Commodity Futures Trading Commission
CEA CASES

NAME: RAWLIN L. STOVALL AND STOVALL & STOVALL INC.

CITATION: Comm. Fut. L. Rep. (CCH) P20,941; [1977-1980 TRANSFER BINDER]

DOCKET NUMBER: 75-7; 206

DATE: DECEMBER 6, 1979

DOCUMENT TYPE: DECISION AND ORDER

NOTE: FORMERLY CEA DOCKET # 206

[P20,941] In re Stovall, et al.

Commodity Futures Trading Commission. CFTC Docket No. 75-7. December 6, 1979. Commission opinion in full text.

Futures Commission Merchants -- Unauthorized Trading in Commodities Futures Contracts. -- Upon consideration of the record, the CFTC has determined that the instant operation did not involve the sale of cash commodities for deferred delivery, but in fact, involved the contracts for sale of commodities for future delivery, commonly known as commodity futures contracts, which are lawfully effected only on or subject to the rules of a board of trade designated as a contract market. Commodity futures contracts are entered into primarily for the purpose of assuming or shifting the risk of change in value of commodities, rather than for transferring ownership of the actual commodities. The activities of the merchant here were directed to the general public, and not to those specific individuals interested in acquiring or disposing commodities. The facts show that the majority of clients were not interested in the delivery aspect of the contracts. The CFTC agreed with the findings of the ALJ that the transactions resembled futures contracts in the standardization of their terms, the purposes for which they were traded, and the methods by which they were traded.

See P 5001, "Commodity Futures Trading Commission" division.

Futures Contracts -- Trading Off Contract Markets -- Legality of Transactions. -- Futures contracts must be traded on or subject to the rules of a designated contract market to be legal. The definition of a futures contract is not dependent upon the trading of that contract on a board of trade, but its legality is determined by its compliance with contract market rules. The floor broker here who contended that his operation was concerned strictly with cash commodity contracts further contended that only contracts which are traded according to contract market rules are futures contracts. This construction of the Commodity Exchange Act was rejected by the Commission.

See P 12,001, "Liabilities -- Prohibitions" division.

The respondents, Rawlin L. Stovall ("Stovall") and Stovall and Stovall, Inc. ("Stovall, Inc."), have appealed to the Commission from the May 6, 1977 initial decision and order of the Administrative Law Judge which would revoke the registrations of both respondents, enter a cease and desist order against Stovall, and suspend Stovall's trading privileges for a period of two years.

I.

On January 22, 1973, the administrative complaint in this action was filed before the Secretary of Agriculture, pursuant to Sections

6(b), 6(c) and 8a(3) of the Commodity Exchange Act, as amended ("the Act"), 7 U.S.C. §§ 9, 13b and 12a (1970). At that time respondent Stovall was registered as a floor broker and was a member of the Chicago Board of Trade and the Chicago Open Board of Trade (now the MidAmerica Commodity Exchange, Inc.). He also was the president and principal shareholder of Stovall, Inc., a registered futures commission merchant.

The complaint charged that during the period May 3, 1972 to December 6, 1972, Stovall, doing business as R.L. Stovall, Sole Proprietor, Principal in Cash Commodities ("Stovall Commodities" or "Stovall"), willfully violated Section 4 of the Act, 7 U.S.C. § 6, by

[engaging] in a course of business in which [Stovall] solicited and accepted orders which he represented to be for contracts for the purchase and sale of cash commodities. Such orders were actually for contracts for the purchase and sale of commodities for future delivery.

The complaint also charged that: 1) Stovall had violated Section 4d of the Act, 7 U.S.C. § 6d, by acting as a futures commission merchant without being registered: 2) Stovall had violated Sections 4b(D) and 4c(a)(A) of the Act, 7 U.S.C. §§ 6b and 6c, and Section 1.38(a) of the regulations of the Commodity Exchange Authority ("CEA"), by bucketing customer orders and by taking the opposite side of each order "with no intention of bona fide execution"; and 3) Stovall had violated Section 1.35(a) of the CEA's regulations on December 20, 1972, by refusing to permit United States Department of Agriculture employees to inspect his books and records. The complaint proposed suspension or revocation of the respondents registrations, n1 the revocation of Stovall's trading privileges, and the entry of a cease and desist order against Stovall.

n1 The complaint did not allege that Stovall, Inc. was an active participant in any of the transactions which were the subject of the charges against Stovall, doing business as Stovall Commodities. Rather, the proposed suspension or revocation of Stovall, Inc.'s registration was based upon Rawlin Stovall's position as president and owner of Stovall, Inc. *See* pp. 25-26 *infra.*

On February 7, 1973, respondents filed an answer to the complaint denying that they had violated the Act in transacting business as Stovall Commodities. Relying on Section 2(a)(1) of the Act, 7 U.S.C. § 2, respondents argued that the Stovall operation involved only the execution of "cash commodity contracts for deferred delivery outside a Regulated Exchange" and that consequently, the CEA had no jurisdiction over the operation. n2

n2 The respondents also contended that: 1) the CEA is estopped from prosecuting this action because, prior to engaging in business, Stovall had discussed his prospective operation with several employees of the CEA and had been advised that the Stovall operation would not require registration with the Department of Agriculture; 2) the CEA had failed to comply with Section 0.3(c) of its regulations which required that

in any case, except one of willfulness or one in which the public health, interest or safety otherwise requires, prior to the institution of a proceeding for the suspension or revocation of a registration of license, facts or conditions which may warrant such action shall be called, in writing, to the attention of the person complained against, and such person shall be accorded opportunity to demonstrate or achieve compliance with all lawful requirements. . . .

and 3) the complaint failed to set forth the specific sections of the Act respondents had allegedly violated and failed to state a cause of action against Stovall, Inc.

