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# MANIPULATION OF FUTURES MARKETS: REDEFINING THE OFFENSE

WENDY COLLINS PERDUE\*

## INTRODUCTION

IN September 1984, a group of farmers collected in front of the Chicago Board of Trade ("CBOT") to protest low farm prices and to urge the criminalization of futures trading.<sup>1</sup> They argued that speculating in commodity futures was "manipulative and improper."<sup>2</sup> This type of protest is not unusual.<sup>3</sup> Futures markets have existed in this country for over 100 years,<sup>4</sup> and, for as long as they have existed, have been the object of protest, suspicion and contempt.<sup>5</sup> Critics have condemned futures trading as nothing more than a form of legalized gambling,<sup>6</sup> have

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1. See Washington Post, Sept. 28, 1984, at D1, col. 2.

2. *Id.*

3. See C.B. Cowing, *Populists, Plungers & Progressives: A Social History of Stock & Commodity Speculation 1890-1936*, at 3-24 (1965); Wilmouth, *Exchange Views of Speculation*, in CBOT Seminar Report on Research on Speculation 5 (1980).

4. The Chicago Board of Trade, the oldest futures exchange in the United States, began operations in 1848. See J. Baer & G. Woodruff, *Commodity Exchanges* 24 (1929); see generally Williams, *The Origin of Futures Markets*, Agric. Hist. 306 (Jan. 1982) (discussing development of futures markets in the United States).

5. See R. Teweles, C. Harlow & H. Stone, *The Commodity Futures Game* 11-14 (1974) [hereinafter *Futures Game*].

6. See *Review of Commodity Exchange Act and Discussion of Possible Changes: Hearings Before the House Comm. on Agriculture*, 93d Cong., 1st Sess. 58 (1973) [hereinafter *Review of CEA Hearings*] (comments of Rep. Rarick) (the speculator "may end up hurting both the producer and the consumer"); 62 Cong. Rec. 9411-12 (1922) (remarks of Rep. Williams) ("My opinion is that every transaction on a board of trade where the actual delivery of the grain is not contemplated is more or less a gambling transaction"; Chicago Grain Exchange is "the most colossal gambling institution in the world."); 61 Cong. Rec. 4763 (1921) (remarks of Sen. Capper), quoted in Rainbolt, *Regulating the Grain Gambler and His Successors*, 6 Hofstra L. Rev. 1, 6-7 (1977) ("[W]e are permitting the biggest gambling hell in the world to be operated on the Chicago Board of Trade."); T. Hieronymus, *Economics of Futures Trading* 137 (1971) [hereinafter T. Hieronymus, *Economics*] ("Commodity speculation has been said, many many, times, to be the 'biggest gamble of them all.'"); Irwin, *Legal Status of Trading in Futures*, 32 Ill. L. Rev. 155, 155 (1937-38) ("The time honored attitude has been that futures contracts are gambling contracts if, at the making of the agreements, the parties do not intend to make and receive delivery on the contracts."); *Securities Week* (McGraw Hill), May 26, 1980, at 5, 6 (statement of Commodity Future Trading Commission ("CFTC") Chairman Stone that silver speculation "was akin to gambling").

Prior to federal involvement in the area, a number of states prohibited futures trading as a form of illegal gambling. See C.B. Cowing, *supra* note 3, at 27; H. Emery, *Speculation on the Stock and Produce Exchanges of the United States 195-97* (1896).

Professor Hieronymus points out two significant differences between commodities speculation and gambling:

1. Gambling involves the creation of risks that would not otherwise exist

described traders as "greedy men blinded by the lust for money, trafficking in human misery,"<sup>7</sup> and have blamed traders for price fluctuations and a host of other evils.<sup>8</sup>

Historically, one of the most common charges raised against the futures market has been that of market manipulation. It would seem that whenever the public perceives prices as being too high or too low, someone will allege that the price is the result of manipulation.<sup>9</sup> The protestors at the CBOT raised this allegation,<sup>10</sup> as did their great-grandfathers three generations earlier.<sup>11</sup>

Despite the ease and frequency with which critics have leveled the charge of manipulation and the fact that federal law has prohibited "manipulation" for over 65 years,<sup>12</sup> a satisfactory definition of manipulation

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while speculation involves the assumption of necessary and unavoidable risks of commerce, and 2. In every futures transaction, the speculator incurs the duties and acquires the rights of a holder of property and thus is an integral part of commerce.

T. Hieronymus, *Economics*, *supra*, at 138; *see also* *United States v. Dial*, 757 F.2d 163, 165 (7th Cir.) (discussing difference between speculation and gambling), *cert. denied*, 474 U.S. 838 (1985).

7. T. Hieronymus, *Economics*, *supra* note 6, at 4 (quoting 1947 statement of U.S. Attorney General); *see* 62 Cong. Rec. 9416 (1922) (remarks of Rep. Bland) ("I would misrepresent my agricultural constituents if I failed to do all in my power to strike down the gambler who would rob them of the fruit of their toil."); 61 Cong. Rec. 1368 (1921) (remarks of Rep. Hudspeth) ("These silk-gloved, gold-collared, and stiff-hat gentry, great benefactors of the horny-handed farmer . . . 'they toil not, neither do they spin,' but Solomon in all his glory never was arrayed like them."); Bianco, *The Mechanics of Futures Trading: Speculation and Manipulation*, 6 Hofstra L. Rev. 27, 31 (1977) (observing that the speculator frequently is viewed as a sinister character). These views may reflect in part an idea dating back to the middle ages that the middleman is an unproductive parasite who simply makes a profit on the labor of others. *See* C.B. Cowing, *supra* note 3, at 83 (N.Y. Tribune urges that all middlemen be conscripted); *id.* at 86-87 (food administrator praised for eliminating "useless" middlemen); A. Eddy, *The Law of Combinations* 40 (1901); Jones, *Historical Development of the Law of Business Competition*, 35 Yale L.J. 905, 910 (1926). As recently as 1973, Senator George McGovern expressed a similar view: "[E]very time a speculator turns an unreasonable profit by trading futures, the housewife and the consumer pay the price. And since it is the speculator, not the producer, who receives the windfall profit, the higher wholesale and retail prices do not act as a stimulant to production." [1973] Sec. Reg. & L. Rep. (BNA) A-15.

8. *See, e.g.*, 61 Cong. Rec. 4763 (1921) (remarks of Sen. Capper) (suicide attributed to futures trading); *id.* (embezzlement of bank funds by bank president attributed to futures trading).

9. *See* J. Baer & G. Woodruff, *supra* note 4, at 183; C.B. Cowing, *supra* note 3, at 5; Tomek, *Speculation and Price Behavior on Commodity Markets: A Survey*, in CBOT Seminar Report on Research on Speculation 8, 18-19 (Nov. 1980).

10. *See* Washington Post, Sept. 28, 1984, at D1, col. 2.

11. C.B. Cowing, *supra* note 3, at 5.

12. *See* Future Trading Act, Pub. L. No. 67-66, § 5(d), 42 Stat. 187, 188 (1921) [hereinafter Future Trading Act]; Grain Futures Act, Pub. L. No. 67-331, § 5(d), 42 Stat. 998, 1000 (1922) [hereinafter Grain Futures Act]; Commodity Exchange Act, Pub. L. No. 74-675, § 9, 49 Stat. 1491, 1499-1500 (1936) [hereinafter CEA]. The current version of the manipulation prohibition provides:

It shall be a felony punishable by a fine of not more than \$500,000 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

has yet to emerge.<sup>13</sup> Although courts<sup>14</sup> and commentators<sup>15</sup> have tried to define the term, this Article argues that none of their definitions is satisfactory.

Most of the definitions of manipulation offered by courts and commentators share a common element: they focus on whether the resulting price is "artificial."<sup>16</sup> Accordingly, a typical definition of manipulation is "the creation of an artificial price by planned action, whether by one man or a group of men."<sup>17</sup> Courts and commentators repeatedly have used this definition and variations of it.<sup>18</sup>

While this definition is short and apparently straightforward, the core of the definition remains a particularly elusive concept—that of "an artificial price." Artificial price, of course, could mean simply a manipulated price, in which case the typical definition of manipulation would be a tautology.<sup>19</sup> But the notion of manipulation as the creation of an artificial price has not been treated as a mere tautology. Rather, cases<sup>20</sup> and

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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 . . . .

7 U.S.C. § 13b (1982).

13. See 1 T. Russo, *Regulation of the Commodities Futures and Options Markets* § 12.01, at 12-5 (1983).

14. See, e.g., *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962); cases cited *infra* note 118.

15. See, e.g., McDermott, *Defining Manipulation in Commodity Futures Trading: The Futures "Squeeze,"* 74 Nw. U.L. Rev. 202 (1979); Van Smith, *Preventing the Manipulation of Commodity Futures Markets: To Deliver or Not to Deliver*, 32 Hastings L.J. 1569 (1981); sources cited *infra* note 119.

16. *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1167-70 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *accord* *Volkart Bros. v. Freeman*, 311 F.2d 52, 58 (5th Cir. 1962); *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 482 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); *General Foods Corp. v. Brannan*, 170 F.2d 220, 231 (7th Cir. 1948); T. Hieronymus, *Economics*, *supra* note 6, at 144-45; Gray, *Economic Evidence in Manipulation Cases*, in CBOT Seminar Report on Research on Speculation 108, 109 (Nov. 1980); Johnson, *Commodity Market Manipulation*, 38 Wash. & Lee L. Rev. 725, 730 (1981) [hereinafter Johnson I].

17. *General Foods Corp. v. Brannan*, 170 F.2d 220, 231 (7th Cir. 1948) (quoting government's brief).

18. See, e.g., *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,281, 27,283 (CFTC 1982); *Hohenberg Bros.*, [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,477 (CFTC 1977); 1 T. Russo, *supra* note 13, § 12.10, at 12-17; Bianco, *supra* note 7, at 35; Irwin, *The Nature of Risk Assumption in the Trading on Organized Exchanges*, 37 Am. Econ. Rev. 267, 268 (1937); see generally 1 T. Russo, *supra* note 13, §§ 12.9 & 12.10, at 12-13 to 12-18 (describing some of the different formulations).

19. See Van Smith, *supra* note 15, at 1579-80.

20. See, e.g., *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406

commentators<sup>21</sup> generally have treated the concept of an artificial price as if it had some ascertainable content. Despite numerous attempts to define and then apply the concept of an artificial price, none has proven satisfactory. All suffer from serious defects<sup>22</sup> that make the concept of artificial price either inappropriate to, or unhelpful in, the determination of what constitutes manipulation. Defining manipulation as the creation of an artificial price simply substitutes one unhelpful term for another.

Over the last few years, however, there has been a growing recognition of the inadequacy of the traditional artificial price approach to manipulation.<sup>23</sup> A few commentators have offered alternative definitions that do not focus on the existence of an artificial price.<sup>24</sup> Although these definitions prove inadequate for other reasons,<sup>25</sup> they represent a step in the right direction.

This Article offers a fresh approach to defining manipulation. Rather than asking a court to determine whether a price is "artificial" or "unreasonable," the proposed definition focuses on whether the conduct of the people involved is reasonable. More precisely, this Article defines manipulation as conduct that would be uneconomical or irrational, absent an effect on market price.<sup>26</sup>

Part I of this Article briefly describes by way of background the operation and purpose of the commodity futures market, and Part II analyzes the legislative history of federal commodity trading laws. Part III describes and analyzes past approaches to defining manipulation that have proven inadequate. Part IV first critiques the various views regarding the purpose underlying the manipulation prohibition and then introduces an alternative view. Based on this view, this Article then proposes a definition of manipulation that focuses on the trader's conduct rather than on the resulting price and demonstrates how this definition can be used to identify common types of manipulation. The Article concludes that this new definition will prove more workable and thus will lead to more accurate identification of manipulative conduct in the commodity futures market than is possible using currently accepted definitions.

## I. THE OPERATION AND PURPOSE OF THE FUTURES MARKET

Before delving into the concept of manipulation, it is useful to describe briefly the operation and purposes of futures markets. A futures contract

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U.S. 932 (1972); *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962); Cox, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,064-66 (CFTC 1987).

21. See, e.g., 1 T. Russo, *supra* note 13, § 12.24; Johnson I, *supra* note 16, at 746-54.

22. See *infra* notes 129-214 and accompanying text.

23. See, e.g., 1 T. Russo, *supra* note 13, § 12.29, at 12-51 to 12-52; McDermott, *supra* note 15, at 212; Van Smith, *supra* note 15, at 1579-81.

24. See Easterbrook, *Monopoly, Manipulation, and the Regulation of Futures Markets*, 59 J. Bus. S103 (1986); McDermott, *supra* note 15; Van Smith, *supra* note 15. For a description and analysis of these approaches, see *infra* notes 216-72.

25. See *infra* notes 216-72 and accompanying text.

26. See *infra* notes 295-320 and accompanying text.

is a contract for the future sale or purchase of a specified commodity.<sup>27</sup> The trading takes place on designated exchanges<sup>28</sup> using standardized contracts, that, among other things, specify a delivery date and particular quality requirements for delivery.<sup>29</sup> By the time the contracts expire, all traders must have "settled," either by making an equal and opposite offsetting transaction<sup>30</sup> or by delivery. Delivery may involve an actual transfer of ownership in the underlying product.<sup>31</sup> This generally is the case with traditional commodities such as agricultural goods. On the other hand, some markets, particularly the more recently developed markets such as stock index futures, use a cash delivery system.<sup>32</sup> Under this system, the short<sup>33</sup> does not transfer actual ownership but transfers the cash value, as of the settlement date, of the underlying product.<sup>34</sup> The delivery mechanism, whether it is a cash system or physical delivery, insures that futures prices and "cash" or "spot" prices<sup>35</sup> for the actual commodity converge.<sup>36</sup>

Futures markets serve several important economic functions.<sup>37</sup> First, the market summarizes and communicates information. A futures price, in essence, consists of a weighted average of the disparate information and expectations of all traders.<sup>38</sup> Second, the price generated by the fu-

27. For a general discussion of the nature and operation of futures contracts, see T. Hieronymus, *Economics*, *supra* note 6, at 28-44; *Futures Game*, *supra* note 5, at 22-28.

28. It is unlawful to trade futures except through a board of trade that has been designated by the CFTC as a contract market. See 7 U.S.C. § 6 (1982).

29. See T. Hieronymus, *Economics*, *supra* note 6, at 40-41.

30. See *id.* at 41-47. Thus, a trader who held 100 long contracts could settle by selling 100 contracts of the same commodity and delivery month.

31. See T. Hieronymus, *Economics*, *supra* note 6, at 41; *Futures Game*, *supra* note 5, at 61. Only a small percentage of futures contracts are settled by actual delivery. See H.R. Rep. No. 975, 93d Cong., 2d Sess. 149 (1974) [hereinafter H.R. Rep. No. 975] (noting that about three percent of futures contracts are settled by delivery).

32. See Markham & Gilberg, *Washington Watch*, 6 Corp. L. Rev. 59, 60 (1983).

33. A "short" contract is a commitment to deliver the commodity in the future. See *Leist v. Simplot*, 638 F.2d 283, 286 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982). A "long" contract is a commitment to accept delivery of the commodity in the future. See *id.*

34. See Hobson, *Cash Settlement of Futures Contracts: Concepts and Experience*, 1 Educ. Q. (CFTC) 1 (Nov. 1982).

35. The "cash" or "spot" price is the price for a specified lot for immediate delivery. See S. Kroll & I. Shishko, *The Commodity Futures Market Guide* 17 (1973). For a discussion of the difference between cash and futures markets, see *id.* at 67. See generally T. Hieronymus, *Economics*, *supra* note 6, at 31-33 (details regarding trading processes).

36. See T. Hieronymus, *Economics*, *supra* note 6, at 151-52; *infra* notes 250-52 and accompanying text.

37. See H.R. Rep. No. 975, *supra* note 31, at 132-33; T. Hieronymus, *Economics*, *supra* note 6, at 99-102, 106-08; Edwards, *The Regulation of Futures Markets: A Conceptual Framework* 19-21 (Center for the Study of Futures Markets, Working Paper Series #CSFM-23 1981).

38. See Arrow, *Futures Markets: Some Theoretical Perspectives*, 1 J. Fut. Mkts. 107, 114 (1981); Carlton, *Futures Markets: Their Purpose, Their History, Their Growth, Their Successes and Failures* 12 (Center for the Study of Futures Markets, Working Paper Series #CSFM-78 1984); Cox, *Futures Trading and Market Information*, 84 J. Pol. Econ. 1215, 1216-18 (1976); Working, *Economic Functions of Futures Markets*, in *Selected*

tures market itself provides an extremely valuable piece of information.<sup>39</sup> Because a futures market creates a homogeneous good traded under standardized terms, futures prices more accurately reflect current commodities' values than do individually negotiated spot transactions by any particular buyer and seller.<sup>40</sup> Futures prices can be disseminated widely and cheaply,<sup>41</sup> even to nontraders. Such knowledge facilitates efficient resource allocation.<sup>42</sup>

Third, the futures market permits "hedging." Hedging is a practice by which a trader with a position in the cash market purchases an offsetting futures position and thereby reduces the risks associated with price variations.<sup>43</sup> This risk reduction method reduces the cost of holding inventory.<sup>44</sup>

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Writings of Holbrook Working 297 (A. Peck ed. 1977) [hereinafter Working I]; see generally *Leist v. Simplot*, 638 F.2d 283, 286-88 (2d Cir. 1980) (discussing the operation and function of futures markets), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982).

39. See Arrow, *supra* note 38, at 115; Cox, *supra* note 38, at 1216; Telser & Higinbotham, *Organized Futures Markets: Costs and Benefits*, 85 J. Pol. Econ. 969, 997 (1977).

40. See Telser & Higinbotham, *supra* note 39, at 973-74.

41. See T. Hieronymus, *Economics*, *supra* note 6, at 101-02; Cox, *supra* note 38, at 1218. In one survey, 50% of farmers reported that their forward contracts were "based" on futures prices. See Carlton, *supra* note 38, at 35 n.27.

42. See Cox, *supra* note 38, at 1216, 1235; Edwards, *supra* note 37, at 19-20; Peck, *The Economic Role of Traditional Commodity Futures Markets*, in *Futures Markets: Their Economic Role* 40 (A. Peck ed. 1985); Tomek, *supra* note 9, at 14-15; Working, *Futures Trading and Hedging*, 43 Am. Econ. Rev. 314, 326-27 (1953) [hereinafter Working II]; Working, *Hedging Reconsidered*, in *Selected Writings of Holbrook Working* 133 (A. Peck ed. 1977); see also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 390 (1982) ("Federal regulation of futures trading benefits the entire economy; a sound futures market tends to reduce retail prices of the underlying commodities.").

43. One writer defines a hedge as "[a] commitment in the futures market which is established to offset a cash commodity position." S. Angrist, *Sensible Speculating in Commodities* 201 (1972); see T. Hieronymus, *Economics*, *supra* note 6, at 148-49; 1 P. Johnson, *Commodities Regulation* § 1.12, at 38-44 (1982); *Futures Game*, *supra* note 5, at 32-43.

44. See H.R. Rep. No. 975, *supra* note 31, at 131; T. Hieronymus, *Economics*, *supra* note 6, at 148-49. The economics of hedging has been the source of some controversy. The traditional view of hedging envisions that those who either hold or need inventory of a particular commodity will take an equal and opposite futures market position. See, e.g., H.R. Rep. No. 975, *supra* note 31, at 131; J. Baer & O. Saxon, *Commodity Exchanges & Futures Trading* 203-04 (1949). The theory asserts that any change in the cash or spot price usually will be offset by an equal change in the futures price, thus eliminating the risks associated with price variance.

Although this view of hedging has been widely described and relied upon, see, e.g., H.R. Rep. No. 975, *supra* note 31, at 131; Ederington, *The Hedging Performance of the New Futures Markets*, 34 J. of Fin. 157, 159-60 (1979) (cited sources), economists have discredited it because its fundamental assumption that changes in spot prices tend to be offset by equal changes in futures prices is incorrect. See Working II, *supra* note 42, at 325-26; see also T. Hieronymus, *Economics*, *supra* note 6, at 148; Kamara, *Issues in Futures Markets: A Survey* 5 (Center for the Study of Futures Markets, Working Paper Series #CSFM-30 1982). Professor Holbrook Working, in his seminal article, *Futures Trading and Hedging*, argued, contrary to the traditional view, that "[m]ost hedging is done in the expectation of a change in spot-future price relations." Working II, *supra*

Despite the animosity often directed toward the futures market and the widely held belief that those markets are prone to excessive and destabilizing manipulation,<sup>45</sup> the economic studies agree overwhelmingly that futures trading tends to stabilize prices.<sup>46</sup> Given this stabilizing ef-

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note 42, at 325. According to Working, hedging represents not the opposite of speculation but simply another type of speculation. See *id.* Instead of speculating in price level fluctuations, the hedger speculates in price relationship fluctuations. See T. Hieronymus, *Economics*, *supra* note 6, at 149; Kamara, *supra*, at 5; Working II, *supra* note 42, at 325-26. Thus, hedging may be understood, not as a means of eliminating all risk, but as a process by which one "insulate[s] one's business activities from price level speculation while retaining the opportunity to speculate [on changes between cash and futures prices]." T. Hieronymus, *Economics*, *supra* note 6, at 149.

Some economists have begun to use portfolio theory to analyze hedging behavior. See, e.g., Ederington, *supra*, at 161-62; Johnson, *The Theory of Hedging and Speculation in Commodity Futures*, 27 *Rev. Econ. Stud.* 139, 142-45 (1960) [hereinafter Johnson II]. This approach treats hedging as a mechanism for "risk management" rather than "risk transferral." *Futures Game*, *supra* note 5, at 42. As in Working's analysis of hedging, portfolio analysis suggests that "parallelism of actual price movements [between cash and futures prices] is neither a necessary nor a sufficient condition for a perfectly effective hedge." Kamara, *supra*, at 2; see Johnson II, *supra*, at 144.

45. See, e.g., CEA, *supra* note 12, §§ 3, 4a(1); see also *infra* note 66.

46. See, e.g., Gray, *Onions Revisited*, reprinted in II *Selected Writings on Futures Markets* 328 (A. Peck ed. 1977); Powers, *Does Futures Trading Reduce Price Fluctuations in Cash Markets?*, 60 *Am. Econ. Rev.* 460, 462 (1970); Working II, *supra* note 42, at 327-32.

One is left wondering why, if futures markets perform such useful functions, they are so widely despised and distrusted. Although a complete answer to this question lies beyond the scope of this Article, a few observations will be offered. For one, people undoubtedly tend to distrust that which they do not understand, and futures trading seems to be particularly poorly understood. See *infra* notes 50-51 and accompanying text. Furthermore, the futures market offers a convenient target for those who are harmed by the prevailing price level of commodities. Ignorance and the need for scapegoats may not, however, provide the complete answer.

