 73 YALE L.J. 171, 182 (1963). Similarly, if Cargill had been prepared to demand delivery at the prices it eventually exacted from the shorts, it would have known that the spot market demand was in fact as high as the futures prices for which it sold. But the evidence clearly showed that Cargill did not want delivery in lieu of the prices it demanded from the shorts in the liquidation of its long position. In fact, Cargill had refused to accept the return of certain wheat stocks which had been purchased from it at a lower price by mistake. 452 F.2d at 1171-72.

trading, its defense was properly rejected by the court. A person is presumed to intend the consequences of his intentional acts.

One ambiguity in the opinion was the failure to distinguish clearly between pressure in the market caused by an actual shortage of deliverable supply and the inflationary effect of holding a large open interest until late in the life of the future, each of which is known as a squeeze. It is clear that in this case the court found only the latter kind of squeeze to be within the prohibition of the Act. However, although the court touched upon the problem, it did not satisfactorily resolve the question of whether the intentional creation of a shortage of deliverable commodity and the simultaneous assumption of a long position in order to take advantage of the shortage falls within the prohibition of the Act.[44] Through its Spanish sales, Cargill virtually eliminated the possibility that the shorts would be able to make delivery and thus insured a squeeze of some dimension from which it could make a profit. However, the court appeared to accept the legitimacy of this conduct, arguing that if Cargill had liquidated its holding in an "orderly fashion . . . it would still have made a handsome profit on its investment, even without the added increment which its manipulation produced."[45]

The question of a supply squeeze created by timing international sales to take advantage of their impact on local market brings into focus some of the chief difficulties posed by the operation of international trading companies in local markets.[46] If large grain traders are able to make foreign sales at less than optimum prices by assuming long positions in the expectation of resulting squeezes on deliverable commodities, they can in effect subsidize the foreign sale from small traders and speculators through the intentional creation and exploitation of a commodity shortage. The issue here must be distinguished from mere rises in prices caused by foreign sales which deplete the total supply of the nation's wheat. Where sales are so timed that it

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44. The court noted that *Volkart* may be distinguished from *Cargill* by the fact that, in the latter, Cargill created the shortage of which it took advantage. However, the significance of this distinction was not developed. 452 F.2d at 1172 n.15. The court refused to endorse the idea that foreign sales were the source of "artificiality." Rather, the court limited itself to examination of Cargill's delaying tactic by comparing it with the action of other traders who were long in the May future. 452 F.2d at 1169-70. *See* notes 33-34 *supra*.

45. 452 F.2d at 1173.

46. 3 FEDERAL TRADE COMMISSION, REPORT ON THE GRAIN TRADE 135-50 (1920).

is too late to cover short positions by moving grains into the local delivery area from outside markets, the shorts are paying for a manipulative finesse of the market. Such intentional squeeze activity in either the spot or the cash market is functionally equivalent to a corner.[47] Although the trader literally does not control the cash market, as is usually the case with corners, his sales effectively preclude control by other traders and his dominant position in the future market gives him an advantageous position with respect to the shorts. However, the difficulties of enforcing any prohibition against such activities are far greater than with domestic corners. Indeed, such a prohibition would have highly undesirable effects. Prohibiting traders who intend to make major sales from taking any speculative position, or placing upon them the burden of proof of good faith would severely hamper speculative activity. Prohibiting traders from extending their long position after making major sales as well as prohibiting traders with large long positions from making sales would severely hamper trading. However, the regulatory authority granted the CEA by the Act for the control of speculation can help to eliminate such strategies.[48] A reduction of the size of the maximum allowable speculative limit on the exchange would diminish the attractivensss of such activity.[49] Secondly, the Department of Agriculture should begin to devise new ways to publish news and developments of potential foreign grain customers. The expansion of world population almost certainly means an increase of foreign grain sales with a corresponding pressure on local markets. The absence of some comon level of information puts smaller traders and speculators at a decided disadvantage. Finally, the institution of a series of premiums for wheats of better grade and class which are deliverable under the contract would enlarge the categories of wheat economically feasible for delivery[50] and substantially reduce, if not eliminate, the possibility of squeezes in the wheat future market.

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47. *See* note 20 *supra*.

48. *See* note 14 *supra*.

49. A corner in rye futures resulted in the downward revision of the speculative limits in the rye commodities exchange. Moore v. Brannan, 191 F.2d 775 (D.C. Cir.), *cert. denied*, 342 U.S. 860 (1951). *See* Wolff, *supra* note 2, at 230. The original recommendation of the Federal Trade Commission would have limited the maximum speculative position to only 1,000,000 bushels. 7 FEDERAL TRADE COMMISSION, REPORT ON THE GRAIN TRADE 294 (1926).

50. This is the suggestion of the court. 452 F.2d at 1173.