On January 13, 14 and 15, 1975, an Administrative Law Judge conducted a hearing on the merits of the proceeding. On September 2, 1975, staff attorneys with the Commission's Division of Enforcement entered appearances. n3

Thereafter, the Division and the respondents filed post-hearing papers and, on April 19, 1977, oral argument was conducted before the Administrative Law Judge. On May 6, 1977, the Administrative Law Judge filed a fifty-five page initial decision in which he set forth his conclusion that respondents had violated the Act as charged, and entered, the sanctions which we described at p. 1, *supra.*

n3 On October 23, 1974, Congress enacted the Commodity Futures Trading Commission Act of 1974, Pub. L. 93-463, 88 Stat. 1389. That legislation extensively amended the Commodity Exchange Act, 7 U.S.C. §§ 1-17b (1970), and created the Commission as an independent regulatory agency, which, on April 21, 1975, took over responsibility for administering and enforcing the provisions of the Commodity Exchange Act from the Commodity Exchange Authority. Sections 411 and 412 of the Commodity Futures Trading Commission Act of 1974, 88 Stat. 1414, provide:

Sec. 411. All operations of the Commodity Exchange Commission and of the Secretary of Agriculture under the Commodity Exchange Act, including all pending administrative proceedings, shall be transferred to the Commodity Futures Trading Commission as of the effective date of this Act and continue to completion. All rules, regulations, and orders heretofore issued by the Commodity Exchange Commission and by the Secretary of Agriculture under the Commodity Exchange Act to the extent not inconsistent with the provisions of this Act shall continue in full force and effect unless and until terminated, modified, or suspended by the Commodity Futures Trading Commission.

Sec. 412. Pending proceedings under existing law shall not be abated by reason of any provision of this Act but shall be disposed of pursuant to the applicable provisions of the Commodity Exchange Act, as amended, in effect prior to the effective date of this Act.

We use the terms "Division" or "Division of Enforcement" to refer to the prosecutorial staff of the Commodity Exchange Authority and of the Commission's Division of Enforcement.

Upon consideration of the record as a whole and the arguments of the parties on appeal, we have determined that Stovall's operation did not involve the sale of cash commodities "for

deferred delivery" and that the contracts executed between Stovall and his customers were contracts of sale of commodities for future delivery, commonly known as commodity futures contracts, n4 which are lawfully effected only on or subject to the rules of a board of trade designated as a "contract market" pursuant to Section 5 of the Act, 7 U.S.C. § 7. Consequently, we have concluded that respondent Stovall violated Section 4 of the Act as charged. In reaching our decision, we rely upon, and adopt as our own, the Administrative Law Judge's findings of fact. We have, however, determined to set forth our conclusions of law based on those facts.

n4 *See* 7 U.S.C. § 5.

II.

Section 4 of the Act provides, in pertinent part, that:

It shall be unlawful for any person to deliver for transmission through the mails or in interstate commerce by telegraph, telephone, wireless, or other means of communication any offer to make or execute, or any confirmation of the execution of, or any quotation or report of the price of, *any contract of sale of any commodity for future delivery* on or subject to the rules of any board of trade in the United States, or for any person to make or execute such contract of sale, . . . except, in any of the foregoing cases, where such contract is

made by or through a member of a board of trade which has been designated . . . as a "contract market", . . . (emphasis added).

However, under Section 2(a)(1) of the Act the term "future delivery" does not include

any sale of any cash commodity for deferred shipment or delivery.

Thus, the threshold issue here is whether the Stovall transactions were contracts of sale of commodities for future delivery. Commodity futures transactions involve standardized contracts for the purchase or sale of commodities n5 which provide for future, as opposed to immediate, delivery, and which are directly or indirectly offered to the general public and generally secured by earnest money, or "margin." They are entered into primarily for the purpose of assuming or shifting the risk of change in value of commodities, rather than for transferring ownership of the actual commodities. Thus, while a party to a commodity futures contract may eventually perform on the contract, that is, make or take delivery, at the maturation of the contract, thereby using the futures market to make or take delivery of actual commodities in exchange for money, he need have no expectation that performance will occur. Indeed, most parties to commodity futures contracts extinguish their legal obligations to make or take delivery by offsetting their contracts with equal and opposite transactions prior to the date on which delivery is called for, accepting a profit or loss for any differences in price between the initial and offsetting transactions. *Cf. Board of Trade of the City of Chicago v. Christie Grain & Stock Co.,* 198 U.S. 236, 247-248 (1905). As we shall discuss, all of these classic elements are present here and, therefore, the Stovall transactions constituted contracts for the sale of commodities for future delivery under Section 4 of the Act which were required to be executed on designated contract markets.

n5 See 7 U.S.C. § 2 (1970) for the definition of "commodity" contained in the Commodity Exchange Act at the time this proceeding was instituted.

In deciding this issue we have considered whether the Stovall transactions fell within the Section 2(a)(1) "cash commodity" exclusion from the term "future delivery" and thus were outside the purview of the provisions of Section 4 of the Act. The "cash commodity for deferred shipment or delivery" exclusion, which originated in the Future Trading Act of 1921, and was incorporated into the Grain Futures Act of 1922, the predecessor of the Commodity Exchange Act (see pp. 14-18 *infra),* was enacted to make clear that the 1921 Act was not intended to "interfere with the cash grain." *Hearings on Futures Trading Before the House Committee on Agriculture,* 66th Cong., 2d Sess. 213 (1921). George T. McDermott, a representative of the Kansas Grain Dealer's Association and the person who first proposed to the House Agriculture Committee that it include this exclusion in the bill, explained at the hearings that "the words 'cash grain for deferred shipment do have a technical meaning." McDermott explained that "they ought to add those words in there; . . . so that we would not tax the farmer in selling his wheat to the mill" (*id.* at 214). Similarly, Senator Capper, proponent of the Senate bill, explained that the words "cash grain," as used in the exclusion, refer to "the actual grain." *Hearings on H.R. 5676 Before the Senate Committee on Agriculture and Forestry,* 67th Cong., 1st Sess. 463 (1921). And, as will be discussed more fully below, the "cash commodity" exclusion was intended to cover only contracts for sale which are entered into with the expectation that delivery of the actual commodity will eventually occur through performance on the contracts. The seller would necessarily have the ability to deliver and the buyer would have the ability to accept delivery in fulfillment of the contract.