In addition, some may dislike futures markets for the very reason that they provide well-publicized information and reduce risks. See Gray & Rutledge, *The Economics of Commodity Futures Markets: A Survey*, 34 *Rev. of Mktg. & Agric. Econ.* 57, 61 (1971). Baer and Saxon recount an incident in which a survey was taken of producers, merchants and manufacturers as to whether they favored creation of a new futures market in a particular commodity. One merchant explained his opposition as follows:

"I have many buyers traveling throughout the producing areas to purchase directly from the growers. They pay cash. When they go to a grower and offer him a definite price per pound in spot cash, the grower is tempted to sell without investigating prevailing prices. He often does so. But, if there were an exchange in existence, its prices would be telegraphed all over the country and would appear in every newspaper of any size and circulation. The seller would know just how closely the price he was offered approached the prevailing market price. Our buyers work to purchase the commodity under the prevailing market, and they make excellent purchases below the market. If the exchange were established, I would probably have to pay current market prices for all I buy."

J. Baer & O. Saxon, *supra* note 44, at 101.

Similarly, a dominant producer might wish to eliminate the futures market because its presence reduces the risk (and hence the costs) to the producer's fringe competitors. By eliminating the futures market and thereby increasing the risk of fringe producers, the dominant producer increases its profits by reducing the supply. See Newberry, *The Manipulation of Futures Markets by a Dominant Producer*, in *The Industrial Organization of*



fect and the other important functions served by futures markets, any regulatory scheme designed to curtail abuses must be carefully tailored so as not to undermine the usefulness of those markets.

## II. THE LEGISLATIVE HISTORY OF FEDERAL REGULATION

Any attempt to determine the meaning of "manipulation" based on congressional intent is certain to be a difficult undertaking. Congress has regulated or attempted to regulate the futures industry for over 100 years.<sup>47</sup> There have been hundreds of bills and congressional hearings on the subject,<sup>48</sup> including a number of proposals to prohibit futures trading completely.<sup>49</sup> Furthermore, the overwhelming ignorance and confusion exhibited by Congress toward the futures industry further complicates analysis of the legislative history. Even modern Congresses have admitted that they find the topic of futures trading to be "esoteric."<sup>50</sup> Former Commodity Futures Trading Commission Chairman William Bagley was even more blunt: "When I go before Congress, I spend four-fifths of my time just explaining the futures market."<sup>51</sup>

### A. Legislation and Debates

Whatever confusion Congress may have experienced regarding futures trading and its economic function, Congress consistently has condemned manipulation. The first comprehensive federal regulation of futures trading, the Future Trading Act of 1921,<sup>52</sup> authorized the Secretary of Agriculture to order a board of trade to suspend the trading privileges of anyone "attempting to manipulate the market price of any grain."<sup>53</sup>

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Futures Markets 43 (R. Anderson ed. 1984). Thus, some may dislike futures markets for the very reason that futures markets decrease price fluctuations and promote national pricing.

47. See Note, *Prevention of Commodity Futures Manipulation Under the Commodity Exchange Act*, 54 Harv. L. Rev. 1373, 1374 n.4 (1941); see also *supra* text accompanying note 12.

48. See Note, *supra* note 47, at 1374 n.4; Note, *Federal Regulation of Commodity Futures Trading*, 60 Yale L.J. 822, 832 n.46 (1951).

49. See, e.g., S. 1093, 70th Cong., 1st Sess. (1928); S. 454, 69th Cong., 1st Sess. (1926); J. Baer & G. Woodruff, *supra* note 4, at 183-84; C.B. Cowing, *supra* note 3, at 43.

50. H.R. Rep. No. 975, *supra* note 31, at 1.

51. Editorial Commentary, *Futures Image and the Conception of an Association*, *Commodities* 14, 14 (April 1977). The problem of ignorance may not be confined to Congress. William Bagley, the first Chairman of the CFTC, also was quoted after his appointment as saying, "I have the luxury of being unfettered by knowledge of, or acquaintance with, the industry." Bosley, *The Assault on the Futures Industry*, *Commodities* 42, 44 (Nov. 1977) (citing Wall Street J., Aug. 13, 1976).

52. Ch. 86, 42 Stat. 187 (1921).

53. Future Trading Act, *supra* note 12, § 6(b); see also Grain Futures Act, *supra* note 12, § 5(d). Congress intended both the Future Trading Act and the Grain Futures Act to limit futures trading to designated boards of trade approved by the secretary of agriculture. To be approved, a board had to, among other things, "provide[] for the prevention of manipulation of prices, or the cornering of any grain, by the dealers or operators upon such board." Future Trading Act, *supra* note 12, § 5(d); see also Grain Futures Act, *supra* note 12, § 5(d).

A year after its enactment, the Supreme Court declared the Futures Trading Act an unconstitutional exercise of congressional taxing authority.<sup>54</sup> A hasty rewrite produced the Grain Futures Act, which withstood constitutional scrutiny.<sup>55</sup> The substantive provisions of the Grain Futures Act are identical to those of the Futures Trading Act.<sup>56</sup> In 1936, Congress renamed the statute the Commodity Exchange Act ("CEA"),<sup>57</sup> enlarged the scope of the Act's coverage,<sup>58</sup> and, for the first time, made it a criminal violation for any person to "manipulate or attempt to manipulate the price of any commodity in interstate commerce . . . or who shall corner or attempt to corner any such commodity."<sup>59</sup> This prohibition against manipulation remains intact today.<sup>60</sup>

Since 1936, Congress has continued to condemn manipulation. It has increased substantially the penalties for manipulation<sup>61</sup> and, in 1974<sup>62</sup> and 1982,<sup>63</sup> it carefully reexamined the CEA. Despite this activity, Congress, since 1936, has paid little attention to defining manipulation. The bulk of the legislative history on the meaning of manipulation, therefore, is found prior to 1936.<sup>64</sup>

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54. See *Hill v. Wallace*, 259 U.S. 44, 66-68 (1922).

55. See *Chicago Board of Trade v. Olsen*, 262 U.S. 1 (1923).

56. The rewrite simply made it clear that Congress was relying on the commerce clause, rather than on its taxing authority, for its power to regulate the futures market. See *infra* note 66.

57. CEA, *supra* note 12, § 1.

58. The Future Trading Act and the Grain Futures Act applied only to transactions involving grain. See *Future Trading Act*, *supra* note 12, § 2; *Grain Futures Act*, *supra* note 12, § 2. The CEA applies to a much broader range of commodities. See CEA, *supra* note 12, § 2(a).

59. CEA, *supra* note 12, § 9. The CEA consisted largely of additions to, rather than revisions of, the Grain Futures Act. For a description of those major additions, see *Leist v. Simplot*, 638 F.2d 283, 294-95 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982).

60. 7 U.S.C. § 13(b) (1982).

61. See *infra* note 64.

62. See *Commodity Futures Trading Commission Act of 1974*, Pub. L. No. 93-463, 88 Stat. 1389; H.R. Rep. No. 975, *supra* note 31; S. Rep. No. 1194, 93d Cong., 2d Sess. (1974).

63. See *Future Trading Act of 1982*, Pub. L. No. 97-444, 96 Stat. 2294; H.R. Rep. No. 565, 97th Cong., 2d Sess. (1982); S. Rep. No. 384, 97th Cong., 2d Sess. (1982).

64. Ironically, the Congress devoting the most time to discussing what manipulation involved ultimately decided that the term was too vague to make criminalization appropriate. As Senator Norris, then chairman of the Senate Agriculture Committee, stated in explaining why Congress did not make manipulation a crime under the *Future Trading Act*: "[T]hese things are various and perhaps impossible of direct definition. I do not know how we would draw a definition to bring it home to the individual." *Future Trading in Grain: Hearings on H.R. 5676 Before the Senate Comm. on Agriculture and Forestry*, 67th Cong., 1st Sess. 335 (1921) [hereinafter *1921 Senate Hearings*] (statement of Chairman Norris). Later Congresses ignored Senator Norris' concern and simply converted manipulation first, in 1936, into a misdemeanor, see CEA, *supra* note 12, § 9, and later, in 1968, into a felony, see *Commodity Exchange Act*, Pub. L. No. 90-258 § 25, 82 Stat. 26, 33 (1968), without any analysis as to the meaning of manipulation.

Congressional documents offer little explanation for the change from misdemeanor to felony other than this statement by the administrator of CEA: "No violations are now classified as felonies under the act. It is our feeling that the serious ones such as price

During the 1920's and early 1930's, the hearings and debates concerning futures trading include frequent references to manipulation,<sup>65</sup> yet they provide little consensus as to the term's meaning.<sup>66</sup> At times it

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manipulation, such as the willful dissemination of false market information, and such as embezzlement are the types of violations that should be felonies." *Amend the Commodity Exchange Act: Hearings Before the House Comm. on Agriculture*, 90th Cong., 1st Sess. 64-65 (1967); see H.R. Rep. No. 743, 90th Cong., 1st Sess. 5-6 (1967). This 1968 amendment was curious because although manipulation had been prosecutable as a crime since 1936, very few criminal prosecutions seem to have occurred. The author has found reference to only one criminal prosecution prior to this amendment. See Comment, *Manipulation of Commodity Futures Prices—The Great Western Case*, 21 U. Chi. L. Rev. 94, 112 n.93 (1953). There is no evidence in the legislative history showing that criminal manipulators were getting off with light misdemeanor sentences. Congress may have hoped that the increased penalty would increase the *in terrorem* effect without the need for enforcement. See S. Rep. No. 947, 90th Cong., 2d Sess. 2 (1968). Whatever the reasons for increasing the penalties, Congress gave no consideration to the meaning of manipulation.

In 1974, the CEA underwent major revisions, one of which provided for the creation of a new, separate agency, the Commodity Futures Trading Commission ("CFTC"), to monitor and regulate futures trading. Despite the breadth of these revisions, the legislative history concerning the 1974 Act and subsequent reauthorizations of the CFTC contain almost no analysis of the meaning or scope of the anti-manipulation provision. Prior to the House hearings on the 1974 Act, the House Agriculture Committee circulated to interested parties a list of twenty-five topics involving the CEA that the Committee would consider. See *Review of CEA Hearings*, *supra* note 6, at 24-29. None of the topics, however, had anything to do with manipulation or cornering. See *id.* at 24-29. Congress reauthorized the CFTC in 1978, see *Future Trading Act of 1978*, Pub. L. No. 95-405, 92 Stat. 865, and again in 1982, see *Future Trading Act of 1982*, Pub. L. No. 97-444, 96 Stat. 2294. Manipulation was not considered in connection with either of these reauthorizations. For reviews of the 1978 and 1982 legislation, see Rosen, *The Impact of the Futures Trading Act of 1982 on Commodity Regulation*, 15 Sec. Reg. & L. Rep. (BNA) 142 (Jan. 14, 1983), and Schneider & Santo, *Commodity Futures Trading Commission: A Review of the 1978 Legislation*, 34 Bus. Law. 1755 (1979).

65. See, e.g., 1921 Senate Hearings, *supra* note 64, at 22, 197, 205, 293, 315, 334-35, 452; *Future Trading: Hearings Before the House Comm. on Agriculture*, 66th Cong., 3d Sess. 320, 355-56, 376 (Jan.-Feb. 1921) [hereinafter *Jan. 1921 House Hearings*]; 61 Cong. Rec. 1315, 1318, 1323, 4762, 4765 (1921).

66. It has been suggested that Congress was preoccupied with the problem of manipulation. See Harrington, *Culpability and Its Content Under the Commodity Exchange Act*, 17 Conn. L. Rev. 1, 6-7 (1984) [hereinafter Harrington I]. This may overstate the case, for although Congress discussed manipulation, it spent as much, if not more, time on other issues such as discriminatory treatment of farmer's cooperatives by the boards of trade. See, e.g., 62 Cong. Rec. 9430 (1922); Virtue, *Legislation for the Farmers: Packers and Grain Exchanges*, 37 Q.J. Econ. 687, 702 (1923). In fact, it was concern about the unfair treatment of farmer's cooperatives that motivated the constitutional attack on the Future Trading Act. See Stassen, *Propaganda as Positive Law: Section 3 of the Commodity Exchange Act*, 58 Chi.-Kent L. Rev. 635, 642 n.32 (1982).

Moreover, the authority cited for the proposition that Congress was preoccupied with manipulation, see CEA, *supra* note 12, § 3; see, e.g., Harrington I, *supra*, at 7, may provide questionable support. Section 3 asserts that regulation in the area is necessary because "sudden or unreasonable fluctuations in [commodity prices] frequently occur as a result of such speculation, manipulation, or control." This section must be approached with some caution in light of its origin. Congress added § 3 to the Future Trading Act in 1922 in order to meet United States Supreme Court objections to the constitutionality of the Act. See *Hill v. Wallace*, 259 U.S. 44, 66-68 (1922). In striking down the Act as an unconstitutional exercise of congressional taxing authority, the Supreme Court dropped a broad hint that it would be far more receptive to regulation in this area as an exercise of

seems to have been used as a shorthand term to describe any conduct thought to be undesirable,<sup>67</sup> or unpatriotically greedy.<sup>68</sup> Much of the discussion during the 1921 hearings and debates focused on distinguishing between speculators and manipulators or among speculators, gamblers, and manipulators.<sup>69</sup> Clearly, many congressmen were uncertain

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congressional interstate commerce power. *See id.* at 68-69. Congress took the hint and hastily removed the tax provisions from the Act, substituting in their stead "legislative findings" that speculation and manipulation were having a serious detrimental impact on interstate commerce. *See Grain Futures Act, supra* note 12, § 3.

The Agriculture Department, which had drafted the language for § 3, candidly admitted that the sole purpose for including the manipulation language was to permit the Act to survive constitutional attack. *See Grain Futures Act: Hearings Before the House Comm. on Agriculture*, 67th Cong., 2d Sess. 2, 12-13 (1922) [hereinafter *1922 Grain Futures Hearings*] (testimony of Chester Morrill, Assistant Secy. of Agriculture); 62 Cong. Rec. 9419 (1922). The House committee report on § 3 is somewhat less candid. It boldly asserts that circumstances warrant the "finding" in § 3, adding: "[i]t is not the purpose to quote testimony in this report, but there are volumes of testimony given by the prominent men of the Nation which uphold the committee in its conclusion." H.R. Rep. No. 1095, 67th Cong., 2d Sess. 2 (1922). It is probably wise that the committee chose not to quote the supposed supporting testimony because the hearings contained little support for the conclusion that manipulation occurred "frequently." *See Stassen, supra*, at 644.

Nearly 60 years after the enactment of § 3, an altered jurisprudence of the commerce clause, *compare* J. Nowak, R. Rotunda, J.N. Young, *Constitutional Law* § 4.5 (3d ed. 1986) (summarizing Court's approach to commerce clause from 1888-1936) *with id.*, § 4.8 (summarizing current commerce clause doctrine), has permitted Congress quietly to amend § 3 to eliminate the statement that excessive speculation, manipulation and control are "frequent" phenomena. In 1982, Congress amended § 3 to eliminate the finding that sudden or unreasonable fluctuations in price frequently occur as a result of speculation, manipulation and control. *See Future Trading Act of 1982*, Pub. L. No. 97-444, § 203, 96 Stat. 2294 (codified at 7 U.S.C. § 5 (1982)). For a fuller discussion of the history of § 3, *see Stassen, supra*.

67. *See Cotton Prices: Hearings Before a Subcomm. of the Senate Comm. on Agriculture and Forestry, Pursuant to S. Res. 142*, 70th Cong., 1st Sess. 220 (1928) [hereinafter *1928 Senate Cotton Hearings*] (it is manipulation to "create disaster to cotton merchants and to the producer"). As one well-known futures trader observed in response to a Senator's question about manipulation: "The word 'manipulation' . . . in its use is so broad as to include any operation of the cotton market that does not suit the gentleman who is speaking at the moment." *Id.* at 154 (statement of William Clayton).

68. *See* C.B. Cowing, *supra* note 3, at 200 (quoting 1931 statement of Pres. Hoover); T. Hieronymus, *Economics, supra* note 6, at 4 (quoting 1947 statement of U.S. Attorney General). The looseness with which the term was used is illustrated by an incident in 1928. President Hoover had appealed to certain traders to stop their short selling of wheat—conduct that Hoover characterized as "manipulation[.]" *Commodity Short Selling: Hearings Before the House Comm. on Agriculture*, 72d Cong., 1st Sess. 182 (1932) [hereinafter *1932 Short Selling Hearings*]. Despite the President's characterization of the conduct, the chief of the Grain Futures Administration made it quite clear that he did not view the conduct in question as manipulation within the meaning of the Grain Futures Act, Pub. L. No. 67-331, ch. 369, 42 Stat. 998 (1922), the federal statute in effect at that time. Rather, he understood the President's comment as referring to manipulation in "a general way." *1932 Short Selling Hearings, supra*, at 218. Throughout the legislative history, it is often difficult to ascertain whether references to manipulation are being used in this "general way," or as a more technical description of what the Act prohibits or should prohibit.

69. A speculator is "[o]ne who voluntarily accepts the risks associated with the ownership of a commodity and relies on a price change in the commodity to produce a profit, or risk premium, for his efforts." S. Angrist, *supra* note 43, at 205. It is speculators who

about these distinctions, as witness after witness was asked to give his view of the distinction.<sup>70</sup> Even the most enlightened congressmen appear to have believed, incorrectly, that while not all speculators are manipulators, all manipulators are speculators.<sup>71</sup>

In addition to attempting to distinguish among speculators, manipulators, and gamblers, much of the discussion about manipulation centered on large-scale transactions. Many congressmen appeared to view large-scale trading as the primary, if not the sole, method of manipulation.<sup>72</sup> The classic problem that seemed to trouble Congress was a scheme by which an individual who ultimately wanted to buy a large quantity of a

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assume the risks that hedgers seek to transfer. See Bianco, *supra* note 7, at 32. Speculators are essential to the functioning of a futures market. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 390 (1982); T. Hieronymus, *Economics, supra* note 6, at 140. For a discussion of congressional recognition of the essential role of speculators, see *Leist v. Simplot*, 638 F.2d 283, 305-07 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982). "A commodity futures market without speculation would be a thing of death; it would not amount to anything. It would serve no economic utility." *Onions: Hearings Before the Subcomm. on Domestic Marketing of the House Comm. on Agriculture on H.R. 376, H.R. 1933, H.R. 1935, H.R. 3418, H.R. 5236 and H.R. 5732*, 85th Cong., 1st Sess. 10 (1957) (statement of Roger R. Kauffman, Administrator, Commodities Exchange Commission). Although futures speculation frequently is equated with gambling, there are significant differences between the two. See T. Hieronymus, *Economics, supra* note 6, at 137-38; see also *supra* note 6.

70. See, e.g., *Future Trading: Hearings Before the House Comm. on Agriculture on H.R. 168, H.R. 231, H.R. 2238, H.R. 2331, H.R. 2363 and H.R. 5228*, 67th Cong., 1st Sess. 155 (Apr.-May 1921) [hereinafter *April 1921 House Hearings*]; *Jan. 1921 House Hearings, supra* note 65, at 355-56, 376, 385, 591, 812; 61 Cong. Rec. 1318, 1319, 1323 (1921). One representative described a manipulator as one "who never owned a bushel of wheat in his life, who just simply figures on futures." *April 1921 House Hearings, supra*, at 133. The witness to whom the representative was speaking attempted to explain that the congressman had described a speculator, not a manipulator, but the representative remained unmoved. See *April 1921 House Hearings, supra*, at 133; see also *Cotton and Grain Futures Act: Hearings Before the Senate Comm. on Agriculture and Forestry*, 71st Cong., 3d Sess. 68 (Feb. 1931) [hereinafter *1931 Senate Cotton and Grain Hearings*]; *1928 Senate Cotton Hearings, supra* note 67, at 35.

71. See, e.g., *Jan. 1921 House Hearings, supra* note 65, at 385, 591; 61 Cong. Rec. 1318 (1921). This conclusion demonstrates substantial confusion about the notion of speculation, if not about manipulation. Modern history has demonstrated that hedgers are at least as capable of manipulation as are speculators. See 1 T. Russo, *supra* note 13, at 12-9 n.5. The 1976 Maine potato scandal, described by one commentator as "perhaps the largest manipulation ever attempted through a contract market," involved hedgers but virtually no speculators. See Bianco, *supra* note 7, at 37 n.57.

72. See S. Rep. No. 1431, 74th Cong., 1st Sess. 3 (1935); S. Doc. No. 123, 71st Cong., 2d Sess. 7 (1930); *To Amend the Grain Futures Act: Hearing on H.R. 6772 Before the Senate Comm. on Agriculture and Forestry*, 74th Cong., 2d Sess. 209 (1936) [hereinafter *1936 GFA Hearings*]; *Regulation of Commodity Exchanges: Hearing on H.R. 3009 Before the House Comm. on Agriculture*, 74th Cong., 1st Sess. 49 (1935); *1932 Short Selling Hearings, supra* note 68, at 201; *1931 Senate Cotton and Grain Hearings, supra* note 70, at 48; *Supervision of Cotton Futures Exchanges: Hearings Before the Senate Comm. on Agriculture and Forestry*, 70th Cong., 1st Sess. 26 (1928) [hereinafter *1928 Cotton Futures Hearings*]; *1921 Senate Hearings, supra* note 64, at 19 (remarks of Sen. Goodling); *Jan. 1921 House Hearings, supra* note 65, at 328, 350, 896, 911; 78 Cong. Rec. 10446 (1934); 61 Cong. Rec. 5559 (1921).

commodity would first sell large quantities short in order to drive the price down and then buy his needs at the new low price.<sup>73</sup>

This concern about large-scale transactions is apparent in several early versions of the Grain Futures Act that provided for limitations on the permissible size of speculative positions.<sup>74</sup> Such provisions were to be included in the same section of the act that prohibited manipulation.<sup>75</sup> The provision concerning position limitations occasionally even was referred to as a "definition" of manipulation.<sup>76</sup> Nonetheless, the Senate rejected a 1921 House proposal to include a provision about position limits in the section dealing with manipulation.<sup>77</sup>

### B. Grain Futures Administration Position

While the above-described comments and concerns do not seem to reflect a coherent and articulable theory of the meaning of manipulation, a relatively coherent theory does emerge from the views expressed to Congress by the Grain Futures Administration ("GFA"), the branch of the Department of Agriculture responsible for enforcing the Grain Futures Act.<sup>78</sup> Between the enactment of the Grain Futures Act and the CEA, the GFA repeatedly expressed to Congress its understanding of manipulation.<sup>79</sup> The GFA position focused unequivocally on the conduct and

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73. It is unlikely that such a scheme would prove effective unless the trader's activities or accompanying false rumors also induced others to sell or go short; otherwise, the trader would depress the price with his large-scale trades and then increase the price again as soon as he started buying. See *1931 Senate Cotton and Grain Hearings*, *supra* note 70, at 68; *1921 Senate Hearings*, *supra* note 64, at 154; H. Emery, *supra* note 6, at 172-73. This scenario is sometimes referred to as the problem of "burying the corpse." See Note, *The Delivery Requirement: An Illusory Bar to Regulation of Manipulation in Commodity Exchanges*, 73 Yale L.J. 171, 185 n.79 (1963); Comment, *supra* note 64, at 100 n.38.

74. See *April 1921 House Hearings*, *supra* note 70, at 13 (statement of Rep. Tincher) (discussing 200,000 bushel limit on single future trades); *1921 Senate Hearings*, *supra* note 64, at 378 (discussing 500,000 bushel limit on single future trades); see also *1932 Short Selling Hearings*, *supra* note 68, at 200-10.

75. *Grain Futures: Hearings Before the Senate Comm. on Agriculture and Forestry on H.R. 11843*, 67th Cong., 2d Sess. 13 (1922) [hereinafter *1922 Senate Hearings*] (statement of Rep. McNary); 61 Cong. Rec. 5559 (1921) (statement of Rep. Kelly).

76. *1922 Senate Hearings*, *supra* note 75, at 13; see also 61 Cong. Rec. 5559 (1921).

77. See 61 Cong. Rec. 5030 (1921). This limitation-as-"prophylactic" interpretation conforms with the rejection in 1921 of a proposed amendment to the bill that ultimately became the Grain Futures Act. The Senate had modified the section in the House version of the Act relating to the prevention of manipulation so as to require the boards of trade to prevent "undue or unfair manipulation." The House subsequently rejected these modifying words and the Senate acceded. See *id.* This rejection of the Senate modification, combined with the position of the Grain Futures Administration, suggests that Congress did not accept the view that all activity affecting price is manipulation and that all that distinguishes legal from illegal manipulation is the extent of that price effect. It further suggests that Congress felt neither the fact of a price effect nor the extent of that effect determines whether conduct qualifies as manipulation.

78. See G. Hoffman, *Future Trading Upon Organized Commodity Markets in the United States* 372 (1932).

79. See *infra* notes 82-93 and accompanying text. The GFA's position possesses par-

intent of traders, not on resulting prices. The basic position of the GFA was that to engage in trades that affect price does not constitute manipulation, even if that effect is dramatic or if the trader knows that his transaction is likely to affect price, so long as the reason for entering into the transaction or the profitability of the transaction does not depend on its effect on price.<sup>80</sup> Thus, under the GFA definition, the motivation behind the transaction forms the critical element in distinguishing manipulation from other transactions. Specifically, manipulation occurs when the trader's expectation of profit derives primarily from his expectation that his transactions will affect the market.<sup>81</sup>

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ticular significance because Congress gave no indication of dissatisfaction with, or desire to alter, the essential elements of the GFA interpretation of manipulation. Congress did, however, overrule the GFA on one technical point. The GFA had taken the position that "cross-trades" did not constitute manipulation and thus were not prohibited by the Grain Futures Act. See 80 Cong. Rec. 7905 (1936). When it enacted the CEA, Congress included a provision specifically prohibiting cross-trades. See CEA, *supra* note 12, § 4c(A) (current version at 7 U.S.C. § 6c(a)(A) (1982)); 1936 GFA Hearings, *supra* note 72, at 17 (statement of Sen. Pope); 80 Cong. Rec. 7867 (1936) (statement of Sen. Connally). Interestingly, Congress implemented the prohibition on cross-trades not by any change in the manipulation section, but by the addition of a new provision. See CEA, *supra* note 12, § 4c(A).

In enacting the CEA, Congress also specifically altered a Supreme Court interpretation concerning manipulation. In *Wallace v. Cutten*, 298 U.S. 229 (1936), the Court held that the Grain Futures Act authorized the Secretary of Agriculture to revoke the trading privileges only of those traders who were in the process of manipulating at the time of the revocation proceeding, but that the Secretary lost his authority over any trader once the alleged manipulation ceased. See *id.* at 236. This absurd holding completely eliminated the revocation proceeding's effectiveness as an enforcement mechanism. Congress corrected this problem by giving the Secretary authority with respect to a person who "is manipulating or attempting to manipulate." 80 Cong. Rec. 6160 (1936) (statement of Sen. Pope) (discussing *Wallace*); see CEA, *supra* note 12, § 6(b).

80. See *Fluctuations in Wheat Futures: Letter from the Secretary of Agriculture Transmitting, in Response to Senate Resolution No. 222, of June 9, 1926, a Report of The Grain Futures Administration Relative to the Extreme Fluctuation in the Price of Wheat Futures During the Early Part of 1925*, 6-7 (June 25, 1926) [hereinafter *GFA Letter*]; see also *Regulation of Grain Exchanges: Hearings Before the House Comm. on Agriculture on H.R. 8829*, 73d Cong., 2d Sess. 253 (1934) [hereinafter *1934 Grain Regulation Hearings*]; *1932 Short Selling Hearings*, *supra* note 68, at 181-85, 218-20.

81. The position expressed by the GFA parallels the position explicitly endorsed by Congress with respect to manipulation of securities. A Senate report made in connection with the antimanipulation provision of § 9(a)(2) of the Securities Exchange Act states:

Any extensive purchases or sales are bound to cause changes in the market price of the security, but mere knowledge on the part of the purchaser or seller that his transactions will have this effect is not sufficient to bring him within the scope of this provision. Thus, if a person is merely trying to acquire a large block of stock for investment, or desires to dispose of a big holding, his knowledge that in doing so he will affect the market price does not suffice to make his actions unlawful.

S. Rep. No. 792, 73d Cong., 2d Sess. 17 (1934); see also *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341, 383 (2d Cir.), *cert. denied*, 414 U.S. 910, *cert. denied*, 414 U.S. 924 (1973); *Opinion of the General Counsel of the SEC*, Sec. Exch. Act Release No. 3056, reprinted in [1941-47 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,214, at 75,469-71 (Oct. 27, 1941); Note, *Manipulation of the Stock Markets Under the Securities Laws*, 99 U. Pa. L. Rev. 651, 664 (1951).

The GFA expressed its position repeatedly and in a variety of contexts. First, in 1926, in response to a Senate resolution calling for an investigation of recent fluctuations in wheat futures prices,<sup>82</sup> the GFA reported to Congress that "the heavy trading by a few large professional speculators, aided by the reckless participation by the general public, was primarily responsible for wide price fluctuations, which were detrimental to legitimate grain interests."<sup>83</sup> The GFA, however, also reported that no evidence existed that this heavy trading, which had so dramatically affected prices, constituted manipulation.<sup>84</sup>

The rationale for the GFA's conclusion was based on a distinction made by the Secretary of Agriculture between "constructive" speculation and manipulation. According to the Secretary, constructive speculators were "[t]hose who trade on the basis of rational appraisal of present and prospective conditions affecting supply and demand, without at the same time trading in a manner or with aids designed to augment or artificially hasten the market results expected."<sup>85</sup> In other words, constructive speculators trade with the expectation of making a profit from price movements, but the expected price movements are the result of external factors and are not caused by the speculators' own trades.<sup>86</sup> The Secretary concluded that such speculation is completely legal.<sup>87</sup>

On the other hand, manipulators, according to the Secretary of Agriculture, are "[t]hose who trade largely on the basis of mob psychology and faith in their ability through heavy trading to bring about temporary market conditions of which they may take advantage to make profits."<sup>88</sup>

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82. S. Res. 222, 69th Cong., 1st Sess. (1926).

83. *GFA Letter*, *supra* note 80, at 7.

84. *See id.*

85. *Id.* at 5. Representative McLaughlin offered a similar definition. According to him, a speculator is "[o]ne who deals under existing conditions as he interprets them but does not attempt to alter them" and a manipulator as one who "attempts to force artificial conditions or to exaggerate conditions for his own advantage." *Jan. 1921 House Hearings*, *supra* note 65, at 446.

86. The Secretary noted that the "constructive" speculators "bought wheat futures because they really believed that the price of wheat at the time was low compared to what it would be at a future date, considering the existing and prospective supply and demand for wheat." *GFA Letter*, *supra* note 80, at 5.

87. *See id.* at 7.

88. *Id.* at 5. A definition of "manipulation" in a proposed bill to regulate cotton futures illustrates this approach of focusing on the trader's conduct and determining whether that conduct serves a legitimate purpose. The bill defined manipulation as:

- (1) Shipping or transferring to any contract market any cotton for the purpose of delivery on such contract market at an obvious loss on the transaction for the purpose of artificially influencing prices.
- (2) Tendering and repeatedly retendering on futures contracts in any designated contract market notices of delivery of the same cotton for the purpose of artificially influencing prices upon such contract market.
- (3) The tender upon futures contracts more than once by the same person in the same calendar month of notices of delivery of the same cotton, or otherwise trafficking in notices of delivery for the purpose of artificially influencing prices.
- (4) Engaging in manipulative straddle operations of large proportions in and



The GFA adopted the basic position that even when an "abnormal movement of prices" results from a trader's activities, those trading activities do not amount to manipulation if they were based on "the bona fide judgment of the individual traders as to proper values."<sup>89</sup>

GFA administrators reinforced this understanding of manipulation in congressional hearings during the 1930's.<sup>90</sup> For example, in a 1932 hearing on short selling before the House Agriculture Committee, Dr. Duvel, Chief of the GFA, was asked a number of questions regarding why neither the GFA nor the Secretary of Agriculture had taken steps to revoke the trading privileges of large-scale traders.<sup>91</sup> Dr. Duvel responded that the fact of a large-scale transaction, or even proof of an effect on the market did not, by itself, demonstrate that there was "manipulation" within the meaning of the Act.<sup>92</sup> Duvel stated that sanctions required proof that the transactions were "intentionally undertak[en] to manipulate the market."<sup>93</sup>

### C. *Marsh-Clayton Confrontation*

As the foregoing discussion indicates, it is difficult to draw any conclusion from the legislative history regarding the meaning of manipulation. Therefore, it is not surprising that case law has placed relatively little reliance on it.<sup>94</sup> Ironically, however, the one piece of legislative history most frequently cited in defining manipulation is one that offers a particularly unreliable reflection of congressional understanding. That piece of history is a statement by a witness, Arthur Marsh, at a 1928 Senate committee hearing concerning a decline in cotton prices.<sup>95</sup> The hearing gave the Senate Agriculture Committee an opportunity to observe a classic confrontation between Arthur Marsh, a former president of the New York Cotton Exchange, and William Clayton, a major cotton trader. Marsh previously had accused Clayton of manipulating the New York

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between various cotton-futures markets with the purpose of artificially influencing the movement of prices in any cotton-futures market.

S. 3871, 70th Cong., 1st Sess. (1928) (quoted in *1928 Cotton Futures Hearings*, *supra* note 72, at 1-2.

89. *GFA Letter*, *supra* note 80, at 7.

90. See *1934 Grain Regulation Hearings*, *supra* note 80, at 253; *1932 Short Selling Hearings*, *supra* note 68, at 181-85, 218-21.

91. *1932 Short Selling Hearings*, *supra* note 68, at 181-85, 218-21. Under the Grain Futures Act, the Secretary could impose such a sanction against a trader who was found to be manipulating the futures market. See *Grain Futures Act*, *supra* note 12, § 6(b).

92. See *1932 Short Selling Hearings*, *supra* note 68, 219-20.

93. *Id.* at 185. The Assistant Chief of the GFA reiterated this point a year later. While testifying on legislation that ultimately became the Commodities Exchange Act, he explained: "This bill is not in any sense a price-fixing measure. We do not think it is intended to eliminate every fluctuation from the market, although we hope it will eliminate those fluctuations that come about by artificial and unnatural means . . ." *1934 Grain Regulation Hearings*, *supra* note 80, at 253.

94. See, e.g., *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1166 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Volkart Bros. v. Freeman*, 311 F.2d 52, 58 (5th Cir. 1962).

95. *1928 Senate Cotton Hearings*, *supra* note 67, at 201-02.

cotton market and had threatened to file complaints with the Department of Justice, the New York State Attorney General and the New York Cotton Exchange.<sup>96</sup> The hearing took on a highly personal tone, with nearly half of the hearing being devoted to testimony of Marsh and Clayton and the cross-examination of each by the other's lawyer.

There exists simply no basis to determine whether the accusations of manipulation made by Marsh reflect congressional understanding.<sup>97</sup> Nonetheless, because the definition of manipulation offered by Marsh during this confrontation has been quoted repeatedly as authoritative,<sup>98</sup> some examination of the circumstances surrounding the Marsh-Clayton confrontation is appropriate.

At the time of the alleged manipulation, cotton futures were sold in both New Orleans and New York. During the early 1920's, a huge cotton crop caused prices in New Orleans to fall very low in comparison with New York cotton prices.<sup>99</sup> With low prices and a shortage of storage space in New Orleans, Clayton bought cheap cotton in the South and shipped it to New York, where he used it to deliver on short contracts he had made in the North, thereby realizing substantial profits.<sup>100</sup> Basically, Clayton arbitrated—he saw a differential between prices in two different markets and exploited this differential to make a profit for himself. His actions thus brought the prices in the two markets into line with each other.<sup>101</sup>

Marsh expressed several specific objections to Clayton's conduct. These objections are significant because they seem to reflect a hostility to some fundamental aspects of futures trading. Marsh's first objection was that Clayton had shipped large quantities of cotton to New York to cover his short<sup>102</sup> contracts rather than simply buying offsetting contracts at whatever premium the longs<sup>103</sup> could extract.<sup>104</sup> The second objection was that in settling his contracts, Clayton delivered the least desirable cotton permissible under the contract.<sup>105</sup> Third, and most fundamental, Marsh objected to the large profit that Clayton had made speculating in

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96. *Id.* at 110.

97. *See infra* notes 111-12 and accompanying text.

98. *See, e.g.,* Volkart Bros. v. Freeman, 311 F.2d 52, 58 (5th Cir. 1962); David G. Henner, 30 Agric. Dec. 1151, 1224 (1971); Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,281 (CFTC 1982).

99. 1928 Senate Cotton Hearings, *supra* note 67, at 108-11.

100. *See id.* at 108-09, 114.

101. *See id.* at 156-57.

102. *See supra* note 33.

103. *See id.*

104. *See 1928 Senate Cotton Hearings, supra* note 67, at 227. Clayton expressed concern that if he had not been prepared to deliver on his contracts, the shorts would have extracted a substantial premium from him. *See id.* at 189-90. In essence, Clayton delivered so he would not be the victim of a squeeze by the longs.

105. *See 1928 Senate Cotton Hearings, supra* note 67, at 229. Marsh did not contend that in so doing Clayton violated the terms of his contract or the rules of the exchange. He simply seemed to think that it was unfair for a trader to take advantage of the shorts in this way. *See id.*

cotton futures at the expense of hedgers.<sup>106</sup> It was in this context that he offered the definition that is so often quoted:

Manipulation, Mr. Chairman, is any and every operation or transaction or practice, the purpose of which is not primarily to facilitate the movement of the commodity at prices freely responsive to the forces of supply and demand; but, on the contrary, is calculated to produce a price distortion of any kind in any market either in itself or in its relation to other markets. If a firm is engaged in manipulation it will be found using devices by which the prices of contracts for some one month in some one market may be higher than they would be if only the forces of supply and demand were operative; or using devices by means of which the price or prices of some month or months in a given market may be made lower than they would be if they were freely responsive to the forces of supply and demand. Any and every operation, transaction, device, employed to produce those abnormalities of price relationship in the futures markets, is manipulation.<sup>107</sup>

The difficulty with this definition is that it appears to impose an obligation not to act in one's own best interest. To trade simply with the expectation of profit will not shelter the trader from charges of manipulation. According to this definition, the nonmanipulative transaction must have as its purpose the facilitation of the forces of supply and demand. Moreover, it is clear that under the Marsh definition, supply and demand means something other than what people are willing to pay in the futures market. Given that Marsh considered Clayton's arbitrage activities to constitute manipulation, Marsh apparently would have imposed on Clayton the obligation to ascertain whether it would be good for overall commerce and industry in New York for there to be more cotton there.<sup>108</sup>

Marsh went on to impose an additional obligation on traders. Elaborating on his definition of manipulation, he asserted that "[i]t is manipulation to offer a particular grade of cotton which is being freely delivered on contracts, below what the generality of the trade believes to be its proper value in the spot markets."<sup>109</sup> Thus, according to Marsh, anyone who evaluates the market differently than "the generality of the trade" and prices accordingly, is guilty of manipulation.<sup>110</sup>

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106. *See id.* at 211. Speculators are, however, essential to the futures market, *see supra* note 69, and it is only the potential for making a profit that brings speculators into the market, *see* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 358 (1982) ("The purchase or sale of a futures contract on an exchange is . . . motivated by a single factor—the opportunity to make a profit . . . from a change in the market price.").

107. 1928 *Senate Cotton Hearings*, *supra* note 67, at 201-02.

108. *Cf.* Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,300 (CFTC 1982) (Stone, concurring) ("We would place an entirely unreasonable and judicially unprecedented burden on an administrative tribunal if, in order to render a manipulation decision, it were required to find that the suspect prices were harmful to national resource allocation.").

109. 1928 *Senate Cotton Hearings*, *supra* note 67, at 202.

110. Clayton took the position that if little manufacturing or other commercial need for cotton existed in New York, then it should not have been made a delivery point. *See generally* 1 T. Russo, *supra* note 13, § 12.23, at 12-42 to 12-43 (observing that normal

There is no indication that the Senate accepted Marsh's view.<sup>111</sup> Other definitions of manipulation were offered at that hearing,<sup>112</sup> yet thereafter, Congress took no action whatsoever.

#### D. "Artificial Price" in Legislative History

While the history of federal legislation dealing with commodity futures trading may not be notable for what it contains, it is at least significant for what it lacks. The legislative history rarely mentions the concept of an artificial price, which many courts and commentators now regard as central to the meaning of manipulation.<sup>113</sup> The congressional debates during the 1920's contain references to the law of supply and demand in discussions of manipulation,<sup>114</sup> but they give little indication of what this meant or how it might relate to the concept of an artificial price.<sup>115</sup>

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price relationships will not exist if contract calls for delivery of noncommercial grades at non-terminal points). He argued that having made New York a delivery point, it was not manipulation for a trader to buy cheap and sell dear on the market, as he had done, because this is exactly the sort of trade a free market allows and even encourages. See 1928 Senate Cotton Hearings, *supra* note 67, at 154-59.

111. Shortly after Marsh gave the above-quoted definition, Senator Smith noted that "there seems to be some doubt as to [the] actual meaning" of "manipulation." 1928 Senate Cotton Hearings, *supra* note 67, at 220.

112. *Id.* at 154, 225.

113. See *infra* notes 115-17 and accompanying text. Early legislative history touches indirectly upon the artificial price concept. The 1921 hearings contain a reference to the "artificial depression" of prices, but no reference to "artificial prices." Jan. 1921 House Hearings, *supra* note 65, at 905 (emphasis added). Similarly, the Assistant Chief of the GFA spoke about fluctuations brought about by "artificial . . . means." 1934 Grain Regulation Hearings, *supra* note 80, at 253; see also GFA Letter, *supra* note 80, at 1.

There is passing reference to an artificial price in the hearings that produced the Marsh/Clayton confrontation. See 1928 Senate Cotton Hearings, *supra* note 67, at 503. As noted earlier, however, Congress took no action based on that hearing. See *supra* notes 111-12 and accompanying text. Moreover, Senator Caraway, who used the phrase, exhibited a particularly high level of confusion about the operation of the market. The Senator expressed the view that a farmer who refused to sell today because he believed there would be scarcity and higher prices in the future, would be acting "artificially" and generating an "artificial price." See 1928 Senate Cotton Hearings, *supra* note 67, at 503. Yet, it is precisely this type of "artificial" conduct that results in economically efficient allocations of scarce resources over time. See generally authorities cited *supra* note 16.

114. See 61 Cong. Rec. 1368, 1391, 5560 (1921).

115. It is not at all clear that Congress had a very sophisticated notion of supply and demand. The frequent fluctuations of prices often were cited as proof that the market was not functioning properly, since the supply available each season is fixed by the harvest and does not fluctuate. See, e.g., 61 Cong. Rec. 1321 (1921). Boyle explained the problems with this argument in an early book on futures trading:

There are two fallacies here—one on the supply side and one on the demand side. No one knows exactly what the supply is: it is a matter of opinion—expert opinion, backed by official government crop estimates plus private crop reporting agencies of all kinds. But it is still an estimate, a mere calculation. And the estimate may change overnight, due to a news report. . . . And as to the demand side of the market, it is perfectly obvious that market news from hour to hour greatly affects this side of the market. The consumer—the ultimate dictator of the market—has his mind (and his demand) influenced by both physical and psychological factors, which it is unnecessary to enumerate here.

The only place in which any prominent discussion of the concept of an artificial price can be found is in the documentation of several bills introduced during the 1960's proposing definitions of manipulation.<sup>116</sup> None of these bills were passed, and they were criticized largely because the concept of artificial price to which they referred was thought to be unreasonably vague.<sup>117</sup> Thus, the legislative history provides little support for the "artificial price" approach to manipulation.

### III. PAST APPROACHES TO MANIPULATION

In the 65 years since Congress first began prohibiting manipulation of futures, only about a dozen cases<sup>118</sup> and even fewer law review articles<sup>119</sup>

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J. Boyle, *Speculation & the Chicago Board of Trade* 126-27 (1920); see David G. Henner, 30 Agric. Dec. 1151, 1203 (1971); J. Boyle, *supra*, at 8; H. Emery, *supra* note 6, at 114; Working I, *supra* note 38, at 293-94.

116. See S. 402, 88th Cong., 1st Sess. (1964); S. 1980, 87th Cong., 1st Sess. (1962); S. 2807, 86th Cong., 2d Sess. (1961); see also H.R. 4685, 81st Cong., 1st Sess. (1954). Another bill, never introduced, contains similar language. See David G. Henner, 30 Agric. Dec. 1151, 1289 (1971) (discussing H.R. 9178, 90th Cong., 1st Sess. (1968)). These proposals apparently came in response to the decision in *General Foods Corp. v. Brannan*, 170 F.2d 220, 230-31 (7th Cir. 1948), which held that intentionally stabilizing or pegging a price does not constitute manipulation. See David G. Henner, 30 Agric. Dec. at 1290.

The definition proposed in 1966 in a bill endorsed by the Department of Agriculture generated the most debate. The bill provided:

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

S. 2859, 88th Cong., 2d Sess. (1965); H.R. 11788, 89th Cong., 1st Sess. (1966); see David G. Henner, 30 Agric. Dec. 1151, 1288-89 (1971). The definition, particularly the second sentence, which was thought to prohibit conduct that unintentionally affected price, aroused considerable controversy. See *To Amend the Commodity Exchange Act: Hearings Before the House Committee on Agriculture, Subcommittee on Domestic Marketing and Consumer Relations on H.R. 11788*, 89th Cong., 2d Sess. 51, 77-78, 80, 93, 129, 151-52 (1966) [hereinafter *1966 House CEA Hearings*]; Vogelsson, *Tightened Regulation for Commodity Exchanges*, 55 A.B.A. J. 858, 860-61 (1969). As witnesses explained, every trade, including perfectly legitimate transactions, has an effect on the market. See, e.g., *1966 House CEA Hearings*, *supra*, at 129. Moreover, all traders are aware of this. Thus, the test for intent must require more than knowledge that the natural and probable consequences of one's trade will be to affect price.