Although the desire to acquire or dispose of a physical commodity is the underlying motivation for entering such a contract, delivery may be deferred for purposes of convenience or necessity *See* pp. 15-18 *infra.*

Thus, a major difference between an excluded cash commodity-deferred delivery contract and contracts of sale of a commodity for future delivery is that the former entails not only the legal obligation to perform, but also the generally fulfilled expectation that the contract will lead to the exchange of commodities for money. In contrast, parties to a futures contract do not usually expect delivery and it rarely occurs.

Given this starting point, it is clear that the Stovall operation did involve contracts of sale of commodities for future delivery, not the contracts Congress had in mind when it carved the cash commodity exclusion out of the requirements of the Act, among them Section 4. Stovalls activities had all the earmarks of the undesignated futures operation Congress has specifically sought to prohibit since 1921. First, as the Administrative Law Judge found, the Stovall operation was directed at and overwhelmingly used by the general public, and not by those persons with specific interests in acquiring or disposing of commodities. Few, if any, n6 of the transactions entered into were motivated by a desire to acquire or dispose of actual commodities. But, the Stovall operation was consistently used and promoted as a means of speculating on changes in the price of cash commodities which might occur in the future. For example, the promotional material used to solicit prospective clients touted the "limited risk," and "big profit opportunities" in cash commodities [CX 8, 51]. n7 Similarly, in one of the documents signed by every client upon opening an account with Stovall Commodities, the client was required to certify that he had been "informed of the speculative nature of cash commodities" [CX 5].

n6 Stovall points to the fact that some of the contracts he made with a customer named Donald Rutherford eventually resulted in delivery. However, we have determined that the Rutherford deliveries were not significant because futures contracts are occasionally settled by delivery. Moreover, Rutherford's deliveries represented only a small percentage of his own total contracts with Stovall, and their quantitative significance is even less when compared with the total volume of transactions for all of Stovall's customers for whom we have records.

The Administrative Law Judge observed that Rutherford did not testify that he and Stovall mutually agreed to non-delivery or rescission of those contracts which were not settled by delivery. Rather, the transactions were simply *offset* by the execution of opposite orders. The Administrative Law Judge's reasoning is an additional factor in our conclusion that the Rutherford transactions were not significant.

n7 We have cited to exhibits introduced by the Division and respondents as "CX" and "RX" respectively. We refer to the hearing transcript as "TR ," and the Initial Decision as "Init. Dec. ."

Daniel Vaccaro, the Stovall client whose inquiry to the CEA led to the investigation of Stovall's operation, told CEA personnel that

he wasn't concerned with the cash commodity and never wanted to take delivery or make delivery. All he was interested in was speculating in cash commodities [TR 19].

Edward Piala, then Deputy Director of the CEA, and Henry Matecki, a CEA auditor, testified that the twenty-five or thirty Stovall clients interviewed by the CEA had stated that they were not interested in acquiring or disposing of cash commodities and, in fact, were unaware of what commodities, and in what amount, were ostensibly purchased and sold for their accounts until they received statements from Stovall.

Vernon Henrichs, a Stovall salesman/client, testified that Stovall had informed him, and his clients, that they could acquire actual commodities through transactions with Stovall but that "this was not the normal operation" [TR 103]. Douglas Newkirk, Stovall's other salesman/client, also testified that he had no personal or business use for the actual commodities which were the subject of his personal transactions with Stovall. Henrichs and Newkirk also testified that neither they nor their clients ever actually selected the

commodities ostensibly bought and sold. n8 Rather, after making an initial cash deposit, a client had no contact with either his salesman or his trading agent, and exercised no control over his account. n9

n8 Hackbarth, Stovall's "trading agent," testified that he received only one actual order, which was a "block order" from a group of clients in Michigan.

n9 As the Administrative Law Judge described the operation.

> To initiate a trade in Stovall's program, either Stovall or Hackbarth would call the other and propose a trade of a specific commodity at a specific price with a specified delivery month. The party receiving the proposition had the option of accepting or declining it. Based on data supplied by Stovall, the International S.C.O.P.E.S. computer was already programmed by Hackbarth, pursuant to Stovall's instructions, to show specific delivery periods and specific delivery points, the latter being determined by the commodity involved. Also based on data from Stovall the computer was programmed to show delivery periods according to whether the initiating party proposed a sale or purchase of a commodity. It was only necessary during the telephone conversations for the initiating party to refer to a specific month such as July and the computer was programmed to show a specific delivery period [Init. Dec. 35-36].

Second, the terms of Stovall's contracts were standardized in the same way as are the terms

of commodity futures contracts. n10 Hackbarth testified that delivery dates were not negotiated. Rather, delivery periods were

n10 Indeed, the pre-programmed contract sizes in fifteen of the twenty-four commodities traded by Stovall were identical to those in the corresponding commodity futures contracts traded on designated contract markets [DE 54, 55]. The remaining nine commodities were not regulated under the Act during the relevant time period, and were neither a part of the complaint nor relevant to this action.

> built in as part of the program and . . . when a given month was specified . . . [the computer] would kick out these specific dates [TR 476].

According to Hackbarth, computer-programmed and predetermined delivery dates were automatically keyed to whether Stovall was the "purchaser" or "seller" of the commodities and the programmed delivery points were keyed to the commodities being traded. n11 Similarly, contract sizes and handling fees in the commodities traded by Stovall Commodities were pre-programmed.

n11 The Computer was programmed so that Stovall always bought Grade # 1 and sold Grade # 3 of any commodity.

Finally, with the qualified exception of Rutherford, n12 not a single party to a Stovall contract fulfilled his legal obligations under the contract by delivering the commodities ostensibly bought or sold through Stovall's operation. Rather, each contract was "offset" when Stovall and the customer subsequently entered into a contract which was exactly opposite the earlier contract, exchanging a cash differential for the difference in price between the initial and off-setting transactions. n13 In view of the other circumstances, this lack of delivery is the clearest indication that the contracts were not "cash commodity contracts for deferred shipment or delivery," as respondents contend.

n12 *See* n. 6, *supra*.

n13 For example, CX 10 entitled "Transactions reported to customers by R.L. Stovall, doing business under the name of R.L. Stovall, Principal in Cash Commodities", shows that on May 4, 1972, Vernon L. Henrichs contracted to buy and Stovall to *sell* 36,000 pounds of # 3 frozen pork bellies to be delivered between July 1 and August 6, 1972. This commodity was never delivered. Rather, on May 5, 1972. Henrichs contracted to *sell* and Stovall to *buy* an identical quantity of of # 3 pork bellies to be delivered during the same period. The matching and opposite obligations, coupled with the payment of the cash differential between the contract prices, "offset" each other, cancelling both contracts. In a similar manner, Stovall and Henrichs entered and cancelled soybean oil contracts on May 12 and 15, 1972 respectively, and soybean contracts on May 17 and 18.

Thus, here it is clear that Stovall's transactions have all of the classic elements of a contract of sale of a commodity for future delivery. We do not mean that all commodity futures contracts must have all of these elements, nor are the elements we have described here an exhaustive catalogue of factors to which we will look in every case to determine whether an instrument is a cash contract for deferred shipment or delivery or is a commodity futures contract. Rather, we will look at each operation in context and will not hesitate to look behind whatever label the parties may give to the instrument. *Tcherepnin* v. *Knight,* 389 U.S. 332, 336 (1967), citing *Securities and Exchange Commission* v. *W. J. Howey Co.,* 328 U.S. 293, 298 (1946). *Cf. In the Matter of Precious Metals Associates, Inc.,* CCH COMM. FUT. L. REP. P 20,882, p. 23, 597 (August 14, 1979), appeal pending, No. 79-1449 (1st Cir. August 29, 1979). n14

n14 We shall not address the issues whether Stovall also violated Sections 4d, 4b(D) and 4c(a)(A) of the Act and Sections 1.35(a) and 1.38(a) of the regulations. In our view, respondent Stovall's deliberate violation of Section 4 of the Act override and, to a large extent, subsume the other violations alleged and, standing alone, supports the sanctions we have determined to impose.

We turn next to respondents' argument that even if the disputed instruments were commodity futures contracts, the Commission has no jurisdiction over them because they were not transacted on or through the facilities of a designated contract market. The Administrative Law Judge rejected respondents' contention on the ground that

the requirement that a futures contract be executed on a designated contract market is what makes the contract legal, and not what makes it a futures contract. To permit execution other than on a contract market would invite bucket shops and other fraudulent and non-regulated activities to the detriment of the public and in contravention of the history of commodity regulation, which was designed to insure honest dealings and protection of the public [Init. Dec. 39] (emphasis added).

The administrative Law Judge was absolutely correct on this point and his conclusion is supported by the legislative history of the earliest statutes regulating commodity futures trading.

The Future Trading Act of 1921 was enacted to curb the increasingly disruptive activities of grain speculators on exchanges and of off-exchange bucket shop operations. Rather than prohibiting all trading in contracts for future delivery, as populist and farming factions wished, Congress recognized the legitimacy and commercial necessity of commodity futures exchanges, n15 and permitted exchange

trading in contracts for future delivery to continue, but only in a controlled environment. The Future Trading Act of 1921 imposed a "prohibitive tax" n16 applicable generally to all contracts for future delivery not exempted by that Act. n17 By its terms, the Act exempted from the tax contracts traded by or through members of boards of trade designated by the Secretary of Agriculture as

"contract markets," that designation being contingent, among other things, upon a board of trade providing for the prevention of manipulative activity in the trading of commodities through its facilities. Thus, with certain exceptions, all contracts for the sale of commodities for future delivery were intended to be taxed prohibitively under this legislation unless they were traded on an exchange designated by the government as a contract market. The Future Trading Act of 1921 also expressly exempted from the tax sales for future delivery made by owners and growers of grain who merchandised the physical commodity. n18 Thus, Congress endeavored to force *all* futures transactions, as opposed to cash-deferred future delivery transactions, onto regulated contract markets, which, as a result of government oversight, were to be free from manipulations and other market disturbances. This is clear when the legislative history of the 1921 Act is examined. n19

n15 *See, e.g., Hearings on Futures Trading Before the House Committee on Agriculture, supra,* at 1043; *Hearings on H.R. 5676 before the Senate Committee on Agriculture and Forestry, supra,* at 452; *Hearings on Futures Trading Before the House Committee on Agriculture,* 67th Cong., 1st Sess. 7-9 (1921); 61 Cong. Rec. 4761 (1921) (remarks of Senator Capper, the sponsor of the Senate bill which became the 1921 Act.).

n16 *Hearings on Futures Trading Before the House Committee on Agriculture, supra,* at 10.

n17 Section 4 of the Future Trading Act of 1921, 42 Stat. 187-188.

n18 Specifically, Section 4 of the 1921 Act exempted from the tax the offer and sale of contracts for future delivery:

(a) Where the seller is at the time of the making of such contract the owner of the actual physical property covered thereby, or is the grower thereof, or in case either party to the contract is the owner or renter of land on which the same is to be grown, or is an association of such owner, or growers of grain, or of such owners or renters of land; or

(b) Where such contracts are made by or through a member of a board of trade which has been designated by the Secretary of Agriculture as a "contract market". . . . 42 Stat. 187.

Sections 4(b) and 5(d) of the 1921 Act, 42 Stat. 187-188. *See* 61 Cong. Rec. 4762 (1921) (remarks of Senator Capper); 61 Cong. Rec. 1314 (1921) (remarks of Rep. Tincher); 61 Cong. Rec. 1371 (1921) (remarks of Rep. Jones).

n19 *E.g.*, 61 Cong. Rec. 4761-4763 (1921) (remarks of Senator Capper); 61 Cong. Rec. 1379 (1921) (remarks of Rep. Bland); 61 Cong. Rec. 1313-1314 (1921) (remarks of Rep. Tincher, the sponsor of the House bill which became the 1921 Act); 61 Cong. Rec. 1376 (1921) (remarks of Rep. Gensman).