117. See, e.g., *1966 House CEA Hearings*, *supra* note 116, at 92-93, 143. As the vice president of the Kansas City Board of Trade explained:

[N]o member of the public has any idea of what [the Secretary of Agriculture] might consider "abnormal" or "artificial". . . . There is no means of ascertaining what the price would be had it not been for the alleged conduct of an individual. This provision contemplates crystal-ball gazing to guess the level a commodity would have maintained had not a particular course of action been taken.

*Id.* at 93. Ultimately, the definition was dropped from the bill, although Congress enacted other portions of the bill in the 1968 amendment to the CEA.

118. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962); *G.H. Miller & Co. v. United States*, 260 F.2d 286 (7th Cir. 1958) (en banc), *cert. denied*, 359 U.S. 907 (1959);

have offered any significant analysis of manipulation. A summary of the facts and holdings of the cases, already undertaken elsewhere,<sup>120</sup> will not be duplicated here. Instead, this Part presents an analysis of the common approaches to the manipulation problem, focusing in particular on the practical problems the various approaches present and on the underlying assumptions about the purpose of the anti-manipulation provision of the CEA.

### A. *Manipulation as an Artificial Price*

Most definitions of manipulation focus on whether a resulting price is artificial, rather than on the process bringing about that price. A classic definition of manipulation calls it "the creation of an artificial price by planned action, whether by one man or a group of men."<sup>121</sup> While most agree that an artificial price occupies a central role in the definition of manipulation,<sup>122</sup> some diversity of views exists as to what precisely is meant by an "artificial price." Two basic approaches to identifying an artificial price have emerged, and within each approach some variations exist.<sup>123</sup> All of these attempts to define an artificial price, however, either prove too vague,<sup>124</sup> require the courts to engage in unreasonably complex

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Great W. Food Distribs., Inc. v. Brannan, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); General Foods Corp. v. Brannan, 170 F.2d 220 (7th Cir. 1948); Strobl v. New York Mercantile Exch., [1982-84] Comm. Fut. L. Rep. (CCH) ¶ 22,050 (S.D.N.Y. 1984); Minpeco, S.A. v. ContiCommodity Servs., Inc., 552 F. Supp. 332 (S.D.N.Y. 1982); Cox, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786 (CFTC 1987); Compania Salvadorena De Cafe, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,886 (CFTC 1983); Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (CFTC 1982); Hohenberg Bros., [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271 (CFTC 1977); David G. Henner, 30 Agric. Dec. 1151 (1971).

119. See Edwards & Edwards, *A Legal and Economic Analysis of Manipulation in Futures Markets*, 4 J. Fut. Mkts. 333 (1984); Harrington, *The Manipulation of Commodity Futures Prices*, 55 St. Johns L. Rev. 240, 252-65 (1981) [hereinafter Harrington II]; Hieronymus, *Manipulation in Commodity Futures Trading: Toward a Definition*, 6 Hofstra L. Rev. 41 (1977) [hereinafter Hieronymus, *Manipulation*]; Johnson I, *supra* note 16; McDermott, *supra* note 15; Van Smith, *supra* note 15; Note, *supra* note 73.

120. See, e.g., Edwards & Edwards, *supra* note 119, at 337-43; Harrington II, *supra* note 119, at 252-65; Johnson, *Key Cases in Manipulation*, in CBOT Seminar Report on Research on Speculation 96 (Nov. 1980) [hereinafter Johnson III].

121. General Foods Corp. v. Brannan, 170 F.2d 220, 231 (7th Cir. 1948) (quoting government's brief).

122. See, e.g., Cargill, Inc. v. Harden, 452 F.2d 1154, 1167 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); 1 T. Russo, *supra* note 13, §§ 12.22-12.29, at 12-40 to 12-43; Johnson I, *supra* note 16, at 746.

123. See *infra* notes 129-67 and accompanying text.

124. Any definition of artificial price and manipulation must be sufficiently concrete and specific to avoid a problem of unconstitutionally vagueness. A few defendants have argued that the term manipulation is unconstitutionally vague. See, e.g., Cox, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,767, at 27,076 (CFTC Initial Decision 1983), *rev'd on other grounds*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786 (CFTC 1987); David G. Henner, 30 Agric. Dec. 1151, 1259 (1971). Courts have disposed of these arguments rather summarily with little more than a cite to Bartlett Frazier Co. v. Hyde, 65 F.2d 350 (7th Cir. 1933). See, e.g., David G. Henner, 30 Agric.

economic analysis,<sup>125</sup> or are unduly rigid.<sup>126</sup>

Dec. 1151, 1224 n.85 (1971). This case, however, hardly can be characterized as the definitive treatment of the issue. In *Bartlett*, the Court of Appeals for the Seventh Circuit rejected the argument that the term "manipulation" was unconstitutionally vague, basing its rejection on the United States Supreme Court's repeated reference to manipulation in its decision in *Chicago Board of Trade v. Olsen*, 262 U.S. 1 (1923). *Olsen*, however, had addressed, not the question of vagueness, but only the issue of whether Congress had the authority under the interstate commerce clause to regulate futures trading. See *id.* at 30-31. Moreover, the Court in *Olsen* never explained what it thought the term manipulation meant. While some notions of manipulation may be sufficiently well-developed to withstand an attack on vagueness grounds, this citation to repeated usage by the Supreme Court of an undefined term, see, e.g., *Volkart Bros. v. Freeman*, 311 F.2d 52, 58 (5th Cir. 1962), does not demonstrate that "creating an artificial price" is sufficiently specific.

This concern regarding vagueness is not frivolous. In a series of decisions during the 1910's and 1920's, the Supreme Court struck down as unconstitutionally vague certain economic legislation. For example, in *International Harvester Co. v. Kentucky*, 234 U.S. 216 (1914), the Supreme Court held unconstitutional a Kentucky antitrust statute prohibiting combinations to enhance or depress the price of an article above or below its "real value." *Id.* at 221-22. "Real value" had been interpreted to mean "'market value under fair competition, and under normal market conditions.'" *Id.* at 221 (quoting state court opinion). The Court found the statute void for vagueness and explained:

To compel [businessmen] to guess on peril of indictment what the community would have given for [goods] if the continually changing conditions were other than they are, to an uncertain extent; to divine prophetically what the reaction of only partially determinate facts would be upon the imaginations and desires of purchasers, is to exact gifts that mankind does not possess.

*Id.* at 223-24; see *American Seeding Mach. v. Kentucky*, 236 U.S. 660, 661-62 (1915) (following *International Harvester*); *Collins v. Kentucky*, 234 U.S. 634, 637-38 (1914) (same). Similarly, in *United States v. Cohen Grocery Co.*, 255 U.S. 81 (1921), the Court struck down a federal law that made it unlawful for anyone "willfully . . . to make any unjust or unreasonable rate or charge in handling or dealing in or with any necessities." *Id.* at 86; see *Cline v. Frink Dairy Co.*, 274 U.S. 445, 458-59 (1927); *A.B. Small Co. v. American Sugar Ref. Co.*, 267 U.S. 233, 238-39 (1925); see also *Connally v. General Constr. Co.*, 269 U.S. 385, 391-92 (1926) (discussing standards of constitutional vagueness).

The temptation exists to dismiss these decisions as mere historical artifacts left over from "an era when economic laissez faire was for the Court the sanctum sanctorum that free speech has become today." Note, *The Void-for-Vagueness Doctrine in the Supreme Court*, 109 U. Pa. L. Rev. 67, 77 (1960) (authored by now Professor Amsterdam); see *id.* at 75. In 1963, the Court suggested, however, in *United States v. National Dairy Products Corp.*, 372 U.S. 29 (1963), that although vague economic regulations would be approached somewhat differently than would vague limits on first amendment freedoms, the vagueness doctrine was not a dead letter in the context of economic regulation. See *id.* at 36. *National Dairy Products* involved an attack on § 3 of the Robinson-Patman Act that makes it a crime to sell goods "at unreasonably low prices for the purpose of destroying competition or eliminating a competitor." 15 U.S.C. § 13a (1982). Although the Court upheld the statute, it did so by construing the statute to prohibit only sales which were "below cost" and made with a predatory intent. 372 U.S. at 34-35. The Court seemed to assume that economic criteria exists for distinguishing "below cost" pricing from other kinds of pricing, see R. Bork, *The Antitrust Paradox: A Policy at War with Itself* 78 (1978), and the Court distinguished *Cohen* on that basis. As the Court explained, the prohibition against "any unjust or unreasonable rate or charge" struck down in *Cohen* "was without a meaningful referent in business practice or usage. '[T]here was no accepted and fairly stable commercial standard which could be regarded as impliedly taken up and adopted by the statute. . . .'" 372 U.S. at 36 (quoting *A.B. Small Co. v. American Sugar Ref. Co.*, 267 U.S. 233, 240-41 (1925)).

125. See *infra* notes 148-64 and accompanying text.

It has been argued that focusing on whether a price is artificial comports with the underlying reason for condemning manipulation—that manipulation generates inaccurate price information that distorts the market.<sup>127</sup> Even accepting the premise that manipulation is bad because of its distorting effect on prices, it does not follow that focusing directly on prices and attempting to determine whether or not they are artificial represents the most efficient or effective way of preserving the pricing function of the futures market. Such a focus makes sense only where courts retain the ability to differentiate between “artificial” and “appropriate” prices. As described more fully below,<sup>128</sup> performing this differentiation is, at best, a most difficult task.

### 1. Meaning of “Artificial Price”

#### a. *Artificial Price as an Historically Unusual Price*

One approach considers a price artificial if it deviates in its relationship to other prices from a set of expected price relationships.<sup>129</sup> Simply put, an artificial price is one that is historically unusual, either because of its absolute level or because of its relationship to other prices. Most of the courts that have analyzed commodities manipulation apparently accept this approach.<sup>130</sup>

In determining whether a price is “unusual,” courts have considered such factors as: the dollar price; the spread between cash and futures prices; the spread between the futures price in the month of the alleged manipulation and the price in succeeding or preceding months; and the spread between prices on different exchanges—all to determine if the price and spreads resemble those that have prevailed in the past.<sup>131</sup>

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126. See *infra* notes 129-41 and accompanying text.

127. See *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,297-99 (CFTC 1982) (Stone, concurring).

128. See *infra* notes 129-67 and accompanying text.

129. See cases cited *infra* note 130.

130. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1167 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 482 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); *Volkart Bros.*, 20 Agric. Dec. 306, 334-35 (1961), *vacated on other grounds*, *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962); *G.H. Miller & Co.*, 15 Agric. Dec. 1015, 1043-46 (1956), *aff'd on rehearing*, *G.H. Miller & Co. v. United States*, 260 F.2d 286 (7th Cir. 1958) (en banc), *cert. denied*, 359 U.S. 907 (1959). For a fuller description of the historical approach adopted in *Great Western* and *Cargill*, see *McDermott*, *supra* note 15, at 211-12. In addition, at least one former commissioner of the CFTC also has accepted this approach. See *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,300 (CFTC 1982) (Stone, concurring).

131. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1167-68 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 482 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); *Volkart Bros.*, 20 Agric. Dec. 306, 334-35 (1961), *vacated on other grounds*, *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962); *G.H. Miller & Co.*, 15 Agric. Dec. 1015, 1043-46 (1956), *aff'd on rehearing*, *G.H. Miller & Co. v. United States*, 260 F.2d 286 (7th Cir. 1958) (en banc), *cert. denied*, 359 U.S. 907 (1959); see generally *Johnson I*, *supra* note 16, at 749-52 (discussing spread relationships as indication of artificial price).



While this approach appears relatively straightforward, it presents a number of difficulties. First, for any meaningful comparison, the prices with which the comparison is being made must be historically comparable and not themselves "artificial" or "manipulated."<sup>132</sup> A number of commentators and economists have recognized that such an assumption about comparability frequently is unwarranted.<sup>133</sup> It has been observed that, in many circumstances, cash prices for a commodity may be less reliable as an indication of actual value than are futures prices.<sup>134</sup> Similarly, in comparing a current price with a prior price, often no basis exists for the belief that the current price, rather than the prior one, is artificial. As Dr. Roger Gray has explained, "while it may be true that the delivery month is the most likely place to look for artificial prices, it is also the most likely place to look for sudden corrections of mistaken or manipulated prices."<sup>135</sup>

It may be possible to eliminate some of the problems surrounding what constitutes a "normal" price or price relationship by using broadly based averages derived from the prices over many years in many markets.<sup>136</sup> Even with this modification, however, the historical approach suffers from a second and more fundamental defect. The approach seems to be

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132. See *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 482-83 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); David G. Henner, 30 Agric. Dec. 1151, 1217-18 (1971).

133. See Gray, *supra* note 16, at 110; Johnson I, *supra* note 16, at 747; Johnson III, *supra* note 120, at 106-07; McDermott, *supra* note 15, at 211-13; Van Smith, *supra* note 15, at 1585.

134. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1168 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Indiana Farm Bureau Coop. Ass'n*, [1977-80] Comm. Fut. L. Rep. (CCH) ¶ 20,964, at 23,859 n.3 (CFTC Initial Decision 1979); 1 T. Russo, *supra* note 13, § 12.23, at 12-41; Johnson I, *supra* note 16, at 725, 747 n.131; McDermott, *supra* note 15, at 212.

135. Gray, *supra* note 16, at 110; see McDermott, *supra* note 15, at 212.

136. Professor Gray has observed that the complexity involved in thoroughly analyzing such broadly based data "may strain the competence of the regulatory agency and the budget of the respondent to the point that it is unlikely to be undertaken in particular cases." Gray, *supra* note 16, at 113. Moreover, he observed that this type of "econometric analysis is better suited to drawing conclusions regarding large price aberrations than smaller ones." *Id.* at 111. Of course, one way for proponents of this approach to eliminate the difficulty of appearing to want "normal" prices even in abnormal times, is to redefine what they mean by "normal." Any changes in the supply or demand of the commodity or in its marketing or distribution system that would be expected to produce certain price changes could be taken into account in calculating a "normal" price. This more sophisticated econometric model could thus take into account the relevant changes in conditions of the market and would identify the expected effect of those changes. See *id.* at 113.

This approach seems quite sensible. Unfortunately, it suffers from the precise defect that proponents of this approach seek to avoid: it still necessitates a subjective determination as to which conditions should be taken into account in the calculus. As Commissioner Stone explained, if *all* market forces that contribute to shaping a price are considered, "there obviously can be no such thing as an artificial price." *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,300 (CFTC 1982) (Stone, concurring). It then becomes necessary to distinguish between legitimate and illegitimate market factors, an inquiry that raises problems of its own. See *infra* notes 145-67 and accompanying text.

based on the unstated assumption that the goal of the anti-manipulation provision is to stabilize prices and prevent them from deviating from historical patterns.<sup>137</sup> Although the legislative history contains statements, particularly during the 1920's, suggesting that price stabilization was viewed as a likely and desirable by-product of regulation,<sup>138</sup> it does not appear that Congress viewed price stabilization as an end in itself, to be pursued regardless of underlying conditions.<sup>139</sup> When unusual circumstances exist, unusual prices should likewise exist.<sup>140</sup> By focusing on historical comparisons, a court runs a serious risk of labeling as artificial any unusual price, even when unusual circumstances justify that price.<sup>141</sup>

Former CFTC Commissioner Stone, a proponent of the historical approach, has offered an analogy in defense of that approach that more aptly summarizes the approach's weaknesses. He has argued that the presence of an artificial or unusual price, like a body in the city morgue, does not prove wrongdoing has occurred, but it certainly makes us suspicious.<sup>142</sup> I would, however, argue that the presence of an "unusual" price ought to be treated precisely the way a body in the morgue is—it

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137. Some cases at least implicitly accept this as the goal. For example, in *Cargill*, the court asserted that among "[t]he main economic functions performed by the futures market [is] the stabilization of commodity prices . . . ." *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1173 (8th Cir. 1971) (emphasis added), cert. denied, 406 U.S. 932 (1972). Similarly, Commissioner Johnson stressed in *Indiana Farm Bureau* that the aim of the CFTC should be "to maintain orderly futures trading." *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,292 (CFTC 1982).

138. The Senate Report to the Future Trading Act stated, "[i]t is believed that this bill will, by wiping out obvious abuses that are practiced on the grain exchanges, result in more stable markets . . . ." S. Rep. No. 212, 67th Cong., 1st Sess. 4 (1921).

139. A colloquy in the House debate on the Future Trading Act between Representative Tincher, a member of the House Agriculture Committee, and several colleagues illustrates this point. Representative Tincher was asked whether he hoped that the bill would "tend to stabilize the price of wheat when it is up and prevent the forcing of it down by speculation." 61 Cong. Rec. 1314 (1921) (Rep. McKenzie). He responded that this was the goal. See *id.* (Rep. Tincher). That, however, did not end the discussion. Others pushed Tincher on this concept, inquiring whether he also hoped to stabilize low prices. See *id.* (Rep. Connally). Tincher responded that his goal was not to stabilize prices, but rather to insure that prices properly reflect underlying conditions of supply and demand. See *id.* (Rep. Tincher).

While Tincher and others clearly believed that a market free from manipulation was likely to be more stable, it is also clear that they viewed price stability not as an end in itself, but as a by-product of a properly functioning market. This point was made quite explicitly in 1934 by a GFA administrator testifying before Congress, who observed that the anti-manipulation provision "is not in any sense a price-fixing measure." *1934 Grain Regulation Hearings*, *supra* note 80, at 253.

140. See *supra* note 40 and accompanying text.

141. Compare *Indiana Farm Bureau Coop. Ass'n*, [1977-80] Comm. Fut. L. Rep. (CCH) ¶ 20,964, at 23,857-59 (CFTC Initial Decision 1979) (finding that the price was artificial) (decision of ALJ) with *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,286-87 (CFTC 1982) (decision of Commission) (unusual price economically justified in light of unusual conditions) and Hieronymus, *How the Practical Aspects of Testimony Directed Some Research*, in CBOT Seminar Report on Research on Speculation 56 (1980) (same).

142. *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,299 (CFTC 1982).

makes us suspicious and causes us to investigate but does not itself represent an element of an offense.

The CFTC, in its most recent manipulation decision, has recognized the limitations of historical or other price comparisons.<sup>143</sup> While not rejecting outright historical and spread comparisons, the Commission held that "it is incumbent on the parties to explain or justify the relevance of such evidence."<sup>144</sup>

b. *Artificial Price as One Not Reflecting Legitimate Supply and Demand*

Another approach defines artificial price as a price that does not reflect the "basic" or "legitimate" forces of supply and demand.<sup>145</sup> The CFTC decision in *Indiana Farm Bureau Cooperative Ass'n*<sup>146</sup> endorsed this approach, defining an artificial price as one "which does not reflect the market or economic forces of supply and demand operating upon the price of the particular contract under scrutiny. It is, in economic language, a non-equilibrium price."<sup>147</sup>

"Supply and demand," like artificial price, can prove a slippery concept.<sup>148</sup> It is sometimes supposed that supply can be determined by counting the physical quantity of the good in existence, and demand can be determined by ascertaining the current level of use for the good.<sup>149</sup> An exchange between William Clayton and Senator Caraway regarding

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143. See Cox, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,064 (CFTC 1987).

144. *Id.* The Commission expressed a similar view about the usefulness of comparisons between cash and futures prices, noting that "cash market prices offer only a crude measuring tool . . . against which to compare the artificial nature of futures prices." *Id.* at 34,065.

145. *Indiana Farm Bureau*, at 27,288 n.2 (quoted with approval in Cox, at 34,064); see Hohenberg Bros., [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,477 (CFTC 1977); Hieronymus, *Manipulation*, *supra* note 119, at 45.

One commentator has observed that "[a]lthough as a matter of principle, an artificial price is thought by the courts to be one that does not reflect the forces of supply and demand, in practice the test of an artificial price generally involves demonstrating that normal price relationships have been disturbed." Anderson, *The Industrial Organization of Futures Markets: A Survey*, in *The Industrial Organization of Futures Markets* 10 (R. Anderson ed. 1984). This suggests that one might accept both the approaches to artificial price described herein, treating the focus on historical relationships as the practical application of the more theoretical concern regarding supply and demand.

146. [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (CFTC 1982).

147. *Id.* at 27,288 n.2 (CFTC 1982). See Cox, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,064 (CFTC 1987). Unfortunately, the Commission has offered little guidance as to how one should ascertain supply and demand. In Cox, the most recent CFTC manipulation case, the Commission reaffirmed the language of *Indiana Farm Bureau*, but then it did little analysis of the conditions of supply and demand in the relevant market. See *id.* The bulk of the analysis in Cox was devoted to demonstrating that the ALJ had incorrectly analyzed historical and other comparative data. See *id.* at 34,064-66.

148. See generally Working, *A Theory of Anticipatory Prices*, 48 Am. Econ. Rev. 188 (1958) [hereinafter Working III] (discussing role of expectations in determining prices).

149. See H. Emery, *supra* note 6, at 114.

the situation where farmers might hold back crops from the market expecting the price to rise may best illustrate this view of supply and demand.<sup>150</sup> The Senator agreed with Clayton that, were farmers to do this, the result would be an immediate increase in price, but he viewed the increase as "artificial" and "unnatural" because "there would not be a bale more to supply the demand."<sup>151</sup> It is, of course, this "unnatural" conduct on the part of the farmer that helps ration scarce supplies over time and reduces wide price fluctuations.<sup>152</sup>

The situation described in the Caraway/Clayton exchange also illustrates a broader principle: not all of the physically existing supply of a storable commodity will be made available for immediate use; some of the commodity will be stored for later consumption. The amount stored reflects expectations about future prices.<sup>153</sup> Such expectations about price changes, however, defy direct measurement.<sup>154</sup> Determining "supply and demand" is not a simple mechanical process,<sup>155</sup> since "neither supply schedules nor demand schedules have tangible manifestations in a marketplace."<sup>156</sup> It is necessary to take into account a wide spectrum of unquantifiable factors.<sup>157</sup> As Professor Gray has observed, "if Mt. St. Helens erupts, or the Ayatollah dies, or the Secretary of Agriculture tells a new fib, or the budworm comes over from Mexico, these and a host of other excluded factors may produce a price abnormality or . . . aberration, temporary or sustained, which is not an artificial price."<sup>158</sup>

Moreover, in assessing whether a past price reflects supply and demand, one must look, not at whether that price reflects conditions as we now know them, but at whether it reflects conditions as they were then understood.<sup>159</sup> For example, if, at a particular time, there existed strong reason to believe that there would be a crop surplus, one would expect the price at that time to reflect that expected surplus. The fact that at some later time an unanticipated event may create a shortage and drive the price up does not make the earlier price "wrong." A "good" price reflects all of the then-available information, not clairvoyance about future events.

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150. 1928 Senate Cotton Hearings, *supra* note 67, at 503.

151. *Id.*

152. See Working II, *supra* note 42, at 326.

153. See David G. Henner, 30 Agric. Dec. 1151, 1203 (1971); Working, *New Concepts Concerning Futures Markets and Prices*, 52 Am. Econ. Rev. 431, 443-44 (1962) [hereinafter Working IV]; Working III, *supra* note 148, at 191.