The House of Representatives passed and sent to the Senate, H.R. 5676, the bill that ultimately became the Future Trading Act of 1921. Section 4 of H.R. 5676 taxed all contracts for the sale of grain for future delivery, other than those exempted by Sections 4(a) and 4(b), "made at, on, or in an exchange, board of trade, or similar institution or place of business." n20 The quoted language was added by the House to insure and emphasize the exemption from tax liability contained in Section 4(a) for any owner or grower who might actually wish to sell grain for deferred shipment. n21 However, the Senate deleted this limiting language and, in substitution, emphasized the tax exemption for growers and owners by adding to Section 2 of the bill the exclusion for "any sale of cash grain for deferred shipment or delivery" from the term "future delivery." n22 The Senate Agriculture Committee explained that this change was necessary because the House, by proposing to limit imposition of the tax to contracts "made at, on, or in an exchange, board of trade or similar institution or place of business," may have inadvertently exempted from the tax the operations of private exchanges or bucket shops, which Congress intended to prohibit completely through imposition of the tax. The Senate Committee's Report stated:

"It is obvious also that if . . . [the limiting House language] [remains] in the bill operations on private exchanges or bucket shops would be possible." S. Rep. No. 212, 67th Cong., 1st Sess. 1 (1921). Senator Capper, the sponsor of S. 212, the Senate companion bill to H.R. 5676, and a member of the Senate Agriculture Committee, explained:

With those words [the limiting House language] in it there is nothing to prevent a private individual or a private corporation from buying or selling futures to the public without a tax. As the business is now conducted, futures are sold simply on seven or eight boards of trade; but if the law taxed future trades on exchanges, I think there would be a tendency for these private institutions to go into the business for they would not be taxed. *Hearings on H.R. 5676 Before the Senate Committee on Agriculture and Forestry, supra* at 462.

n20 This language was originally set forth in the United States Cotton Futures Act of 1914 and was added without change by the House to Section 4 of H.R. 5676. The definition of "board of trade" contained in section 2 of the Commodity Exchange Act was first set forth in Section 2 of the 1921 Act.

n21 S. Rep. No. 212, 67th Cong., 1st Sess. 1 (1921). The limiting language was added to the House bill at the insistence of the Department of Agriculture to make clear that the tax was to be imposed upon contracts for future delivery as distinguished from transactions in which owners and growers would be involved as part of their cash commodity businesses. *Hearings on H.R. 5676 Before the Senate Committee on Agriculture and Forestry, supra,* at 8-11, 461-463; *Hearings on H.R. 168, 231, 2238, 2331, 2363 and 5228 Before the House Committee on Agriculture, supra,* at 326, 344-345.

n22 42 Stat. 187. This provision was re-enacted without change as part of the Grain Futures Act of 1922, 42 Stat. 998, and, as amended to refer to "any cash commodity," was enacted as part of the Commodity Exchange Act in 1936, 49 Stat. 1491. *See* Section 2(a)(1) of the Act.

Ultimately, the Senate version prevailed and, as enacted, the Future Trading Act of 1921 contained both the exemption from the tax for owners and growers of grain and, for emphasis, the exclusion from the term "future delivery" for cash-deferred delivery transactions. However, the 1921 Act was shortlived for it was almost immediately declared unconstitutional as an impermissible attempt at regulation through the taxing power. *Hill* v. *Wallace,* 259 U.S. 44 (1922).

In invalidating the 1921 Act in *Hill* v. *Wallace, supra,* the Supreme Court suggested that it would be possible to regulate contracts for future delivery under the commerce clause of the Constitution, 259 U.S. at 69. Thus, barely four months after the Supreme Court's decision, Congress enacted the Grain Futures Act of 1922, which regulated commodity futures trading under the commerce clause. That Act was clearly intended to accomplish the same legislative purpose as the 1921 Act with no material change in its regulatory provisions. Indeed, in its Report accompanying the new legislation the House Committee on Agriculture described the differences between the 1921 and 1922 Act and, in describing the changes in Section 4, stated "[these] regulations are practically as they were in the old bill, except for slight changes." n23 The Report went on to state that "[otherwise], we think there are no material changes in the regulatory provisions of this bill and the law, which this same committee and the present Congress considered so fully and passed." H. Rep. No. 1095, 67th Cong., 2d Sess. 3 (1922). n24

n23 The 1921 version of Section 4 provided for a tax of 20 cents "a bushel on every bushel involved therein, upon each contract of sale of grain for future delivery" subject to the exceptions discussed above. The 1922 version of Section 4 made it unlawful, with identical exceptions, to use the means of interstate commerce to offer, execute or confirm

a contract of sale of grain for future delivery on or subject to the rules of any board of trade in the United States, or for any person to make or execute such contract of sale, which is or may be used for (a) hedging or (b) determining the price basis of any such transaction in interstate commerce, or (c) delivering grain sold, shipped, or received interstate commerce for the fulfillment thereof.

42 Stat. 187-188.

n24 *See also* 62 Cong. Rec. 9417 (1922) (Remarks of Rep. Timberlake); 62 Cong. Rec. 9519-9420 (1922) (Remarks of Rep. Ellis); 62 Cong. Rec. 9428 (1922) (Remarks of Rep. Voigt); 62 Cong. Rec. 9446 (1922) (Remarks of Rep. Hays). The constitutionality of the Grain Futures Act of 1922, including its regulatory scheme based on the commerce clause, was sustained in *Chicago Board of Trade* v. *Olsen,* 262 U.S. 1 (1923)

Thus, Section 4 of the 1922 Act was patterned after Section 4 of the 1921 Act except that it directly prohibited any offer to make, execute or confirm, through interstate facilities, any contract for the sale of grain for future delivery, subject to two exemptions -- contracts traded by or through a member of a designated contract market and contracts for deferred shipment or delivery by owners and growers. n25 And, like the 1921 Act, the Grain Futures Act of 1922 also contained the definitional exclusion for owners and growers. Thus, Congress intended to permit only: 1) those futures transactions which were executed through the facilities of designated contract markets, markets regulated by the federal government, which were required, in turn, to regulate the activities of their members; and 2) cash commodity transactions for deferred shipment or delivery.

n25 42 Stat. 999-1000.

Respondents would have us construe the words "on or subject to the rules of any board of trade in the United States," contained in Section 4, to limit the prohibitive effect of that section to transactions actually consummated on boards of trade, and argue that the Stovall operation was not a board of trade. Such an interpretation would leave untouched any private exchange or bucket shop operation which is arguably not a "board of trade," regardless of whether the transactions consummated thereon involve contracts for the sale of commodities for future delivery. Given the historical background of the legislation, that interpretation would undercut the central purpose of the 1922 legislation, n26 which is to permit only contracts for the sale of commodities for future delivery executed on designated -- and regulated -- exchanges, and to exclude from regulation cash commodity-deferred delivery transactions. Accordingly, we read Section 4 of the Act to require that all contracts for the sale of commodities for future delivery be executed by or through a contract market member, and on a contract market designated by this Commission. n27 We unequivocably reject respondents' argument to the contrary. n28

n26 *See Organized Migrants in Community Action, Inc.* v. *Brennan,* 520 F.2d 1161, 1166-1167 (D.C. Cir. 1975).

n27 This view was articulated by the Senate Agriculture Committee of the ninety-third Congress, which enacted the Commodity Futures Trading Commission Act of 1974. In discussing the Commodity Exchange Act as it existed prior to the 1974 amendments, the Committee stated that:

The Commodity Exchange Act requires that all futures transactions in regulated commodities be executed on a commodity exchange designated by the Secretary of Agriculture as a "contract market."

S. Rep. No. 93-1131, 93d Cong., 2d Sess. 16 (1974). *Cf.* *Goodman* v. *Benson,* 286 F.2d 896.898 (7th Cir. 1961).

n28 Thus, we need not reach respondents' argument that the Stovall operation was not a board of trade, and, hence, that the transactions to which Stovall was a party were beyond the scope of Section 4 and the

jurisdiction of this Commission. Indeed, his operation may well fall within the broad statutory definition of "board of trade" found in Section 2(a)(1). However, in our view, the prohibition found in Section 4 of the Act was intended by Congress to apply regardless of the locus of the transaction. Clearly, that was the intent of Congress in 1921, and, since no substantive change, except the shift from the taxing clause to the commerce clause, was intended in 1922, or has been made since that time, we do not attach significance to the words upon which Stovall relies. *See also* Section 4h of the Act, enacted in 1936, which does not require that any means or instumentality of interstate commerce be employed in the transaction, so long as the transaction may be used for hedging, determining price basis or delivery in interstate commerce.

Similarly, we reject respondents argument that Section 4 might be read literally to require only that commodity futures contracts be executed by or through a *member* of a contract market, but not necessarily through the facilities of a contract market. Stovall, a member of two contract markets during the time period in issue here, would have us determine that he therefore was free to engage with impunity in activities that have been proscribed since 1922. However, the analysis we have undertaken of the legislative history and statutory purpose of Section 4 of the Act and the history of futures trading in general also leads us to conclude that Congress could not have intended such a narrow application of Section 4. *See e.g. S. Rep. No. 212,* 67th Cong., 1st Sess. 1 (1921), *Hearings on H. R. 5676 Before the Senate Committee on Agriculture and Forestry, supra,* at 10-11, 461-63; *Hearings On Futures Trading Before the House Committee on Agriculture, supra,* at 326, 344-345; 62 Cong. Rec. 9417 (1922) (Remarks of Rep. Timberlake); 62 Cong. Rec. 9519-9520 (1922) (Remarks of Rep. Ellis); 62 Cong. Rec. 9420 (1922) (Remarks of Rep. Voigt); 62 Cong. Rec. 9446 (1922) (Remarks of Rep. Hays). *See also* note 27, *supra.*

III.

Respondents also attack the initial decision on a number of other grounds, all of which we have considered and most of which we have found to be frivolous. We shall address in depth only those few arguments which, in our view, merit discussion. n29 Respondents observe that the agreements signed by Stovall clients [CX5] contained a clause that

CLIENT agrees that any and all purchases and/or sales with STOVALL contemplate actual delivery and/or receipt of the (actual) commodities . . . [CX5 at 1].

Respondents urge that in determining the intent or understanding of the parties to the transactions, the Commission is bound by the language of the customer agreement and thus, that we may not hold that, contrary to the terms of the agreement, the parties did not intend to enter cash contracts for deferred shipment of commodities [Doc. 95 at 11-14]. n30

n29 We have considered respondents' arguments that: 1) Congress' failure to define "commodity futures" precludes the Commission from interpreting the term and 2) the sample of Stovall's customers, upon which the Administrative Law Judge's decision was based, was only a small percentage of the customers and therefore did not reliably represent the total universe of customers. As to Stovall's argument regarding our authority to interpret the Commodity Exchange Act. we shall say little more than that we have not only the right, but the duty to do so. As to Stovall's contention with regard to the sample of customers, we observe that the record clearly indicates that it was Stovall himself who prevented CEA investigators from obtaining the names of all of his customers by refusing to produce his books and records. We infer, from Stovall's refusal to produce his records either initially or in defense of his action that those records would have disclosed information against Stovall's interest -- namely, that the sample of customers was entirely representative of the

whole group. *Alabama Power Co.* v. *Federal Power Commission,* 511 F.2d 383 (D.C. Cir. 1974).

n30 Respondents are apparently referring to the "parol evidence rule" applied in most states, which holds that extrinsic evidence is not admissible to add to detract from, or vary *unambiguous* terms in a written agreement.