154. See Telser, *Futures Trading and the Storage of Cotton and Wheat*, 66 J. Pol. Econ. 333 (1958); Working I, *supra* note 38, at 294.

155. Moreover, determining existing supply and current demand can be quite difficult. No one ever knows precisely how much supply or demand there is for any given commodity. These can only be estimated based on various reports and calculations. See J. Boyle, *supra* note 115, at 126.

156. Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,300 (CFTC 1982) (Stone, concurring).

157. See Working III, *supra* note 77, at 195.

158. Gray, *supra* note 16, at 110.

159. See Tomek, *supra* note 9, at 19; Working IV, *supra* note 153, at 447.

In the antitrust area, the Supreme Court long has rejected any inquiry into the reasonableness of prices resulting from price-fixing, fearing that such inquiry would take the Court into a very complex area of economic analysis that they were ill-equipped to handle.<sup>160</sup> The problems associated with assessing the reasonableness of prices in the price-fixing context occur with equal frequency in the area of futures trading. Trying to determine the proper price for a particular commodity in a particular month can launch the fact finder into an extremely difficult and arcane area.<sup>161</sup>

For example, in *Indiana Farm Bureau Cooperative Ass'n*,<sup>162</sup> the administrative law judge ("ALJ") received testimony from numerous expert witnesses, each analyzing in detail the operation of the cash and futures markets for corn, nationwide supply and demand for corn at the time of the alleged manipulation, and historical levels and relationships of corn prices.<sup>163</sup> As an ALJ for the CFTC, the judge who handled *Indiana Farm Bureau* most likely had some familiarity with futures trading, if not with the particular issues involved.

Manipulation cases, however, are not confined solely to administrative proceedings. Parties can bring suit in federal court,<sup>164</sup> before judges and juries who know nothing about futures trading and even less about soybeans, pork bellies, stock indices or the other traded commodities. Moreover, an approach that focuses on resulting prices must assume that not only is it possible, with the benefit of scores of experts, to identify the proper price after the fact, but that traders can identify this price while actively engaged in trading and can conform their conduct accordingly. It is not clear that this assumption is appropriate given the fast pace of futures trading.

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160. See, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221-22 (1940) ("Congress has not left with us the determination of whether . . . particular price-fixing schemes are wise or unwise . . ."); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 396-97 (1927) (rejecting argument that a price fixing agreement is reasonable and, therefore, permitted, even if resulting prices are reasonable).

In addition to these practical considerations regarding proof, the Court apparently has concluded that the fundamental goal of the Sherman Act is not to preserve some particular set of prices or some particular formula for determining prices (for example, cost plus a certain profit), see *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945), but, instead, to preserve a particular process for determining price. As the Court explained in *Socony-Vacuum*: "[M]arket manipulation in its various manifestations is implicitly an artificial stimulus applied to (or at times a brake on) market prices, a force which distorts those prices, a factor which prevents the determination of those prices by free competition alone." 310 U.S. at 223.

161. One commentator has suggested that the complexity involved in proving a distorted price has made manipulation a very difficult offense to prosecute. See Van Smith, *supra* note 15, at 1580; see also Gray, *supra* note 16, at 113 (the complexity of determining under traditional criteria whether manipulation has occurred "may strain the competence of the regulatory agency and the budget of the respondent to the point that it is unlikely to be undertaken in particular cases").

162. [1977-80] Comm. Fut. L. Rep. (CCH) ¶ 20,964 (CFTC Initial Decision 1979).

163. See *id.* at 23,839-57.

164. See 7 U.S.C. § 25 (1982).

Last, although one court relying on supply and demand analysis has held that a price deviating from the "proper" price by less than 1.5% was artificial,<sup>165</sup> the complex analysis required generally is not well-suited for detecting small price aberrations.<sup>166</sup> It is simply unrealistic to believe that a court, unfamiliar with the industry, can sort through the complex data and determine the proper price with the required degree of certainty.<sup>167</sup>

## 2. Additional Problems with the Artificial Price Approach

In addition to the problem of identifying an artificial price, the approach focusing on an artificial price suffers from other related deficiencies. One problem is that a definition of manipulation centering on the creation of an artificial price proves completely inadequate to deal with unsuccessful attempts to manipulate. Attempted manipulation is illegal and carries the same sanctions as does successful manipulation.<sup>168</sup> If it is difficult to determine whether a realized price is artificial, surely it is even more difficult to determine what price would have resulted had the at-

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165. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1169 (8th Cir. 1971) (observing that the market price was \$2.27 to \$2.28 and 1/4 per bushel, rather than \$2.25 per bushel), *cert. denied*, 406 U.S. 932 (1972). As Russo has pointed out, the court failed to indicate whether any of the price differences it observed were statistically significant. See 1 T. Russo, *supra* note 13, § 12.27, at 12-49.

166. See Gray, *supra* note 16, at 111.

167. Further complicating matters is the fact that advocates of this approach do not mean to suggest that *all* factors that affect futures prices are to be taken into account to determine if the price properly reflects those factors. As CFTC Chairman Johnson noted, "if *all* influences in the futures market are absorbed into the supply/demand equation, it would follow logically and almost automatically that no futures price could be considered artificial . . ." *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,295 n.8 (CFTC 1982) (emphasis in original); see *id.* at 27,300 (Stone, concurring). Former CFTC Chairman Johnson advocates one approach to determining what factors are legitimate. Johnson, who also concurred in *Indiana Farm Bureau*, solves the dilemma of deciding which market conditions should be legitimately considered with the simple answer that a market factor that affects the futures price cannot be considered unless it affected the cash price to an equal degree. *Id.* at 27,291.

This latter approach, however, appears to misperceive the purpose of the futures markets. Futures markets exist, in part, because of their ability to respond more quickly to changes in conditions than do cash markets. Johnson apparently assumes that, if a market condition causes more reaction in the futures market than the cash market, it must be the futures price which overreacted. Moreover, this approach may be underinclusive, as artificial market conditions such as false rumors, that affect both cash and futures prices, apparently would not constitute manipulation. See McDermott, *supra* note 15, at 212-13.

Deciding which supply and demand factors are "legitimate" has proven controversial. In particular, a question has arisen whether the demand generated by shorts needing to cover their obligations qualifies as a "real" demand which should be included in the calculation. See *infra* note 242 and accompanying text. At least one court has suggested that this demand should not be included. See *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 482 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953).

168. 7 U.S.C. § 13b (1982); see Comment, *Commodities: Futures Control—Manipulation Under the Commodity Exchange Act*, 57 Minn. L. Rev. 1243, 1252 (1973).

tempts been successful and whether that unknown price would have been artificial.

Another, even more troubling problem with placing the focus on the resulting price is that it apparently legitimizes a defense that even the proponents of the artificial price approach agree should not be allowed.<sup>169</sup> If it is illegal to cause prices to move away from the "appropriate" level, the corollary of this would seem to be that it is *legal* to intentionally cause prices to move toward that "appropriate" level.<sup>170</sup>

*General Foods Corp. v. Brannan*<sup>171</sup> illustrates this potential defense. In this case, a group of traders were charged with manipulating the price of rye by purchasing large quantities of "distress rye" that was about to be dumped on the market and that the traders feared would cause a dramatic decline in the price of rye.<sup>172</sup> They hoped by their purchases to maintain the price at the level which then prevailed.<sup>173</sup> The Court of Appeals for the Seventh Circuit held that this activity did not constitute manipulation, stressing that the whole purpose of defendants' conduct was to stabilize the price—that is, to maintain the price existing prior to the introduction of the distress rye.<sup>174</sup>

The *General Foods* decision has been criticized widely and justifiably,<sup>175</sup> but its holding logically flows from the traditional emphasis on artificial price. The court's approach suggests that a trader is forbidden to do anything that produces an unusual price, even in unusual times. The corollary, however, is that a trader may do anything to maintain the usual price and to prevent that price from being affected by unusual conditions.

*David G. Henner*<sup>176</sup> provides another illustration of how this defense might be used. There, the accused manipulator bid up the price of eggs at the close of trading.<sup>177</sup> Defendant argued that eggs were then underpriced and that he had intended simply to cause the market to notice the low price and to properly assess and price eggs.<sup>178</sup> In essence, defendant argued that because the price was artificially low, his actions merely represented an attempt to move the market to a non-artificial level. However one defines artificial price, this specious defense apparently will be

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169. See *infra* note 175.

170. In the area of antitrust, the Supreme Court has rejected inquiry into the reasonableness of resulting prices, giving as one reason that it did not want to open the door to this defense. See *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 221 (1940).

171. 170 F.2d 220 (7th Cir. 1948).

172. *Id.* at 229.

173. *Id.* at 230.

174. *Id.* at 231.

175. See, e.g., David G. Henner, 30 Agric. Dec. 1151, 1228-32 (1971); 1 T. Russo, *supra* note 13, § 12.24, at 12-43 to 12-44; Johnson I, *supra* note 16, at 754; McDermott, *supra* note 15, at 205 n.12; Note, *Federal Regulation of Commodity Futures Trading*, 60 Yale L.J. 822, 842 (1951).

176. 30 Agric. Dec. 1151 (1971).

177. *Id.* at 1161-62.

178. *Id.* at 1177.

available to all manipulators who assert that they intended not to create an artificial price, but to move the market away from an artificial price.<sup>179</sup>

A third problem presented by the artificial price approach to manipulation results from the fact that courts and commentators using this approach agree that for liability to exist, the defendant must have both "intended" that artificial price<sup>180</sup> and "caused" that price.<sup>181</sup> The concepts of intent and causation in this context have proved almost as slippery as the concept of artificial price itself.

On the issue of intent, general agreement now exists that the defendant must have acted with more than the mere knowledge that a consequence of his actions would be to affect the price; rather, he actually must have intended to create an artificial price.<sup>182</sup> For example, the CFTC has stated that the defendant must have intended to create a price that does "not reflect the legitimate forces of supply and demand."<sup>183</sup> Unfortunately, the manipulator is unlikely to have intended anything about whether the price reflected legitimate supply and demand or whether the price is consistent with historical patterns. A manipulator intends to make as much money as possible, and is unlikely to care whether the price does or does not reflect legitimate supply and demand.<sup>184</sup> The manipulator probably will feel similar indifference as to whether the resulting price is consistent with historical patterns. The historically consistent price may or may not be the price at which the manipulator

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179. The ALJ in *David G. Henner* quite properly rejected this argument. The ALJ concluded that any given price is not, in and of itself, either normal or abnormal, appropriate or artificial. It is the conditions creating the price that are either normal or artificial. *Id.* at 1207. The ALJ held that conduct intended solely to affect price was artificial and thus the resulting price, no matter how high, how low, how stable, or how consistent with history, was "artificial." *Id.* at 1198. The ALJ in *Henner*, like the Court in *Socony-Vacuum*, focused on interference with a process, rather than on whether the resulting price was, in and of itself, either good or bad.

180. See, e.g., *Volkart Bros. v. Freeman*, 311 F.2d 52, 59 (5th Cir. 1962); *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 479 (7th Cir.), cert. denied, 345 U.S. 997 (1953); *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,061 (CFTC 1987); *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,283 (CFTC 1982); 1 T. Russo, *supra* note 13, § 12.19, at 12-31 to 12-32; *Johnson I*, *supra* note 16, at 755.

181. See, e.g., *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1169 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,066-68 (CFTC 1987); *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,301 (CFTC 1982) (Stone, concurring); 1 T. Russo, *supra* note 13, § 12.21, at 12-37 to 12-40; *Johnson I*, *supra* note 16, at 754.

182. See, e.g., 1 T. Russo, *supra* note 13, § 12.19, at 12-31; *Johnson I*, *supra* note 16, at 755-59 and cases cited therein.

183. *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,283 (CFTC 1982).

184. In fact, manipulators are likely to be firm believers in supply and demand. They rely on these forces to accomplish their schemes by reducing supply or increasing demand, with the firm expectation that a change in price will result.



makes a profit. But it is making a profit, not altering historical patterns, that interests the would-be manipulator.

To frame an intent element in terms of something that most manipulators have either never thought of, or if they have thought of it, are totally indifferent to, simply invites unnecessary complication. To use Dr. Stone's analogy,<sup>185</sup> society would never define murder as intentionally causing a body to end up in the city morgue.<sup>186</sup> To solve the problems created by such a definition, courts either must rely on convoluted notions of intent or attribute to people intentions and expectations bearing little relation to what they actually think about or even reasonably can be expected to think about.

The issue of causation creates similar problems. Defining causation in this context can be as difficult as identifying whether the price is artificial.<sup>187</sup> The problem stems from the fact that price formation is a two-sided process: it requires the agreement of both a buyer and a seller.<sup>188</sup> Asking whether the buyer or the seller "caused" the price, thus, is useless—like trying to cut with only one blade of a scissor.<sup>189</sup> Focus by the courts on the price formation stage after the conditions affecting the bargaining process have fully developed creates a related problem in attempting to establish who "caused" an artificial price. There simply exists no meaningful way to determine who, in the two-sided bargaining process, "caused" the price.

Some courts have dealt with the problem of delineating causation simply by inferring a causal link whenever the defendant holds a dominant position in the futures market.<sup>190</sup> As the Chief Administrative Law

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185. See *supra* note 142 and accompanying text.

186. See *supra* note 142.

187. As the Commission noted in *Cox*, "considerable confusion still surrounds the element of causation." *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,067 (CFTC 1987).

188. See Hieronymus, *Manipulation*, *supra* note 119, at 54-55; Van Smith, *supra* note 15, at 1587.

189. In *Cox*, the Commission recognized that a price rise may be the result of conduct by both longs and shorts. See *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,062, 34,066-68. It further held that in order to find liability, it was necessary first to "sort[] out" the "multiple causes." *Id.* at 34,068. Unfortunately, the Commission was somewhat unclear about the liability rules to be applied once this "sorting out" had occurred. The Commission stated that it is sufficient for liability that a party "played a substantial part" in bringing about the artificial price. *Id.* at 34,066 n.8. It also stated that proof that some factor other than the defendant's conduct "materially contributed to the artificial prices" would constitute an affirmative defense. *Id.* at 34,067. This affirmative defense suggests that where there are multiple material causes, no party can be held liable. Yet after having analyzed the facts in *Cox* and concluding that "the price rise was the result of several competing factors," the Commission went on to state that "[i]n these circumstances, it was not appropriate for the ALJ [to find liability] without first sorting out the multiple causes." *Id.* at 34,068. This implies that liability could be found notwithstanding the existence of multiple causes and the affirmative defense, provided the ALJ first engaged in a proper "sorting out," yet the Commission did not elaborate on what specifically the ALJ should seek to identify in this sorting out process.

190. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1164 (8th Cir. 1971), *cert. denied*, 406

Judge of the CFTC has explained, "Causation has been construed to be present when 'a long has sufficient control of enough futures contracts to force the shorts to come to him to settle their contracts.'"<sup>191</sup>

The focus on market dominance as a surrogate for causation, however, is misplaced.<sup>192</sup> Market dominance constitutes neither a necessary nor a sufficient condition to manipulation. *David G. Henner*<sup>193</sup> provides the clearest example of a situation in which dominance was not necessary for a finding of manipulation.<sup>194</sup> There, the defendant bid up the price of eggs at the close of the day.<sup>195</sup> He had hoped to make it appear that a "key reversal" had occurred so that "chartists," who trade on the basis of past price moves, would enter the market and bid the price up further.<sup>196</sup> The ALJ had no problem finding this to be an illegal attempt to manipulate, even though Henner's total position in the market was small.<sup>197</sup>

Market dominance also fails as a sufficient condition to give rise to a

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U.S. 932 (1972); *Compania Salvadorena De Cafe*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,886, at 27,817 (CFTC 1983).

191. *Compania Salvadorena De Cafe*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,886, at 27,817 (quoting *Cargill*, 452 F.2d at 1164); see *Edwards & Edwards*, *supra* note 119, at 336.

192. The emphasis on market dominance creates yet another set of problems for the courts. In determining whether a defendant dominated the cash market, the court must first decide what to include in that market. Typically, the courts focus on the "deliverable supply," that is, goods that could have been delivered to fulfill the futures contract. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1164-65 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Volkart Bros. v. Freeman*, 311 F.2d 52, 59-60 (5th Cir. 1962); 1 T. Russo, *supra* note 13, § 12.13, at 12-20 to 12-22, § 12.14, at 12-26 to 12-27; Johnson III, *supra* note 120, at 101; Johnson I, *supra* note 16, at 733-42. But few courts agree on how broadly to construe this concept: should it include, for example, only those goods that were in fact deliverable at the expiration of the contract, or should it include goods that could have been made deliverable if the necessary steps had been taken? If a court takes the latter approach, then it must decide whether to include goods that could have been made deliverable only with considerable expense and effort. The courts seem to lack any coherent theory in analyzing these questions, and the approaches vary considerably. Compare *Volkart Bros. v. Freeman*, 311 F.2d 52, 59-60 (5th Cir. 1962) (including in deliverable supply cotton located at approved delivery points, but for which the shorts had failed to obtain certification) and *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,062-63 (CFTC 1987) (holding that deliverable supply must be analyzed "as it emerged throughout the delivery month," not merely in the context of the last day of trading and that out-of-town premium grades should not be excluded routinely from deliverable supply) with *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1165-66 (8th Cir. 1971) (excluding from available supply wheat where cost of shipment was an economic impediment to its delivery), *cert. denied*, 406 U.S. 932 (1972) and *Cox*, at 34,071 (West, Comm'r, dissenting) (arguing that deliverable supply should not include supplies that "could have been present had the shorts acted differently") (emphasis in original). See 1 T. Russo, *supra* note 13, § 12.13, at 12-20 to 12-22, § 12.14, at 12-26 to 12-27; Johnson III, *supra* note 120, at 101-02; Johnson I, *supra* note 16, at 733-42.

193. 30 Agric. Dec. 1151 (1971).

194. See 1 T. Russo, *supra* note 13, §§ 12.18 & 12.29; *Harrington II*, *supra* note 119, at 269.

195. 30 Agric. Dec. at 1161-62.

196. *Id.* at 1178.

197. *Id.* at 1232-34.

presumption of manipulation.<sup>198</sup> The fact that a particular trader holds a large percentage of the open interest proves little. As the maturity date approaches, markets almost always become more concentrated, and the last trader in the market will necessarily control 100% of the market.<sup>199</sup> Courts tend to pick out concentration figures and then conclude whether those figures are unreasonably high based on comparisons to other cases involving different markets.<sup>200</sup> As one noted commentator has observed, however, empirical evidence on which to make a meaningful assessment of these concentration figures remains unavailable:

We don't know what the typical concentration ratio in a particular delivery month is, with four days, seven minutes, or any other interval of trading time remaining. We don't know what factors influence changes from year to year, or the rate of change within a year, in concentration ratios for particular markets and delivery months.<sup>201</sup>

Those cases that do not infer causation on the basis of the defendant's position attempt to ascertain who bears responsibility for the price.<sup>202</sup> Most of these courts use a lexicon suggesting some concept of moral fault or culpability. The cases speak of traders acting with "excessive greed,"<sup>203</sup> acting irresponsibly,<sup>204</sup> or demonstrating "foolishness."<sup>205</sup>

The difficulty with this approach is that no standards exist for determining when it is greedy or wrong to "hold out" for a higher price and when such behavior is normal and appropriate. For traders to try to sell at the highest price they can or to "hold out" for a more advantageous price represents normal activity in the futures market as well as all other markets.<sup>206</sup> As the CFTC has observed, the desire of traders for greater profit "gives lifeblood to the forces of supply and demand, and makes the

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198. See McDermott, *supra* note 15, at 210-11.

199. See *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1164 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Tomek, *supra* note 9, at 10.

200. See, e.g., *Compania Salvadorena De Cafe*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,886, at 27,817 n.29 (CFTC 1983); McDermott, *supra* note 15, at 210-11.

201. Gray, *supra* note 16, at 111-12. Further, as Russo has observed, it is odd that only the large trader is "punished for his or her size, while many smaller long speculators, gambling on the large trader's presence and ability and willingness to force prices upward, go along for a free ride." 1 T. Russo, *supra* note 13, at 12-50.

202. See *Volkart Bros. v. Freeman*, 311 F.2d 52, 59-60 (5th Cir. 1962); *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,286 (CFTC 1982).

203. *Sam Wong & Son, Inc. v. New York Mercantile Exch.*, 735 F.2d 653, 674 (2d Cir. 1984).

204. *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,286 (CFTC 1982); see *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,062, 34,068 (CFTC 1987).

205. *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,303 (CFTC 1982) (Stone, concurring); see *Johnson III*, *supra* note 120, at 105.

206. See *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,284-85 (CFTC 1982); *Hohenberg Bros.*, [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,478 (CFTC 1977).

price discovery function of the marketplace viable."<sup>207</sup> How can one tell when this conduct becomes blameworthy?

The Eighth Circuit's analysis in *Cargill, Inc. v. Hardin*<sup>208</sup> illustrates this problem well. There, the court concluded that the price of wheat had risen as high as it did because of "the high prices [Cargill] set for liquidation."<sup>209</sup> Apparently the court believed that Cargill "caused" the high price because it asked for and received that price. But surely the shorts likewise "caused" the price by agreeing to pay that much. If the shorts simply had scoffed at Cargill's offer and responded that they would not pay a penny over \$2.25, then the price would not have gone over \$2.25 because the parties would not have consummated the deal at a higher price.<sup>210</sup>

Thus, the rule that emerges requires that traders who stand in a position to benefit from an unusual situation must not be too greedy, while those who stand to lose must not panic in a childish or irresponsible manner.<sup>211</sup> Under this approach, the manipulation prohibition functions as a kind of code of good conduct.<sup>212</sup> Unfortunately, these rules of the code of good conduct are quite vague,<sup>213</sup> and traders bear a high price for not knowing them. Even more fundamental, however, this approach suggests that the purpose of the manipulation prohibition is to prevent

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207. *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,283 (CFTC 1982).

208. 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); see *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 358 (1982) ("The purchase or sale of a futures contract on an exchange is . . . motivated by a single factor—the opportunity to make a profit (or to minimize the risk of loss) from a change in the market price.").

209. *Cargill*, 452 F.2d at 1170.

210. Of course, under some circumstances, an offer or bid might be thought to cause a price increase. This might be the case if the offer is not itself a good faith offer that the offeror expects to be accepted, but instead is intended to convey false information in order to create panic. See, e.g., *David G. Henner*, 30 Agric. Dec. 1151, 1234 (1971). There is no indication that this was the case in *Cargill*.

211. Not long before Philip Johnson became Chairman of the CFTC, he gave the following description of the law of manipulation:

What is a long to do when a short, who should have made preparation for delivery, comes begging to him to get out of the market? What is a long to do? Remember that these are competitive markets. These markets work only as long as everybody is fighting to get the best possible price he can. What is a long to do? I think the policy of the CFTC says: "Faced with that situation, pull your punches; don't get the best price you can; don't negotiate toughly; let the guy out somehow. Otherwise, face a manipulation investigation and the strong possibility that instead of blaming him for having put himself in this predicament, you're going to get charged with a manipulation."

Johnson III, *supra* note 120, at 106.

212. See Note, *supra* note 73, at 184 (a future contract should be understood to include "good faith" provision that buyer will not demand delivery simply to force a price increase).

213. See 1 T. Russo, *supra* note 13, at 12-50 (criticizing *Cargill* because it "places the holder of a large long position in the position of having to police his or her own conduct in what is usually a dynamic, nebulous situation").

greed or unfair profits. This view of the prohibition is unwarranted. As the Second Circuit has observed, a commodity exchange "is not a social club."<sup>214</sup> Throughout the legislative history of federal futures trading regulation, the concern with respect to manipulation has focused on curbing the price effects of manipulation and maintaining a functioning market, not on whether some traders were becoming too rich at other traders' expense.<sup>215</sup>

### B. *Alternatives to the "Artificial Price" Approach*

Within the last few years two alternative approaches to defining manipulation have been proposed. Both of the approaches focus on a trader's threat to demand delivery and downplay the concept of artificial price. Though the move away from a focus on the resulting price represents a step in the right direction, each of these approaches suffers from conceptual problems.<sup>216</sup> Moreover, because both focus primarily on only one particular type of manipulation, known as a "corner" or "squeeze,"<sup>217</sup> their utility is limited largely to analyzing this particular

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214. *Sam Wong & Son, Inc. v. New York Mercantile Exch.*, 735 F.2d 653, 678 (2d Cir. 1984). No one questions that the futures markets do rely on fraternal concepts of fair play and proper conduct to some extent. An exchange sometimes may appeal to such notions to persuade a trader to reduce a position or to accept or take other steps that the trader might not be legally obligated to take. *See id.* at 673-74; Cox, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,059-60 (CFTC 1987); Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,289 n.18 (CFTC 1982).

215. *See, e.g.*, CEA, *supra* note 12, at § 3; H.R. Rep. No. 975, *supra* note 31, at 34 (explaining that the danger of manipulation is that it destroys usefulness of market to hedgers); H.R. Rep. No. 421, 74th Cong., 1st Sess. 1 (1935) (goal was to control "those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves"); S. Rep. No. 212, 67th Cong., 1st Sess. 4 (1921) ("[T]his bill will, by wiping out obvious abuses . . . result in more stable markets, and thereby enable the producers to secure more nearly the market price for their grain than has been possible in the past."). For a more detailed discussion of various views of the purpose of the manipulation prohibition, see *infra* notes 273-94 and accompanying text.

216. *See infra* notes 220-55 and accompanying text.

217. A "corner" or "squeeze" is a method of exploiting the congestion that can occur at the end of the delivery month, by which time all contracts must be settled. Specifically, this congestion arises in the following manner:

By continuing long up to and into the delivery month, speculative short sellers find it increasingly difficult to buy in their contracts. The short interest, it will be recalled, has the option of choosing the day during the delivery month when the actual commodity will be delivered. This option only serves to postpone the time when an ultimate settlement will have to be made. With the hope that prices will break or that the long interest will take the initiative and liquidate, they may carry along their position well into the delivery month with little thought of acquiring the necessary supplies. At the end of the month when delivery must be made supplies may be scarce and, in a frantic effort to close out their position, the current future advances rapidly. This process may or may not be accompanied by any manipulative intent but in any event it is an artificial situation producing a temporary derangement in prices.

G. Hoffman, *supra* note 78, at 315. It is possible to create a similar type of abnormal

price situation by the shorts threatening to make delivery and thereby depressing the price. This is much more rare than a squeeze or corner by the longs but it is not unheard of. See *Cargill, Inc.*, 29 Agric. Dec. 880, 906 (1970), *aff'd*, *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); Vincent W. Kosuga, 19 Agric. Dec. 603, 622 (1960); Hohenberg Bros., [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271 (CFTC 1977); T. Hieronymus, *Economics*, *supra* note 6, at 325; G. Hoffman, *supra* note 78, at 313-15.

A situation such as the one described above can develop inadvertently, see VII Federal Trade Commission, Report on the Grain Trade 243 (1926) [hereinafter FTC Report], but when a trader consciously creates or exploits such a situation, it is known as a "corner" or "squeeze".

The distinction between a corner and a squeeze is not precise, and, in fact, the terms frequently are used interchangeably. See David G. Henner, 30 Agric. Dec. 1151, 1286 (1971). When a distinction is drawn, "corner" describes the situation where a trader intentionally causes a price to rise by acquiring a dominant position in the futures market and simultaneously achieving sufficient dominance in the cash market "to dry up the sources of deliverable goods." Note, *supra* note 73, at 175; see *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1162 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Great W. Food Distribs., Inc. v. Brannan*, 201 F.2d 476, 478 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); G. Hoffman, *supra* note 78, at 317.

A "squeeze" presents a less extreme situation. "[T]here may not be an actual monopoly of the cash commodity itself, but for one reason or another deliverable supplies of the commodity in the delivery month are low, while the open interest on the futures market is considerably in excess of the deliverable supplies." *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1162 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); see *Volkart Bros. v. Freeman*, 311 F.2d 52, 59 (5th Cir. 1962). Thus, "if the futures market alone is dominated, the trader's action is referred to as a 'squeeze'." Note, *supra* note 73, at 175-76; see 1 T. Russo, *supra* note 13, at 12-17.

Federal law specifically prohibits corners. See 7 U.S.C. § 13(b) (1982). The law is less clear with respect to squeezes. Both cases and commentators split as to whether it is illegal for a trader to take advantage of a price increase that occurs as a result of a shortage of deliverable supply, where the trader owns none of the supply and has done nothing to restrict that supply. Compare *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972) (illegal for trader to take advantage of shortage, regardless of source of shortage) and David G. Henner, 30 Agric. Dec. 1151, 1287 (1971) (same) and Note, *supra* note 73, at 180-83 (same) with *Volkart Bros. v. Freeman*, 311 F.2d 52, 58-59 (5th Cir. 1962) (trader may take advantage of shortage he did not create) and T. Hieronymus, *Economics*, *supra* note 6, at 310-11 (same) and Bianco, *supra* note 7, at 37 (same) and Hieronymus, *Manipulation*, *supra* note 119, at 53-55 (same).

An understanding of a corner requires an understanding of the role of delivery in a futures contract. Futures contracts typically provide for delivery of a physical commodity as a means of settlement. The delivery requirement is important because it is what causes futures prices and cash prices to converge. Convergence occurs because if a wide disparity exists, arbitrage becomes profitable and is practiced until the prices come into line. For example, if cash prices are substantially lower than futures prices, an arbitrageur will buy cash commodities, sell a futures contract and deliver on the contract. These transactions themselves will tend to increase cash prices and decrease futures prices. Arbitrage will prove profitable as long as a disparity exists, but the arbitrage transactions will ultimately tend to force cash and futures prices to converge. See Garbade & Silber, *Cash Settlement of Futures Contracts: An Economic Analysis*, 3 J. Fut. Mkts. 451, 454 (1983).

Although it is impossible to predict exactly what price parties will agree on, ordinarily, it is to be expected that the price at which an offset occurs would be less than the cost of delivery for the shorts and greater than the value to the longs of the delivered commodity. A shortage of the physical supply available for delivery increases the cost to the short of making delivery and renders it likely that the settlement price at which the shorts and the

type of manipulation.<sup>218</sup> In addition, Judge Easterbrook has proposed a third approach, focusing on the presence of fraud or concealment in a trader's activities.<sup>219</sup> Although this approach offers an interesting alternative to the artificial price approach, it too suffers from certain conceptual and practical problems.

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longs arrive will be higher than when no shortage exists. See Kyle, *A Theory of Futures Market Manipulations*, in *The Industrial Organization of Futures Markets* 141, 145-48 (R. Anderson ed. 1984). Of course, if the shortage reflects a nationwide shortage, then the price increase is completely appropriate and expected. See 1 T. Russo, *supra* note 13, at 12-50 (noting that a shortage in the cash market should cause futures prices to rise and such a price rise is not artificial). Cash prices everywhere will go up, as will futures prices, as should happen when there is a shortage.

A troublesome situation arises when the shortage of deliverable supply is a local problem, out of scale with broader conditions. See, e.g., *Volkart Bros. v. Freeman*, 311 F.2d 52, 59-60 (5th Cir. 1962). In such a situation, logic again would dictate that it would be in the best interest of both parties to offset, rather than to settle by delivery. It is likely, however, that the settlement price will be substantially above both the cash price that prevails in other locations and the futures price for nonexpiring contracts. See Kyle, *supra*, at 147.

218. The CEA prohibits both "manipulation" and "corners," and, thus, the terms could be interpreted as referring to distinct phenomena. Nonetheless, corners generally have been treated as a subcategory of manipulation. See, e.g., *Grain Futures Act Amendment: Hearings before the House Comm. on Agriculture*, 70th Cong., 1st Sess. 19 (1928); see also 1928 *Senate Cotton Hearings*, *supra* note 67, at 203 (most important example of manipulation is the "accumulation in a given market of such a quantity of contracts for a given month that it is physically impossible to fulfill those contracts by delivery."). Although corners have been treated as a type of manipulation, the two terms are not synonymous. See *Jan. 1921 House Hearings*, *supra* note 65, at 320 (witness indicates that there is a difference between corners and manipulation); *id.* at 683 (can have manipulation without a corner).

Relatively little discussion of corners is found in the CEA's legislative history. This may stem from a general perception that the "old-fashioned" corner had been largely eliminated. See *Jan. 1921 House Hearings*, *supra* note 65, at 911. Moreover, corners generally were thought to raise, rather than lower, prices. See 1921 *Senate Hearings*, *supra* note 64, at 315. This is significant for two reasons. First, a perception existed that the boards of trade worked hard to stop all practices that caused prices to rise. See *id.* at 335. Second, and probably more important, during the 1920's and 1930's, congressional concern focused on prices being too low, as opposed to their being too high. See, e.g., *id.* at 315; 61 Cong. Rec. 1330 (1921). This preoccupation with low, rather than high, prices may explain why selling short, which was thought to depress prices, was considered a far greater evil than buying long, which was thought to raise prices. See, e.g., 1934 *Grain Regulation Hearings*, *supra* note 80, at 25 (discussing whether short selling is illegal or violative of the Act); 1932 *Short Selling Hearings*, *supra* note 68, at 181-82 (concerning a bill that would limit, and in some cases prohibit, short selling but would include no limitations on long transactions); 1931 *Senate Cotton & Grain Hearings*, *supra* note 70, at 68-69 (on a proposed bill to eliminate short selling); 1921 *Senate Hearings*, *supra* note 64, at 205 (discussing manipulation and its effect on depressing prices). Although the CBOT argued that upward price manipulation occurs more often than downward manipulation, see 1921 *Senate Hearings*, *supra* note 64, at 476, Congress seemed more concerned about downward manipulation. See *Dickson v. Uhlman Grain Co.*, 288 U.S. 188, 199 n.4 (1933); S. Res. No. 9, 68th Cong., 1st Sess. (1924); 1921 *Senate Hearings*, *supra* note 64, at 205; Stassen, *supra* note 66, at 645-46; Virtue, *supra* note 66, at 693.

219. See *infra* notes 256-72 and accompanying text.

## 1. McDermott Approach

One of the approaches for dealing with corners or squeezes is that proposed by Edward McDermott.<sup>220</sup> McDermott defines a squeeze as "a trader's buying or threatening to take delivery of what it has already bought or owns."<sup>221</sup> McDermott gives the example of a trader who owns a large futures position and a large percentage of the deliverable supply.<sup>222</sup> He reasons that the long's purpose in maintaining his position could not be to obtain the physical commodity because there are no physicals available.<sup>223</sup> Therefore, the only reason for maintaining the position must be to force up the price. This, he argues, violates the common law contract doctrine that prohibits one party from hindering the other's performance.<sup>224</sup>

McDermott's analysis of the doctrine of hindrance is incomplete. The doctrine of hindrance is not an absolute principle in contract law; rather, it applies only where the court finds that parties implicitly promised not to hinder performance.<sup>225</sup> As Professor Williston explains:

[Hindrance is permissible] where the hindrance is due to some action of the promisor which under the terms of the contract or the customs of business he was permitted to take. Thus if a party, seeking to secure all the merchandise of a certain character which he could, entered into a contract for a quantity of the required goods, and subsequently made performance of the contract by the seller more difficult by making other purchases which increased the scarcity of the available supply, his conduct would furnish no excuse for refusal to perform the prior contract.<sup>226</sup>

In a footnote, McDermott indirectly but unsatisfactorily addresses this point<sup>227</sup> in an attempt to distinguish *Iron Trade Products Co. v. Wilkoff Co.*<sup>228</sup> In *Wilkoff*, the defendant justified its failure to deliver rails that it had contracted to sell by arguing that the plaintiff's other purchases of rails caused the price of the remaining rails to rise so high that performance was impossible.<sup>229</sup> The court rejected this defense.<sup>230</sup> McDermott argues that *Wilkoff* is a case of an "unintentional squeeze,"<sup>231</sup> but he

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220. See McDermott, *supra* note 15.

221. McDermott, *supra* note 15, at 204.

222. See *id.* at 217.

223. See *id.*

224. See McDermott, *supra* note 15, at 214-15.

225. See 3 A. Corbin, Corbin on Contracts § 571 (1950); Restatement (Second) of Contracts § 245 (1979); 3 S. Williston, A Treatise on the Law of Contracts § 677, at 1956 (1936).

226. S. Williston, *supra* note 225, § 677, at 1956.

227. See McDermott, *supra* note 15, at 219 n.88.

228. 272 Pa. 172, 116 A. 150 (1922). *Wilkoff* cited and relied on the excerpt quoted from Williston, *supra* text accompanying note 226. See 272 Pa. at 175, 116 A. at 151.

229. See 272 Pa. at 174, 116 A. at 150.

230. See *id.* at 177, 116 A. at 151.

231. McDermott, *supra* note 15, at 220 n.88.



never explains what was unintentional about the plaintiff's conduct.<sup>232</sup> The *Wilkoff* court offers a more straightforward explanation for its ruling: there was no implied promise in the contract "that plaintiff was to refrain from purchasing other rails."<sup>233</sup>

McDermott admits that one might argue that the shorts, having contracted to deliver a commodity, should be held to their contract, and if they are unable to deliver, should expect to pay a price.<sup>234</sup> McDermott rejects this argument, however, and offers several reasons. First, he asserts that if a long already owns a large quantity of the same commodity he has contracted for, then it is improper to demand delivery because to do so is "threatening to take delivery of the same thing twice."<sup>235</sup> The characterization of this conduct as taking "delivery of the same thing twice" does not explain why it is improper for a long to insist that the shorts fulfill their contractual obligations. The fact that the shorts will have to pay a price for their inability to perform is hardly shocking—under ordinary contract law,<sup>236</sup> it is not uncommon for people to extract a price from those who do not fulfill their contracts.<sup>237</sup> McDermott's second response is that standing for delivery to drive the price up is im-

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232. In the same footnote in which he addresses *Wilkoff*, McDermott quotes an illustration from the Restatement of Contracts that likewise seems to undermine his hindrance approach. The illustration provides:

A promises to sell and B to buy 1000 bales of hemp in six months from the date of the contract. B is buying hemp heavily from various sources, and in consequence A has difficulty in securing 1000 bales and the market price is largely increased. A is not excused from performing the constructive condition of tendering the hemp in order to subject B to a duty of immediate performance.

Restatement of Contracts § 295, illustration 3 (1932). Although McDermott relies on the Restatement of Contracts to support his hindrance approach, he never explains why this illustration is not inconsistent with his proposal.

233. 272 Pa. at 175, 116 A. at 151. The court concluded, as McDermott himself notes, see McDermott, *supra* note 15, at 220 n.88, that the parties had not contracted for any particular rails. See 272 Pa. at 175, 116 A. at 151. This, of course, is true of all futures contracts. A futures contract does not call for the delivery of some particular truck-load of the commodity; it calls for delivery of a fungible product of specific grade.

234. See McDermott, *supra* note 15, at 218.

235. *Id.*

236. Curiously, having invoked the contract principle of hindrance to impose liability on certain traders, McDermott appears to argue that because of differences between the cash and futures markets, those same traders cannot rely on ordinary contract law to justify their extracting a price from the shorts for their failure to deliver. See McDermott, *supra* note 15, at 218.

237. Of course, it may be argued that, because in futures contracts, only a tiny percentage of traders actually expect to take delivery, use of a contract analogy in which the parties do expect to take delivery is inappropriate. But if the parties do not expect actual delivery, one still must ask what it is they do expect. In response to this, it can be argued that futures traders have contracted for and expect to receive the physical commodities or an amount of money equal to what it would cost to purchase those physical commodities at the delivery point on the delivery date. See Hobson, *supra* note 34, at 1-2. It is this principle that permits cash settlement contracts to work. If this is, in fact, what the parties have contracted for, it is not at all evident why it is wrong for a trader to refuse to settle his contracts until the other side offers a price consistent with this contractual understanding.

proper because the longs have "exclusive knowledge and power."<sup>238</sup> He does not explain, however, why the presence of knowledge or power makes the conduct improper.

Although McDermott frames his analysis in terms of hindrance, the essence of his analysis may be that he considers the demand created by the need to fulfill a futures contract to be illegitimate.<sup>239</sup> McDermott never explains why the demand created by the need to fulfill a futures contract is illegitimate, while demand created by the need to fulfill all other contracts is legitimate.<sup>240</sup> In reality, it is the delivery requirement that causes the cash and futures prices to converge.<sup>241</sup> As a former chairman of the CFTC has observed, those who differentiate between "real" demand and "technical" demand generated by shorts needing to cover their obligation in the market "would appear to deny the economic inter-relationship between the futures and cash markets."<sup>242</sup>

## 2. Van Smith Approach

Van Smith offers a second approach.<sup>243</sup> He would establish a presumption that traders who stand for delivery after a particular date are guilty of manipulation.<sup>244</sup> The burden would then shift to traders "to prove their innocence."<sup>245</sup> Not only is this approach incomplete, but it is based on the erroneous premise that delivery is an unnecessary element of futures trading.

Van Smith notes that the "conventional argument" for delivery provisions is that they cause cash and futures prices to converge.<sup>246</sup> He then rejects this conventional explanation and argues that it is not the presence of a delivery provision that causes cash and futures prices to converge.<sup>247</sup> Instead, he argues, the convergence results from the traders' "belief" that "there is no other rational standard by which to measure the value of the intangible contract rights."<sup>248</sup> Van Smith then concludes that because it is this belief that causes the convergence of cash and futures prices, delivery provisions could be eliminated entirely, and the

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238. See McDermott, *supra* note 15, at 219.

239. See *id.* at 218 n.84.

240. Cf. H. Emery, *supra* note 6, at 115 (expectations about future demand and supply are expressed in genuine offers to buy and sell goods and thus affect price).

241. See *infra* notes 250-52 and accompanying text; *supra* text accompanying notes 35-36.

242. Johnson I, *supra* note 16, at 749; see 1 T. Russo, *supra* note 13, at 12-48; see also Working, *Theory of the Inverse Carrying Charges in Future Markets*, in Selected Writings of Holbrook Working 7 (A. Peck ed. 1977) (noting that cash and futures prices are determined in a single market and futures prices reflect prices of the actual commodity); Working I, *supra* note 38, at 273 (same).

243. See Van Smith, *supra* note 15.

244. See *id.* at 1606; see also Note, *supra* note 73, at 184-85.

245. Van Smith, *supra* note 15, at 1606.

246. See *id.* at 1603.

247. See *id.*

248. *Id.* (footnote omitted).

only reason they have been retained is because exchanges desire to keep prices unstable.<sup>249</sup>

While it is true that cash delivery mechanisms are possible in some markets, they are not feasible in all markets. There must exist a "good" cash price, that is, a price that is widely known and available, is an accurate indicator of value of the underlying commodity or security, and that is not itself easily subject to manipulation.<sup>250</sup> More fundamental, the existence of cash delivery systems does not demonstrate that no mechanism is necessary to force the convergence of cash and futures prices. Cash settlement forces convergence because the settlement price for futures is based on actual cash prices.<sup>251</sup> One cannot simply eliminate the delivery mechanism, put nothing in its place, and expect that futures prices will continue to bear some relation to cash prices.<sup>252</sup>

Another problem with Van Smith's approach is that it does not solve the problem of defining manipulation. He would shift the burden to the trader to prove his innocence, but he does not explain what such proof would entail.<sup>253</sup> Apparently, a trader must have had a "good reason" for standing for delivery,<sup>254</sup> but Van Smith offers no analysis of what would constitute such a reason.<sup>255</sup>

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249. See *id.* at 1604.

250. See Garbade & Silber, *supra* note 217, at 454-59; Hobson, *supra* note 34, at 2; Martell & Salzman, *Cash Settlement for Futures Contracts Based on Common Stock Indices: An Economic and Legal Perspective*, 1 J. Fut. Mkts. 291, 292 (1981) (and sources cited therein); Paul, *The Role of Cash Settlement in Futures Contract Specification*, in *Futures Markets: Regulatory Issues* 302-04 (A. Peck ed. 1985); see also Edwards & Edwards, *supra* note 119, at 353. It has been noted by others that cash settlement may not eliminate manipulation but may simply result in the transfer of the manipulative activities into the cash market. See Kyle, *supra* note 217, at 169; Paul, *supra*, at 275.

251. See, e.g., A. Paul, K. Kahl & W. Tomek, *Performance of Futures Markets: The Case of Potatoes* 118-21 (1981); Garbade & Silber, *supra* note 217, at 455; Hobson, *supra* note 34, at 1-2; Martell & Salzman, *supra* note 250, at 291-92; Working I, *supra* note 38, at 279.

252. A study of the pork belly market in the early 1960's by Mark Powers illustrates the need for a mechanism to cause the convergence of cash and futures prices throughout the delivery month. See Powers, *Effects of Contract Provisions on the Success of a Futures Contract*, 49 J. Farm Econ. 833 (1967). In this study, Professor Powers found that during 1961-62, cash and futures prices tended not to converge until the last day of trading. He concluded that this occurred because delivery was not allowed until after trading for the contract month ceased. See *id.* at 839. However, in 1963, the exchange changed its rules to permit delivery throughout the contract month, and, as a result, prices began to converge throughout the delivery period. See *id.* As this study suggests, little reason exists to believe that if delivery at the end of the contract month was eliminated, cash and futures price convergence would continue.

253. Van Smith, *supra* note 15, at 1606.

254. "Standing for delivery" is accepted terminology for what a trader does when he does not offset his contract and thus demands delivery.

255. For example, it is unclear whether Van Smith would allow a trader to decline to offset because that trader believed there was an impending shortage that would cause the price to go higher. Yet, permitting traders to act on these beliefs is the only way that more extreme price fluctuations are avoided and the proper relationship between cash and futures prices is maintained.