Respondents are wrong. First, it is well settled that the word "contemplate" is subject to various interpretations. Moreover, extrinsic evidence is always admissible to explain an ambiguous term in a contract, *Lucie* v. *Kleen-Leen, Inc.,* 449 F.2d 220, 221 (7th Cir. 1974); *Marbury-Patillo Construction Company, Inc.* v. *Bayside Warehouse Co.,* 490 F.2d 155 (5th Cir. 1974); *American Casualty Company of Reading, Pennsylvania* v. *Reidy,* 386 F.2d 795 (7th Cir. 1967); *Dancy* v. *William J. Howard, Inc.,* 297 F.2d 686 (7th Cir. 1961); *Personal Finance Co.* v. *Meredith,* 39 Ill. App 3d 695, 350 NE 2d 781, 789 (1976), and is likewise always admissible to determine the intentions of contracting parties. n31 More importantly, however, were we unable to look beyond the terms of an instrument drafted in clear and unambiguous language to determine the true intent of parties to a contract, it might be impossible for us to distinguish between commodity futures contracts and those falling within the exclusionary

language of Section 2(a)(1). n32 Indeed, the language in futures contracts presently traded on markets designated by the Commission does, on its face, appear to fall within the Section 2(a)(1) exclusion. Surely, Congress would not have charged us with the responsibility of discriminating between two classes of transactions, yet left us without the ability to do so.

n31 In *Lucie* v. *Kleen-Leen, Inc., supra,* 499 F.2d at 221, the court held that

We cannot accede to the defendant's assertion that no extrinsic evidence reflecting on the parties' intentions should be considered. It is well-established that the test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether the instrument appears to be plain and unambiguous, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. A rule that limits the determination of the meaning of a written contract to its four-corners, merely because the court deems it clear and unambiguous, is a rule that ignores the intentions of the parties or presumes a degree of verbal precision and crystallization presently unattainable by our language.

n32 Nearly a century ago, in 1882, addressing the issue whether, in a contract to buy rye for deferred delivery, the parties intended to deliver the rye, a circuit court observed:

In seeking to ascertain the intentions of parties to such transactions as the one under consideration, it is evident that it will not do to place any great stress upon the mere terms of their contract, or upon their own declarations, whether under oath or not. Parties to such contracts will always seek to give them the form and semblance of legality, and all our experience admonishes us to receive with extreme caution, if not absolute distrust, what parties charged with transactions apparently illegal say respecting the innocency of their own intentions.

The Court also noted that

We must look at the actions of interested or accused parties, rather than their mere words, to ascertain their real intentions. *We must consider what they have done, rather than what they have said, when called to account for their actions.* We can best learn what interpretation the parties themselves have put upon their own contract, by considering what

> they have done under and in pursuance of it, with a view to its settlement of fulfilment (emphasis supplied).
>
> *Melchert* v. *American Union Telegraph Co.*, 11 F. 193, 196-7 (C.C.D. Iowa 1882).

Next, citing the Administrative Procedure Act and Section 0.3(c) of the CEA's regulations, Stovall argues that this action should not have been instituted without first calling to Stovall's attention the violations charged and providing Stovall "an opportunity to demonstrate or achieve compliance with all lawful requirements." However, that opportunity need not be afforded if the conduct complained of is willful. *See* 5 U.S.C. § 558(c)(2). In *Goodman* v. *Benson, supra,* 286 F.2d at 900, the court held that

> if a person 1) intentionally does an act which is prohibited-irrespective of evil motive . . . or 2) acts with careless disregard of statutory requirements, the violation is willful.

See also Haltmier v. *Commodity Futures Trading Commission,* 554 F.2d 556 (2nd Cir. 1977); *Cargill, Incorporated* v. *Hardin,* 452 F.2d 1154 (8th Cir. 1971), *cert. denied* 406 U.S. 932 (1972); and *Great Western Food Distributors* v. *Brannan,* 201 F.2d 476 (7th Cir.), *cert. denied,* 345 U.S. 997 (1953). In all of those cases, the courts adopted the principle that "willfulness" means the knowing doing of the act charged. There is no question that Stovall's operation was undertaken knowingly. Consequently, we find Stovall's violations were willful such that these sections of the Administrative Procedure Act and the CEA regulations did not require that Stovall be provided an opportunity to conform his conduct with the law prior to the institution of this action.

Stovall also contends that the government is estopped from prosecuting this action because CEA employees endorsed Stovall's operation by informing Stovall that he need not register. However, the record shows that when Stovall came to the offices of the CEA in April 1971, he asked if the CEA "had jurisdiction over the cash grain operation *per se,*" and did not explain the mechanics of the "cash grain" operation he intended to pursue. Thus, it is not surprising that Stovall was simply informed that, generally, cash grain transactions need not be conducted on an exchange. In our view the calculated ambiguity of Stovall's inquiry undercuts absolutely his argument that actual approval was given to Stovall's operation. n33 We also observe that when CEA officials became aware, through information provided by a third party, of the details of the operation, they began the investigation which led to this action. n34

> n33 Even assuming, *arguendo,* that CEA employees had given Stovall an erroneous impression, such a mistake would not bind the Commission but would be relevant only in determining the sanctions to be entered upon a finding of a violation based on activities which were erroneously approved by CEA staff. *Nelson* v. *Secretary of Agriculture,* 133 F.2d 453, 455 (7th Cir. 1943); *Nichols & Co.* v. *Secretary of Agriculture,* 131 F.2d 651, 658-659 (1st Cir. 1942); *Goodman* v. *Benson, supra,* 286 F.2d at 900; *In re Arthur N. Economou and Arthur Economou & Co.*, 32 Agric. Dec. 14 (32 A.D. 14) (1973), *rev'd on other grounds sub nom. Economou* v. *U.S. Dept. of Agriculture,* 494 F.2d 519 (2d Cir. 1974).
>
> n34 During the course of the proceeding, Stovall also made a number of allegations, both on and off the record, of misconduct by specific Commission staff members. We have considered those made on the record in the context of this proceeding and have found them to be without merit. The Commission's General Counsel determined that those allegations made off the record should be considered under the Commission's regulations with regard to unethical conduct, 17 §§ 140.735-1 -- 140.735-16 (1979), and 28 U.S.C. § 535, and appropriate disposition was made. The record of investigation and determination of the Office of the General Counsel, while separate and distinct from the record here, will certainly be made available to any reviewing court, should it find it necessary to consider the matter.

IV.