### 3. Judge Easterbrook's Manipulation as Fraud Approach

In the securities area, illegal manipulation requires an element of fraud or deceit.<sup>256</sup> A fully disclosed transaction, therefore, cannot constitute manipulation, regardless of its effect on the market.<sup>257</sup> Judge Easterbrook has argued that fraud or concealment forms the essence of futures manipulation as well.<sup>258</sup> Judge Easterbrook bases his argument on the observation that deceit or secrecy about one's position and intentions ordinarily constitutes a prerequisite to a successful manipulative scheme.<sup>259</sup> According to Judge Easterbrook, manipulation is "conduct in which the profit flows solely from the trader's ability to conceal his position from other traders and the trades do not move price more quickly in the direction that reflects long-run conditions of supply and demand."<sup>260</sup>

No question exists that fraud and concealment constitute important aspects of many, if not all, forms of manipulation. The Commodity Futures Trading Act,<sup>261</sup> like its predecessor, the Commodity Exchange Act,<sup>262</sup> specifically prohibits deception in the form of false rumors,<sup>263</sup> wash sales<sup>264</sup> or fictitious transactions.<sup>265</sup> Deception can, however, also take more subtle forms<sup>266</sup> in which the line between deceit and astuteness can be quite difficult to draw.

256. See *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 8 (1985); *Santa Fe Indus. v. Green*, 430 U.S. 462, 474-77 (1977); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). A full examination of manipulation in securities markets is beyond the scope of this Article. For comparisons between securities and futures markets, see *Futures Game*, *supra* note 5, at 16-20; Harrington II, *supra* note 119, at 248 n.50; Wolff, *Comparative Federal Regulation of the Commodities Exchanges and the National Securities Exchanges*, 38 Geo. Wash. L. Rev. 223 (1969).

257. See *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 8-12 (1985); Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. Miami L. Rev. 671, 720-21 (1986) (concealment necessary for deceit or fraud).

258. See Easterbrook, *supra* note 24, at S106.

259. *Id.*

260. *Id.* at S118.

261. Commodity Futures Trading Commission Act, Pub. L. No. 93-463, 88 Stat. 1389 (1974).

262. CEA, *supra* note 12.

263. 7 U.S.C. § 13(b) (1982); CEA, *supra* note 12, § 9.

264. 7 U.S.C. § 6c(a)(A) (1982); CEA, *supra* note 12, § 4c(A). "Wash sale" is not defined by the Act but is understood to mean "the purchase and sale of the same commodity futures contract for the same principal under which both sides of the trade 'wash out' each other and, in practical effect, the principal does not gain ownership of any new contract." 1 P. Johnson, *supra* note 43, § 3.94, at 527; see *id.* § 2.29, at 259-63; 1 T. Russo, *supra* note 13, § 12.98.

265. 7 U.S.C. § 6c(A) (1982); CEA, *supra* note 12, § 4c(A). The Act does not define the phrase "fictitious sale," but it has been understood to include "transactions not made but reported as having been made." 1 T. Russo, *supra* note 13, at 12-101. In a criminal case, the phrase was held to be unconstitutionally vague. See *United States v. La Mantia*, [1978-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,667, at 22,715-17 (N.D. Ill. 1978).

266. For example, in *David G. Henner*, 30 Agric. Dec. 1151 (1971), a trader carefully timed his orders to give a false impression of a broad-based and growing interest in a commodity. See *id.* at 1152, 1177-78.

One of Judge Easterbrook's own examples demonstrates how difficult it can be to distinguish deceit and astuteness. Judge Easterbrook describes what he calls "position fraud":

[A] party may simply decline to liquidate his position, so that at the very close of trading a formerly small holding becomes large in relation to the open contracts. The holder of these contracts then demands or tenders delivery (depending on whether he is long or short). Holders of opposite positions, surprised by the sudden demand or tender, unable either to make or take delivery without incurring large costs, and unable to find other parties with whom to close out their positions, must pay a premium to negotiate around the demand.<sup>267</sup>

The "fraud" in this context consists of a trader's failure to disclose to the world that his holdings have become relatively large. Yet to call this fraud skirts the central issue. It suggests an obligation to disclose whenever other traders might misinterpret or misunderstand one's position or intentions. But why should traders have this disclosure obligation? As Judge Easterbrook himself acknowledges, secrecy is important to the efficient functioning of the market.<sup>268</sup> Secrecy protects hedgers from having to disclose commercially sensitive information about their cash positions.<sup>269</sup> Judge Easterbrook deals with the problem of distinguishing deceit from astuteness by explaining that "[t]he essential distinction is between secret strategies necessary to capture the value of new information about underlying conditions and secrecy designed to cause prices to diverge from those that reflect the underlying conditions."<sup>270</sup>

Whatever its value as a theoretical matter, this approach suffers from many of the practical problems discussed earlier, including the problems of determining "conditions of supply and demand" and defining the "long-run."<sup>271</sup> Moreover, in attempting to ascertain the motivation for a trader's desire for secrecy, many courts likely will find themselves lost in a standardless examination of intent, the difficulties of which were illustrated earlier.<sup>272</sup>

#### IV. AN ALTERNATIVE DEFINITION OF MANIPULATION

The following Part offers an alternative approach to manipulation. The proposed definition, like all definitions of manipulation, necessarily reflects a view of the underlying purposes served by the manipulation prohibition. Therefore, before setting forth the alternative approach, this Part first describes and critiques the purposes underlying other ap-

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267. Easterbrook, *supra* note 24, at S106.

268. *See id.* at S118; *see also* Edwards, *supra* note 37, at 30 n.17 (increased public disclosure of positions may reduce usefulness of markets to large hedges and may reduce market liquidity).

269. *See* Easterbrook, *supra* note 24, at S111 n.8.

270. *Id.* at S118.

271. It is interesting to note that Judge Easterbrook does not offer his definition of manipulation as a legal definition, but as an "economic" one. *Id.*

272. *See supra* notes 180-86 and accompanying text.

proaches to manipulation. It then introduces the proposal and sets forth its underlying purposes.

### A. *Underlying Purpose of the Manipulation Prohibition*

#### 1. Stabilizing Prices

Some have suggested that the prohibition on manipulation exists to stabilize prices. For example, former CFTC Commissioner Johnson has stressed that the aim of the CFTC should be to "maintain orderly futures trading."<sup>273</sup> Similarly, those who advocate an historical approach to manipulation seem to accept, at least implicitly, this view of the goal of the manipulation prohibition.<sup>274</sup> As discussed earlier, while the legislative history, particularly during the 1920's, demonstrates concern about the instability of prices and expresses the expectation that the prohibition on manipulation will have the effect of stabilizing prices,<sup>275</sup> this result appears to have been understood as the likely by-product of better functioning markets, rather than as an end in itself.<sup>276</sup> The manipulation prohibition seems a relatively blunt and ineffective way of insuring price stability for other reasons as well. Regulating futures markets while excluding cash and forward transactions serves as a limited and indirect way of stabilizing prices of the underlying commodities. Moreover, the anti-manipulation provision serves as an extremely limited way to stabilize even futures prices. If the goal of the prohibition of manipulation is to prevent dramatic changes in futures prices, it would seem to be simpler and more effective to do so directly by adopting rules specifying maximum price changes.<sup>277</sup>

Even more fundamental, this view of the goal of the manipulation prohibition is at odds with a basic purpose of a futures market. One of the main values of futures markets is that they provide information necessary to promote the efficient allocation of resources.<sup>278</sup> If the futures market is to serve this function effectively, prices must be permitted to fluctuate to reflect actual conditions. If "normal" prices prevail in abnormal times, people will make allocation decisions that do not reflect actual conditions.

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273. Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,292 (CFTC 1982) (Johnson, concurring).

274. See *supra* notes 137-39 and accompanying text.

275. See, e.g., S. Rep. No. 212, 67th Cong., 1st Sess. 4 (1921); 61 Cong. Rec. 1314 (1921).

276. See *supra* notes 138-42 and accompanying text.

277. Many exchanges in fact do this by establishing limits on daily price fluctuations. See 1 P. Johnson, *supra* note 43, § 2.20, at 244-45; see also Cox, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,066 (CFTC 1987) (in determining whether a price change was excessive, it is relevant that futures prices "showed active resistance to an increase less than regular limit levels").

278. See *supra* notes 40, 42 and accompanying text.

## 2. Stabilizing the Spread Between Cash and Futures Prices

Another possible goal of the manipulation prohibition focuses on the hedging function served by the futures market. It has been suggested that successful hedging requires a stable and predictable relationship between cash and futures prices, and that the goal of the manipulation prohibition should be to insure this stability.<sup>279</sup>

As a goal, this raises several problems. First, the goal appears to be based on a simplistic understanding of hedging. As Holbrook Working has explained, it is inaccurate and simplistic to view the "perfect hedge" as one where the spread between cash and futures prices remains constant and which, therefore, results in no profit or loss.<sup>280</sup> Contrary to the assumption of this simplistic view of hedging, Working has explained that "[m]ost hedging is done in the expectation of a change in spot-future price relations."<sup>281</sup> Thus, under the more sophisticated theories of hedging, it is not at all central to hedging that there be a stable spot-futures price spread.<sup>282</sup>

In addition, this view suffers from the same problems associated with the goal of price stabilization discussed earlier.<sup>283</sup> The mere fact that prices or spreads differ from historical levels does not indicate that those prices or spreads are inappropriate to the currently prevailing conditions. Throughout the duration of a contract, the spread between cash and futures prices will vary depending on a variety of factors, including the cost of storage, interest and insurance for cash supplies.<sup>284</sup> As the time for delivery approaches, the cash and futures prices will tend to converge.<sup>285</sup> Admittedly, shortages or excesses of deliverable supplies at the delivery point can cause a temporary price divergence,<sup>286</sup> but the conditions producing that divergence may not be the result of wrongdoing. There is little reason to think that the risks associated with these end-of-delivery-month price divergences significantly increase the costs of hedging because the trader can avoid them easily. As Hieronymus has advised, "The defense against this kind of unhappy occurrence is quite simple: Stay out of the delivery month. . . . [T]he delivery game is one played between the terminal merchants and large scale speculators."<sup>287</sup>

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279. See Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,298-99 (CFTC 1982) (Stone, concurring).

280. Working II, *supra* note 42, at 325-26; see T. Hieronymus, Economics *supra* note 6, at 150 ("a perfect hedge is one that makes all of the money"); see also *supra* note 44 and accompanying text.

281. Working II, *supra* note 42, at 325.

282. See *supra* note 44.

283. See *supra* notes 273-78 and accompanying text.

284. See T. Hieronymus, Economics, *supra* note 6, at 147-69.

285. See *id.* at 152-54.

286. See *id.* at 168-69.

287. *Id.* at 169.

### 3. Protecting the Lambs from the Wolves

A third view envisions the underlying goal of the manipulation prohibition as protecting weak and ignorant traders from other traders who might take advantage of them.<sup>288</sup> For example, one commentator expresses concern about giving licenses to "the scalpers . . . to fleece the lambs."<sup>289</sup> Similarly, according to former CFTC Chairman Johnson, "Recognizing the duty of shorts while avoiding undue exploitation of their plight . . . should be the objective of the Act."<sup>290</sup>

As with the concern about price stabilization, however, the manipulation prohibition seems an inappropriate tool for implementing this goal. Although studies indicate that a high percentage of all speculators lose money,<sup>291</sup> it appears that the vast majority of these "lambs" lose their money, not as a result of manipulation, but as a result of their own lack of forecasting skills.<sup>292</sup> The problem of weak and ignorant traders should be handled directly through the imposition of stricter suitability<sup>293</sup> and disclosure requirements.<sup>294</sup> Once traders have entered the market, they should be permitted to seek and demand the prices they believe reflect futures values. If futures prices are to reflect accurately the expectations of traders, they cannot indicate a value discounted to insure that traders on the other side will not lose too much money.

### 4. An Alternative View

This Article advances a definition of manipulation premised on the

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288. See *supra* notes 203-07 and accompanying text.

289. Harrington II, *supra* note 119, at 268.

290. Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,292 (CFTC 1982) (Johnson, concurring).

291. One study estimates that, in any given year, seventy-five percent of all speculators lose money. See *Futures Game*, *supra* note 5, at 296-97. For a description of other related studies, see *id.* at 297-307.

292. See *Futures Game*, *supra* note 5, at 307. There is simply no evidence that manipulation is occurring on such a scale and with such regularity that it could possibly explain these losses year after year.

293. A suitability requirement obligates brokers to make an inquiry into the financial situation of prospective customers to determine whether a particular investment vehicle is appropriate for that customer. See 1 T. Russo, *supra* note 13, § 12.38.

The CFTC considered, but decided against, adopting a suitability requirement. See 43 Fed. Reg. 31886, 31889 (1978); 42 Fed. Reg. 44742, 44743-45 (1977). It is unclear the extent to which a suitability requirement should be treated as implicit in the antifraud provision of the commodities laws. In declining to adopt a suitability requirement, the CFTC stated that such a rule "would merely have codified principles that are implicit in the anti-fraud provisions of the Act and the CFTC's rules." *Id.*

Nonetheless, in 1986, the CFTC held that no inherent suitability requirement exists in § 4b, although it left open whether such a requirement could be grounded in some other provision. See *Phacelli v. ContiCommodity Servs., Inc.*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,250, at 32,674-75 (CFTC 1986).

294. The CFTC requires that futures trading professionals make specific risk disclosure statements to their customers. See 17 C.F.R. § 4.21 (commodity pool operators); *id.*, at § 4.31 (commodity trading advisors); *id.*, at § 32.5 (commodity option dealers); *id.*, at § 155.3 (futures commission merchant).



belief that the proper goal of a manipulation prohibition is to ensure the proper functioning of the futures market. In this regard, the author begins with Holbrook Working's definition of "the perfect futures market" as "one in which the market price would constitute at all times the best estimate that could be made, from currently available information, of what the price would be at the delivery date of the futures contracts."<sup>295</sup> A futures market produces a reliable<sup>296</sup> price by providing an incentive to traders to seek out and analyze accurately all available information.<sup>297</sup> Such informed trading is essential to the operation of the market and should be encouraged. In contrast, traders who seek to profit, not through their superior ability to predict future prices, but by their ability to alter the market price, do not contribute to the efficient operation of the market. Such conduct should be considered illegal.

In addition to this basic premise, the proposed definition is built on several other important principles. First, it recognizes that, while manipulation imposes costs on society,<sup>298</sup> an overinclusive prohibition also imposes costs on society. One effective way to stop all manipulation in the futures markets would be to stop all futures trading, but that "cure" would eliminate all the socially useful aspects of futures markets. The prohibition's goal should be to eliminate wasteful and counterproductive conduct while encouraging conduct necessary to make the market function properly.

Second, this definition recognizes that there exists a very wide range of conduct that is likely to have an effect on market prices.<sup>299</sup> One cannot, however, define manipulation as any and all conduct intended to affect price. Virtually all trading can affect price,<sup>300</sup> yet manipulation must in-

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295. Working IV, *supra* note 153, at 446.

296. The reliability or "correctness" of a futures price depends, not on the correspondence between expectation and actual events, but rather on the "correspondence between the actual expectation and what ought to be expected in the light of available information." *Id.* at 447.

297. See Easterbrook, *supra* note 24, at §117. This is not to suggest that the only legitimate way to trade is on the basis of information concerning underlying supply and demand. There are some traders, known as "chartists" or technical traders, who believe future prices can be predicted on the basis of past price patterns. See, e.g., *Futures Game*, *supra* note 5, at 165-215. Whether one is trading on the basis of sun spots, astrology or knowledge of economics, the legitimate trader still is attempting to make predictions based on currently available information.

298. One should not, however, overestimate those costs. A recent study of manipulation found that courts focus on, and are best able to detect, short-term price aberrations that typically occur during the last day or two before a contract matures. See Edwards & Edwards, *supra* note 119, at 343. Moreover, these short-term price aberrations are unlikely to interfere seriously with price discovery. People who rely on futures prices generally have a planning horizon of more than one or two days and, thus, do not rely on prices from the last two days of a trading period. See *id.* at 346-47.

299. False rumors are a blatant form of conduct likely (and intended) to have such an effect. As noted below, however, virtually all trading is capable of affecting price. See *infra* note 300 and accompanying text.

300. See Moore & Wiseman, *Market Manipulation and the Exchange Act*, 2 U. Chi. L. Rev. 46, 50 (1934). For example, all buy orders reflect a new demand and tend to urge

volve something more than trading with the knowledge of this truth.<sup>301</sup>

Third, the proposed definition incorporates the premise that a price standing alone is neither proper nor improper. Prices reflect the conclusions reached by traders after weighing the innumerable conditions that traders consider relevant to predicting future prices.<sup>302</sup> Those conditions may be usual or unusual, created by people or the result of natural disaster. Courts should focus on these conditions, not on the resulting price.<sup>303</sup>

### B. Description of the Proposed Definition

Based on this view of properly functioning futures markets, this Article defines manipulation as conduct that would be uneconomical or irrational, absent an effect on market price.<sup>304</sup> This proposed approach to manipulation comports with the GFA's understanding of manipulation—the only coherent theory of manipulation that emerges in the legislative history.<sup>305</sup> As discussed earlier, under the GFA's approach, manipulators "trade largely on the basis of . . . their ability . . . to bring

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prices upward, while all sell orders represent new supply and tend to urge prices downward. See Belveal, *Commodity Speculation with Profits in Mind* 93-94 (1967) (quoted in David G. Henner, 30 *Agric. Dec.* 1151, 1195 (1971)).

301. As the GFA made clear sixty years ago, to engage in a large scale transaction that affects price and that the trader must have known would affect price does not necessarily amount to manipulation. See *supra* notes 82-93 and accompanying text.

302. See *supra* note 158 and accompanying text.

303. The CFTC appears to be moving in this direction. The decision of the Commission in *Indiana Farm Bureau* focuses much more on how the conditions of shortage arose than on whether the price was "artificial." As explained in a footnote, "when a price is affected by a factor which is not legitimate, the resulting price is necessarily artificial. Thus, the focus should not be as much on the ultimate price, as on the nature of the factors causing it." *Indiana Farm Bureau Coop. Ass'n*, [1982-84 Transfer Binder] *Comm. Fut. L. Rep. (CCH)* ¶ 21,796, at 27,288 n.2 (CFTC 1982) (quoted with approval in *Cox*, [1986-87 Transfer Binder] *Comm. Fut. L. Rep. (CCH)* ¶ 23,786, at 34,064 (CFTC 1987)). In addition, the Commission has recognized that traders rationally and legitimately seek the best prices and that, in fact, the efficient operation of the market presumes that traders will do just that. See *Indiana Farm Bureau*, at 27,283. Thus, the Commission apparently has rejected a simplistic causation analysis that focuses on the price formation stage after all the conditions affecting valuation have occurred. In *Cox*, for example, the Commission held that the deliverable supply must be evaluated not simply on the last day of trading, but throughout the delivery month. See *Cox*, at 34,062. Unfortunately, the Commission continues to hold that proof of an artificial price is a central element of manipulation, see *Cox*, at 34,061, though it has offered little explication of its definition of artificial price. See *supra* note 147.

304. In *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972), the appellant argued that an "uneconomic act" constitutes a prerequisite for a finding of manipulation. See *id.* at 1162. The court construed this argument to mean that, in order for the scheme to be considered manipulation, the complete manipulative scheme must have proved unprofitable. See *id.* at 1162-63. Having so construed it, the court rejected the argument out of hand. See *id.* at 1163. The *Cargill* court, however, completely misinterpreted appellant's argument. The appellant asserted, not that the entire manipulative scheme ultimately must have proved unprofitable, but that the alleged manipulative acts were economically inexplicable *absent* a manipulative intent.

305. See *supra* notes 78-93 and accompanying text.

about temporary market conditions of which they may take advantage to make profits."<sup>306</sup>

The proposed approach to manipulation also is consistent with an analogous antitrust concept—that of predatory practices. The essence of predation is that the conduct in question is rational only because of the expected future effect that conduct will have on the market or on one's competitors.<sup>307</sup> In cases of predatory pricing, for example, a firm sets prices below cost because it hopes through these unprofitable transactions to alter the marketplace—for example, to eliminate competition—in a way that will make future profits possible.<sup>308</sup> As one court has explained, "[T]he anticipated benefits of defendant's price depended on its tendency to discipline or eliminate competition and thereby enhance the firm's long-term ability to reap the benefits of monopoly power."<sup>309</sup> Thus, predation, like manipulation, occurs when the profitability of a transaction or other conduct depends on the tendency of that transaction or conduct to affect the market.

The basic premise of the proposed approach seems to have been ac-

306. *GFA Letter*, *supra* note 80, at 5; *see supra* notes 82-93 and accompanying text.

307. Professor Sullivan defines predatory business conduct as "conduct which has the purpose and effect of advancing the actor's competitive position, not by improving the actor's market performance, but by threatening to injure or injuring actual or potential competitors." L. Sullivan, *Antitrust* 108 (1977). Professors Ordover and Willig offer a similar definition:

[P]redatory objectives are present if a practice would be unprofitable without the exit [of a rival] it causes, but profitable with the exit. Thus, although a practice may cause a rival's exit, it is predatory only if the practice would not be profitable without the additional monopoly power resulting from the exit.

Ordover & Willig, *An Economic Definition of Predation: Pricing and Product Innovation*, 91 *Yale L.J.* 8, 9 (1981); *see also* Sidak, *Debunking Predatory Innovation*, 83 *Colum. L. Rev.* 1121, 1124-26 (1983) (criticizing some aspects of the analysis by Ordover and Willig but accepting the basic definition of predatory business conduct).

308. Predatory pricing closely resembles manipulation in at least one respect—both concern the unilateral pricing activities of marketplace participants.

Numerous theories exist with respect to predatory pricing concerning the appropriate measure for determining when a price is "below cost." *See* Brodley & Hay, *Predatory Pricing: Competing Economic Theories and the Evolution of Legal Standards*, 66 *Cornell L. Rev.* 738 (1981). Of course, none of this cost-based analysis is relevant to futures trading. Nonetheless, the underlying theory of predation may be applied to the unilateral pricing activities of futures traders.

309. *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1035-36 (9th Cir. 1981), *cert. denied*, 459 U.S. 825 (1982) (*quoted with approval in* D.E. Rogers Assocs. v. Gardner-Denver Co., 718 F.2d 1431, 1436 (6th Cir. 1983), *cert. denied*, 467 U.S. 1242 (1984)); *see Matsushita Electric Indus. v. Zenith Radio Corp.*, 475 U.S. 574, 589-92 (1986). Despite the wide range of views on the best method for deciding whether a particular price is predatory, there seems to be fairly broad agreement on the general dynamic of predation—that is, that the conduct in question is rational or profitable only because of the expected future effect of that conduct on the marketplace. *See, e.g.,* R. Bork, *The Antitrust Paradox* 144 (1978); III P. Areeda & D. Turner, *Antitrust Law* 151 (1978); F. Scherer, *Industrial Market Structure & Economic Performance* 335 (2d ed. 1980); Hurwitz & Kovacic, *Judicial Analysis of Predation: The Emerging Trends*, 35 *Vand. L. Rev.* 63, 67-69 (1982).

cepted by both the CFTC<sup>310</sup> and a leading commentator.<sup>311</sup> They agree, for example, that to engage in conduct that does "not have a bona fide investment or commercial purpose,"<sup>312</sup> "[o]ther than the investment or commercial purpose of extracting a profit through the creation of an artificial price"<sup>313</sup> constitutes manipulation. They also agree that to stand for delivery in order to meet "legitimate commercial commitments,"<sup>314</sup> even if that conduct has a foreseeable price effect, does not amount to manipulation.<sup>315</sup>

The proposed approach to manipulation generalizes these basic propositions to avoid the need to determine whether an artificial price exists and to avoid any implication that some reasons for desiring a commodity are not legitimate, even if those reasons have nothing to do with the price impact of one's conduct. For example, a trader might demand delivery of silver because he uses silver in certain industrial processes, or uses it to make dental fillings or jewelry. This would seem to be a legitimate commercial need. But traders also may possess their own idiosyncratic reasons for desiring some commodity.<sup>316</sup> Little basis exists for a court or agency to distinguish among these different types of demand. Those who want silver in order to construct a palace, or simply because it makes them feel good, should receive the same treatment as those who want silver for dental fillings, jewelry or industrial processes.<sup>317</sup> A strong indication of manipulation does arise, however, when a trader holding physical supplies located at a delivery point foregoes the opportunity to sell that commodity there and instead ships the commodity away and sells it for a lower net price.<sup>318</sup> In such a case, the fact that the sale may have been made to a legitimate commercial enterprise in no way lessens the indications of manipulation.

To reiterate, the proposed approach would classify as manipulation any conduct where the anticipated profitability of that conduct depends

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310. Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,286 (CFTC 1982).

311. 1 T. Russo, *supra* note 13, § 12.19, at 12-34.

312. *Id.*

313. *Id.* at 12-34 n.13 (emphasis omitted).

314. Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,286 (CFTC 1982) (quoted in 1 T. Russo, *supra* note 13, § 12.19, at 12-35).

315. Unlike this author's proposed approach, however, the CFTC and Russo continue to treat artificial price as a central element of manipulation. See Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,283 (CFTC 1982); 1 T. Russo, *supra* note 13, §§ 12.22-12.29.

316. It has been suggested, for example, that the Hunt brothers sought to own huge quantities of silver because they viewed metals as the only real store of value. See H. Hurt III, Texas Rich 327 (1981).

317. Judge Easterbrook has observed that "[i]f people want to purchase wheat to admire its beauty rather than to mill it into flour, they may be weird, but their demand is real." Easterbrook, *supra* note 24, at S117.

318. The trader, of course, would have an opportunity to offer an innocent explanation for this suspicious behavior. See *infra* notes 352-55 and accompanying text.

on its affecting the price of the commodity traded. While critics might argue that this approach unduly focuses on the trader's intent, the CFTC has observed that intent has always been "the essence of manipulation."<sup>319</sup> What this approach does is to recast the intent inquiry into a more workable test that corresponds to the actual intentions and concerns of traders and manipulators.<sup>320</sup>

### C. Applying the Proposed Approach

Although the proposed approach to manipulation turns on intent, objective indicia of intent do exist. Certain types of conduct are likely to be associated with manipulative intent under the proposed definition. A guiding principle in identifying such conduct is that rational investors ordinarily "try to buy as cheaply as they can and . . . sell as high as they can."<sup>321</sup> Therefore, a trader who buys for more, or sells for less, than was necessary to execute the transaction is likely to be acting, not as an investor or speculator, but for the purpose of affecting price. This type of apparently uneconomic conduct evinces itself in a variety of practices, all of which are designed to accentuate the price impact of any trade or series of trades.<sup>322</sup> Frequently, traders accomplish this price impact by the way in which they place their orders. As noted earlier, all trading has some price effect, and this is particularly true with large-scale trading.<sup>323</sup> Thus, any attempt to purchase a large quantity of a commodity will tend to drive up the price. The rational trader, however, ordinarily will seek to minimize the price impact of his own trades because this will permit him to get the best price. When trades are executed in a manner that seems designed to increase the price impact, manipulative intent may be indicated.<sup>324</sup>

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319. Indiana Farm Bureau Coop. Ass'n, [1982-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796, at 27,282 (CFTC 1982).

320. As discussed earlier, when intent is combined with the artificial price approach, the resulting intent test focuses on something manipulators have either never thought of or to which they are totally indifferent. See *supra* notes 180-86 and accompanying text.

321. David G. Henner, 30 Agric. Dec. 1151, 1197 (1971).

322. See *Opinion of General Counsel of Commission*, [1941-47] Fed. Sec. L. Rep. (CCH) ¶ 75,214, at 75,471 (1941).

323. See *supra* note 300 and accompanying text; see also David G. Henner, 30 Agric. Dec. 1151, 1258 n.149 (1971), and sources cited therein; *Opinion of General Counsel of Commission*, [1941-47] Fed. Sec. L. Rep. (CCH) ¶ 75,214, at 75,470; S. Rep. No. 792, 73d Cong., 2d Sess. 17 (1934); G. Hoffman, *supra* note 78, at 332-38.

324. See, e.g., *Cargill Inc. v. Hardin*, 452 F.2d 1154, 1169-70 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); Vincent W. Kosuga, 19 Agric. Dec. 603, 615 (1960); cf. *Opinion of General Counsel of Commission*, [1941-47] Fed. Sec. L. Rep. (CCH) ¶ 75,214, at 75,471 (discussing securities manipulation); accord Note, *supra* note 81, at 664.

The mere fact of large-scale purchases alone, however, would not be sufficient to infer a manipulative intent. In *Hohenberg Bros.*, [1975-77 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,271, at 21,474 (CFTC 1977), the Commission noted that "[t]he Division of Enforcement has not contended that maintenance of a large short futures position in and of itself constitutes manipulation in violation of the Act." In three other cases, the defendants were found not to have engaged in a manipulation or corner despite their very large futures holdings. See *Volkart Bros. v. Freeman*, 311 F.2d 52, 60 (5th Cir. 1962);

One type of uneconomic conduct that accentuates the price impact of a particular trade is "reaching."<sup>325</sup> Reaching occurs when the trader makes a bid at a price that is substantially higher, (or lower) than the last bid or transaction.<sup>326</sup> *David G. Henner*<sup>327</sup> provides a good example. There, the defendant, within the last few seconds of the closing period, "bought the board"—that is, he simultaneously accepted all of the posted offers.<sup>328</sup> Then, at the ringing of the bell announcing the end of the closing period, he shouted out a bid for one contract at a price of \$41.85—fifty-five points higher than the highest offer and 165 points higher than the lowest offer he had just bought.<sup>329</sup> The price of \$41.85 represented the high price for the day and the maximum to which prices were permitted to rise.<sup>330</sup> The ALJ found that defendant Henner had made his reach bid with the primary intent of increasing the price of the commodity<sup>331</sup> and that this was prohibited manipulation.<sup>332</sup> Henner thus engaged in uneconomic conduct because he intentionally paid more than necessary.<sup>333</sup>

Because trading in a manner designed to accentuate the price impact of a trade does seem uneconomic, one may be left wondering why anyone who is not crazy or ignorant would engage in such a practice. Several rationales, in fact, exist. One common explanation is that the trader hopes his activity will generate new demand and thus create a more favorable market in which to dispose of his purchases.<sup>334</sup> This is what

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*General Foods Corp. v. Brannan*, 170 F.2d 220, 231 (7th Cir. 1948); *Cox*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,786, at 34,059-60 (CFTC 1987); cf. *Chris-Craft Indus. v. Piper Aircraft Corp.*, 480 F.2d 341, 383 (2d Cir.) (discussing this principle in the context of securities), *cert. denied*, 414 U.S. 910, *cert. denied*, 414 U.S. 924 (1973); S. Rep. No. 792, 73d Cong., 2d Sess. 17 (1934); *Opinion of General Counsel of Commission, supra*, at 75,470-71.

325. *Wright v. SEC*, 112 F.2d 89, 92 (2d Cir. 1940).

326. See *id.*; Note, *supra* note 81, at 664. Reaching is uneconomic because the trader is not seeking to buy as cheaply as he can. See *David G. Henner*, 30 Agric. Dec. 1151, 1197 (1971).

327. 30 Agric. Dec. 1151 (1971).

328. *Id.* at 1161.

329. See *id.*

330. See *id.*

331. See *id.* at 1192.

332. See *id.* at 1258. A slight variation of price reaching occurs when, rather than entering one bid that represents a dramatic change from the earlier bid, the trader enters a series of steadily increasing bids or offers. See *David G. Henner*, 30 Agric. Dec. 1151, 1207 n.73 (1971). This gives the impression of a broad-based and continuing interest in the commodity and may be even more damaging to the market than a single, large price jump. Cf. *SEC v. Bennett*, 62 F. Supp. 609, 610 (S.D.N.Y. 1945) (manipulation of securities).

333. Of course, in some markets where very rapid price fluctuations occur, it is necessary to offer a substantial change in price in order to induce anyone to sell. See *T. Hieronymus, Economics, supra* note 6, at 39. In such a case, although the bid would constitute a jump, it would not be uneconomic because it would represent the lowest price at which the trader could purchase.

334. The basic object of reaching is to generate new demand (or supply) so that the price will continue to rise (or fall) once the manipulator removes his demand (supply).

the defendant in *David G. Henner*<sup>335</sup> apparently had in mind. He did not make his reach bid until the sounding of the closing bell, because it is the closing price on which most traders concentrate in deciding how to trade.<sup>336</sup> Moreover, he timed his trades for a period in the month so that it would appear that a "key reversal" had occurred.<sup>337</sup> Although the scheme failed and the price returned the next day to the level it was at prior to the jump bid, the trader, nonetheless, was found to have manipulated the market.<sup>338</sup>

Sometimes the manipulator hopes to generate new demand among those who do not realize what a good buy the commodity is or even from those who get caught up in an irrational, speculative frenzy. Here, the object is achieved through something known as "stop-order raiding" or "gunning."<sup>339</sup> In futures trading, a trader commonly places stop-loss or-

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Frequently, either rising prices or increased activity attract new buyers. Thus, by generating a price surge or flurry of activity, a trader may be able to attract new buyers who will keep the price rising long enough to permit him to reap his profit. See *Opinion of General Counsel of Commission*, [1941-47] Fed. Sec. L. Rep. (CCH) ¶ 75,214, at 75,470; see also *Minpeco, S.A. v. ContiCommodity Servs., Inc.*, 552 F. Supp. 332, 336-37 (S.D.N.Y. 1982) (discussing how one might lure others into the market by creating a "price mirage"). This type of scheme is sometimes referred to as "bulling" the market (or "bearing" the market when the trader causes a price decline). See *David G. Henner*, 30 Agric. Dec. 1151, 1191 (1971); see also Note, *supra* note 81, at 660 (discussing bull and bear pools in securities trading). As one tribunal explained, a bulling scheme includes any attempt "to attract a public following or to generate a more favorable market in which to dispose of at a profit futures that were bought in [sic] during a preceding period when prices were lower." *David G. Henner*, 30 Agric. Dec. 1151, 1191 (1971) (quoting Thomsen, *Agricultural Prices* 292-93 (1936)). It is important to note that in order for the scheme to work, the trader must be able to generate demand on the part of others, because if the price is supported only by reason of the manipulator's activities, he will not be able to get his money out. Once he stops buying, the price will return to its prior level and he will have accomplished nothing other than simply to have paid more than anyone else for the commodity. See *supra* note 73.

335. See 30 Agric. Dec. at 1177.

336. See *id.* at 1177.

337. *Id.* at 1178.

338. See *id.* at 1174. Reuben E. McGuigan, 5 Agric. Dec. 249 (1946), provides another example of a trader attempting to generate new demand. There, the respondent advertised himself as being in the business of giving market advice. See *id.* at 249. He would assume market positions and then advise purchases or sales that would favorably affect his position. See *id.* at 250. When the market had moved sufficiently, he would sell his positions at a profit. See *id.*; cf. *R.J. Koeppe & Co. v. SEC*, 95 F.2d 550, 552 (7th Cir. 1938) (involving a similar scheme in the securities market). Ordinarily, there is nothing uneconomic about a businessman advertising to others the product he is attempting to sell. In the context of investments, however, it is somewhat suspect when a trader, having told others what a great investment something is and how much money they will make on it, then turns around and sells that very investment. As the FTC has noted: "For a speculator to put out market circulars advising the public to buy (or sell) and then himself do the contrary is thoroughly dishonest." FTC Report, *supra* note 217, at 258 (1926).

339. Gunning for stop-loss orders has been referred to as "one of the 'main forms of manipulation.'" See *David G. Henner*, 30 Agric. Dec. 1151, 1181 n.25 (1971) (quoting Irwin, *The Nature of Risk Assumption in the Trading on the Organized Exchanges*, 27 Am. Econ. Rev. 269 (1937)).

ders.<sup>340</sup> A stop-loss order is a standing order to the broker to liquidate the trader's position should the price reach a particular level in order to prevent devastating losses.<sup>341</sup> By increasing the price somewhat, a manipulator may be able to generate stop-loss purchasing on the part of shorts, and this, in turn, will push the price even higher.<sup>342</sup> The manipulator may be able to turn a quick profit by pushing the price up and then selling at an even higher price to those with stop-loss orders.<sup>343</sup>

In addition to the desire to generate new demand in order to permit a manipulator to sell his newly acquired holdings at a profit, other possible explanations exist for apparently uneconomic conduct. Sometimes the explanation becomes apparent when the allegedly manipulative transaction is viewed in relation to the other holdings and dealings of the defendant. A classic situation in which this occurs is when something in which the trader has a great interest is pegged to the manipulated price. For example, in *Zenith-Goodley Co.*<sup>344</sup> the government pegged its support price of milk to the price of butter on the New York Mercantile Exchange at given times.<sup>345</sup> In order to increase the price of milk, the Dairymen's League Cooperative Association concluded it was desirable to keep the price of butter above eighty-four cents per pound.<sup>346</sup> During the critical period, the League made large purchases of butter at eighty-four cents or higher, and thereby maintained the price.<sup>347</sup> The Cooperative was willing to pay more than the going price for butter because it anticipated making a substantial profit in other related transactions.<sup>348</sup>

Uneconomic conduct also can be identified in the typical corner or squeeze. For example, a trader might ship supplies away from the delivery point, selling them at a loss.<sup>349</sup> In the alternative, a trader might

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340. See B. Gould, *The Dow Jones-Irwin Guide to Commodities Trading* 321, 323-24 (2d ed. 1981).

341. Futures trading is a highly leveraged activity. Initial margins are low, but even relatively small adverse price changes can result in a trader not only losing his posted margin but having to post further margin amounts as well. Stop-loss orders allow traders to plan in advance the amount they are willing to risk. See B. Gould, *supra* note 340, at 323-24; T. Hieronymus, *Economics*, *supra* note 6, at 60; Note, *supra* note 81, at 674.

342. See H. Emery, *supra* note 6, at 122 n.1; Anderson, *supra* note 145, at 7; Note, *supra* note 81, at 660-61.

343. See Anderson, *supra* note 145, at 7.

344. 6 Agric. Dec. 900 (1947).

345. See *id.* at 903. The pegged and the manipulated commodities need not be different. For example, in *Howard Randolph*, 21 Agric. Dec. 219 (1962), the trader had made a contract to deliver eggs with the price he would receive to be based on the spot price of eggs on the day of delivery. See *id.* at 222. On the day of delivery, the trader placed an order on the spot market causing the price to rise to the desired level. See *id.*

346. 6 Agric. Dec. at 905.

347. *Id.* at 904.

348. In a similar vein, the *Opinion of General Counsel of Commission* states that one relevant circumstance in the case of suspected manipulation is "whether [the trader] was being pressed to repay or reduce bank loans for which securities of the same issues were held as collateral." [1941-47] Fed. Sec. L. Rep. (CCH) ¶ 75,214, at 75,471.

349. See *Landon V. Butler*, 14 Agric. Dec. 429, 433 (1955); see also Vincent W. Kosuga, 19 Agric. Dec. 603, 616 (1960) (respondent made agreements with growers and



make delivery difficult by tying up the necessary transportation. Traders allegedly used this latter technique in a potato manipulation scheme.<sup>350</sup> There, the defendants reportedly tied up the trains using phony export shipments and left the boxcars loaded or only partially unloaded.<sup>351</sup> In both of these situations, the trader has engaged in conduct falling within the proposed definition of manipulation—the profitability of the conduct depends on its tendency to reduce supply and affect the price. Shipping supplies at a loss or leaving rail cars to sit without being unloaded ordinarily would be unprofitable unless one hoped and expected that the conduct would have a price effect. Hence, unless the defendant can demonstrate a nonmanipulative purpose, such conduct clearly would be illegal.

The above scenarios describe conduct that appears uneconomic absent a manipulative intent. Proof of such conduct should be sufficient to establish a *prima facie* case of manipulation. After a *prima facie* case is established, the burden then would shift to the defendant to articulate a legitimate, nonmanipulative reason for the conduct.<sup>352</sup> The reason for shifting the burden to the defendant is that, in the face of such suspicious conduct, the defendant stands in the best position to come forward with evidence to explain his own conduct. It is important to emphasize, however, that under this approach, when the burden of proof shifts, the defendant is expected to come forward, not with proof that the price is “normal,” but with proof that his conduct was economically rational even absent an effect on price.

A variety of possible legitimate explanations exist for ordinarily suspicious conduct. The trader may have had unusual obligations or needs.<sup>353</sup> Likewise, unusual market conditions may have caused the unusual trad-

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shippers of onions to keep onions from being used for deliveries on the exchange); FTC Report, *supra* note 217, at 251 (1926) (alleged cornerer sold his pork in the local market, but first cut it to make it unsuitable for delivery on futures contracts).

350. See *Leist v. Simplot*, 638 F.2d 283, 290 (2d Cir. 1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982).

351. See *id.*

352. In *General Foods Corp. v. Brannan*, 170 F.2d 220 (7th Cir. 1948), the government argued that the defendants tried to change one of the rules of the Exchange in order to assist in a manipulative scheme. See *id.* at 228-29. When the defendants attempted to justify their conduct on the ground that the rule that they had tried to change was unfair, the government replied that the “merits” of the rule change were irrelevant. *Id.* at 229. The court, however, accepted evidence concerning the merits of the proposed change, noting that such evidence “affords a sound basis for the argument by . . . [the defendants] that they were motivated by a legitimate rather than an ulterior purpose.” *Id.*; see also *Vincent W. Kosuga*, 19 Agric. Dec. 603, 615-16 (1960) (dismissing one count of manipulation charge because defendant’s explanation of his conduct raised a sufficient question about the presence of manipulative intent).

353. For example in *David G. Henner*, Henner contended that he very much wanted to purchase one more contract and he had to “reach” because he thought it would be necessary in order to insure that someone would accept the bid. 30 Agric. Dec. 1151, 1184-85 (1971). While under some circumstances the explanation might have been plausible, the judicial officer found that other conduct by the defendant in this case was completely inconsistent with his explanation. See *id.* at 1187-88.

ing conduct. For example, bids that might otherwise appear to be jump bids may be necessary in a rapidly changing market.<sup>354</sup> Last, the uneconomic trading simply may reflect bad judgment. Sometimes traders make bad decisions, and there is nothing illegal about simply having been wrong.<sup>355</sup>

Even under this proposed approach, ambiguous cases and close calls, of course, will still arise. Sometimes, a defendant's motives may be mixed and complex. In handling such situations, the proper course of action is that which is articulated by Thomas Russo: "[D]oubts concerning the legitimacy of the conduct should generally be resolved in favor of permitting the behavior. Where conduct is in furtherance of a legitimate business purpose . . . the best course is to let the market be the final arbiter."<sup>356</sup>

### CONCLUSION

Congress, courts, and commentators have condemned manipulation for over 65 years. Despite this long history, manipulation never has been adequately defined. The traditional focus on whether the resulting price is "artificial" not only has made the offense of manipulation vague, but also has required courts to engage in an extremely complex economic analysis that they are ill-equipped to perform. The approach proposed in this Article, instead of focusing on the resulting price, focuses on the conditions of shortage or surplus that the price reflects. The basic issue is whether the accused manipulator created those conditions. Specifically, this Article defines manipulation as conduct that would be uneconomical or irrational, absent an effect on the market price. This approach is intended to promote, in both usual and unusual times, the process of price discovery and to strike a balance between over-deterrence and under-deterrence.

The proposed approach does not attempt to sweep all problems of the futures markets into the manipulation prohibition.<sup>357</sup> In the author's

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354. In analyzing a defense along these lines, it is necessary to consider the nature of the information available to the market at the time of the trades, as well as the pattern of trading prior to the bid in question. Expert opinion, or the lack of it, may prove particularly helpful and persuasive on this point. See *General Foods Corp. v. Brannan*, 170 F.2d 220, 227 (7th Cir. 1948); *David G. Henner*, 30 Agric. Dec. 1151, 1191, 1213-15 (1971).

355. See *Henner*, 30 Agric. Dec. at 1252. In assessing such a defense, however, it certainly would be appropriate to consider the trader's experience and whether the trades in question were unusual for that trader. Thus, in *David G. Henner*, the fact that Henner was an experienced and successful trader strongly influenced the judge. See *id.* at 1260. The experts had characterized the bid in question as "atrocious," *id.* at 1191, and the fact of Henner's experience made his claim of mere bad judgment implausible. In addition, the judicial officer found it very unusual for Henner to make bids at all. Ordinarily, he operated simply by accepting offers made by others. See *id.* at 1187. All of these factors combined to lead the officer to the conclusion that the defendant's conduct was not simply a bad decision, but a deliberate attempt to increase prices. See *id.* at 1192.

356. 1 T. Russo, *supra* note 13, § 12.01, at 12-6.

357. The examples used in this Article have focused on manipulation in the context of

view, it is a mistake to use that prohibition as a catch-all for all the perceived inadequacies of the marketplace.<sup>358</sup> If discrete problems remain, they should be dealt with directly rather than by turning manipulation into a vague and open-ended concept. Surely the time has come to adopt a definition of manipulation that will be relatively easy to apply and will advance the goal of an efficiently operating futures market.

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traditional commodity futures requiring physical delivery. The Article does not directly address financial and stock index futures that use a cash delivery system. The approach suggested here, however, is not dependent on the existence of a physical delivery system. Reaching, *see supra* notes 325-38 and accompanying text, stop-order raiding, *see supra* notes 339-43 and accompanying text, and the type of purchasing undertaken in Zenith-Goodley Co., 6 Agric. Dec. 900 (1947), *see supra* notes 344-48 and accompanying text, all are types of manipulation that are covered by this Article's analysis and that could be undertaken in a market that involved a cash delivery system. It is, of course, possible that further analysis focused specifically on financial and stock index futures would identify problems unique to those markets that would warrant a different approach to manipulation in those markets. As in more traditional futures markets, however, the author would caution against using the manipulation prohibition as a catchall device for correcting all perceived problems in these markets. It may well be that the unique problems that exist in these markets are better addressed directly, rather than indirectly. For a general discussion of financial futures, see M. Powers & D. Vogel, *Inside the Financial Futures Markets* (1981), and for a general discussion of stock index futures, see Markham & Gilberg, *supra* note 32.

358. For a discussion of some of the problems that others have attempted to pull within the manipulation prohibition, see *supra* notes 273-94 and accompanying text.