Section 8a(3) of the Act provides, in pertinent part, that the Commission is authorized "to suspend or revoke the registration of any person registered under this Act if cause exists under sub-paragraph (2)(B) . . . which would warrant a refusal of registration of such person,. . . ." Section 8a(2)(B) provides that registration might be refused

(B) if it is found, after opportunity for hearing, that the applicant is unfit to engage in the business for which the application for registration is made, (i) because such applicant, or, if the applicant is . . . a corporation, any officer or holder of more than 10 per centum of the stock, at any time engaged in any practice of the character prohibited by this Act . . . or (ii) for other good cause shown;. . . .

As set forth above, we have found that Rawlin Stovall violated Section 4 of the Act. Stovall is the president and principal shareholder of Stovall and Stovall Inc. Accordingly, with regard to both respondents, pursuant to Sections 8a(2)(B) and 8a(3) of the Act, 7 U.S.C. § 12a, and with regard to Stovall, pursuant to Section 6(b) of the Act, 7 U.S.C. § 9, n35 we have determined to revoke the registrations of both Stovall and Stovall, Inc. and Rawlin Stovall. n36 We have also determined to order that Rawlin Stovall cease and desist from violating Section 4 of the Act.

n35 Section 6(b) of the Act provides, in pertinent part:

> If the Commission has reason to believe that any person . . . is violating or has violated any of the provisions of this Act or of the rules, regulations, or orders of the Commission thereunder, . . . the Commission may [after hearing] . . . suspend, for a period not to exceed six months, or revoke, the registration of such person, . . .

n36 Neither respondent is currently registered with the Commission. The registration of both lapsed in 1973 without timely applications for renewal being made. Thus, the provisions of the Administrative Procedure Act, 5 U.S.C. § 559, did not operate to extend respondents' registrations to the present. However, we shall order that respondents' registrations existing at the time this proceeding was instituted be revoked in order to preserve any collateral implications of revocation. *See e.g.*, Sections 4n(6) and 8a(2)(A) of the Act, 7 U.S.C. §§ 6(n)(6) and 12a(2)(A).

We also wish to point out that we have not considered the evidence of Stovall's perjury conviction in our determination to revoke Stovall's and Stovall Inc.'s registrations. Stovall was convicted on January 14, 1974, after the institution of this action [CX 12]. 5 U.S.C. § 558(c)(1) (1976) clearly requires that a respondent in an administrative proceeding have notice of each charge which he will be required to answer. Of course, if events occur after the filing of a complaint which might form additional bases for the sanctions sought, a complaint may be amended to add the additional counts, or Section 10.24(d) of the Rules of Practice may be invoked. However, in the first instance, the respondents is offered an opportunity to answer formally the supplemental allegations and to prepare a defense. In the second instance, the respondent, by addressing and defending the supplemental allegations on the merits, may be said to have waived his right to challenge the informal supplementing of the complaint. Clearly, neither of the recognized methods of supplementing the complaint was invoked here. Moreover, respondents did not have an opportunity to address fully the ramifications of the perjury conviction, which were not addressed by the Division until its brief to the Administrative Law Judge.

Stovall strenuously opposes the Administrative Law Judge's imposition of a two-year revocation of trading privileges, arguing that the penalty is too harsh. However, in our view, the sanction imposed by the Administrative Law

Judge was not harsh enough. The statutory requirement that all commodity futures trading be conducted on designated contract markets is the centerpiece of the pervasive regulatory scheme embodied in the Act. Therefore, we view Stovall's willful violation of that requirement, through a deliberate scheme, a most serious offense, deserving of serious remedial sanctions. Recognizing our statutory responsibilities to insure that futures trading be conducted as Congress has required, we shall not permit Stovall to avail himself of the rules of the marketplace which he has flouted by his actions and have determined to bar him from trading on or subject to rules of any contract market for a period of five years. n37

n37 In conjunction with pleas of guilty and *nolo contendre* in the criminal proceedings against him. *United States* v. *Rawlin L. Stovall and American Cash Commodities of Missouri, Inc.*, a Corporation, No. 73 CR 679 (N.D. Ill. 1973), the Honorable Abraham Marovitz placed Stovall on probation for a five-year period, which ended on February 28, 1979. The terms of that probation prohibited Stovall from

[trading] in any manner whatsoever for or on behalf of any person, business, partnership, or corporation, or for or on behalf of the account of any person, business, partnership, or corporation.

Stovall notes that in conjunction with his probation, Judge Marovitz rejected a request from the government that he be prohibited from commodity futures trading for his own account. Judge Marovitz stated that while he would prohibit Stovall from trading for others, he would not deprive Stovall of his livelihood by prohibiting Stovall from trading for himself However, our responsibilities in enforcing Section 4 of the Commodity Exchange Act differ from the concerns of Judge Marovitz in connection with Stovall's conviction for perjury. In our view, Stovall's deliberate violation of Section 4 of the Act more than justifies a five-year suspension of trading privileges.

We note in passing that since Stovall is not registered with the Commission, he may not engage in trading activities for others on contract markets.

The Commission, having reviewed the record as a whole and considered all of respondents' arguments, has determined by the weight of the evidence that respondent Rawlin L. Stovall has willfully violated Section 4 of the Commodity Exchange Act, as amended, as charged in the complaint for the reasons set forth in the Opinion of the Commission, filed herewith.

Accordingly, IT IS ORDERED that the registration of respondent Rawlin L. Stovall as a floor broker is REVOKED. IT IS FURTHER ORDERED that the registration of respondent Stovall and Stovall, Inc. as a futures commission merchant is REVOKED. IT IS FURTHER ORDERED that respondent Rawlin L. Stovall is prohibited from trading on or subject to any contract market, and all contract markets are directed to refuse him trading privileges, for a period of five years from the date of this order. IT IS FURTHER ORDERED that respondent Rawlin L. Stovall shall cease and desist from further violations of Section 4 of the Act. Respondents' motion for oral argument before the Commission is denied.

This order shall become effective upon service of a copy hereof upon respondents.

By the Commission (Chairman STONE, Commissioners DUNN, MARTIN and GARTNER).

LOAD-DATE: August 6, 2008