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COMMENT

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April 9, 2001

VIA FACSIMILE AND REGULAR MAIL
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Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
Attention: Office of the Secretariat

Re: Regulatory Reinvention

I have submitted this letter in my personal capacity[1] to offer comments on the Commission's proposal to amend Rule 1.3, 17 C.F.R. § 1.3. The Commission has proposed adding language to that regulation.[2] I respectfully suggest that the Commission consider deleting text from Rule 1.3. To be more precise, I propose that the Commission delete the words "unless the context otherwise requires" from the sentence

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[1] The letter reflects my views only and not those of Henderson & Lyman or any other organization of which I am a member.

[2] The Commission has proposed amending the preamble of 17 C.F.R. § 1.3 so that the introductory paragraph would state,

> Words used in the singular form in the rules and regulation in this chapter shall be deemed to import the plural and visa versa, as the context may require. The following terms, as used in the commodity Exchange Act, or in the rules and regulations of this chapter, shall have the meanings hereby assigned to them, unless the context otherwise requires:

A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations, 66 Fed. Reg. 14262, 14269 (2001) ("Proposed Rulemaking").

that begins "The following terms, as used in the Commodity Exchange Act, or in the rules and regulations of this chapter, shall have the meanings hereby assigned to them . . . ." This change may serve the public interest for a number of reasons. First, the introductory paragraph, as literally read, may exceed the Commission's authority. In addition, the regulatory language at issue appears to have been treated as superfluous and, therefore, confers no present benefit upon the public. Moreover, to the degree that the industry, courts and/or even the Commission take any notice (or makes any use) of it, the language creates uncertainty that imposes inefficiencies. Finally, the Commission use of the language implicates the due process clause of the United States Constitution's Fifth Amendment.

Regulatory provisions that neither prescribe nor prohibit private or public action, and that do not cause public or private cause actors to follow (or consider them) would appear serve no beneficial purpose.[3] The "unless the context otherwise requires" language appears to be such a regulation, one that has apparently fallen from the radar screen of industry, the courts and even the Commission. For example, in a 1998 decision, the Commission held that term "commodity trading advisor," as it appeared in 17 C.F.R. § 4.33, did not necessarily mean to designate a person that met the definition set forth in 17 C.F.R. § 1.3(bb). In re New York Currency Research Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,223 at 45,914-15 (CFTC Feb. 6, 1998). Although the Commission used the occasion to make a clear departure from its own regulatory definition, it did not purport to rely on the "unless the context otherwise requires" exception of Rule 1.3. Id. In addition, I am not aware of any instance in which an adjudicator has done so[4] or in which the Commission has sought to do so in its capacity as a litigant.[5] Thus, it appears that the Commission makes no virtually use of the language.[6] Upon further consideration, that appears to be a prudent choice.

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[3] They do of course, preserve some "flexibility." However, this flexibility imposes costs. In addition, governmental actors often cannot exercise the ability to vary from clearly-stated legislative (or quasi-legislative language) without running afoul of congressional or constitutional mandates.

[4] For example, the Second Circuit held that the Commission did not have latitude to depart from its own regulatory definitions in New York Currency Research Corp. v. CFTC, 180 F.3d 83, 92-93 (2d Cir. 1999). The Second Circuit not only held the Commission to its self-imposed definitions, it found the definitions sufficiently clear to deprive the Commission of the deference that the Commission enjoys in the interpretation of ambiguous guidance under the doctrine set forth in Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). 180 F.3d at 89-90, 92-93

[5] On this last point I have not performed an exhaustive survey. Accordingly, I may be mistaken.

If it exercised the maximum degree of latitude that Rule 1.3 may be read as providing, the Commission could exceed its congressionally-mandated authority.[7] The "unless the context otherwise requires" language refers to the Commodity Exchange Act ("CEA") as well as the Commission's regulations. Thus, while the Commission may not have intended to grant itself the general authority (or create the impression that it had general authority) to modify those definitions contained in 7 U.S.C. § 1a[8] that have Rule 1.3 counterparts, the introductory language of Rule 1.3 could create the impression that

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The Commission referred to the language once. Re: Application of the Cantor Financial Futures Exchanges for Designation as a Contract Market in the US Treasury Ten-year Note Futures Contract, the US Treasury Five-year Note Futures Contract, and the Treasury Two-year Note Futures Contract, 1998 CFTC LEXIS 130, at *28 (CFTC Sept. 1, 1998) ("Cantor Release"). However, it did not rely on it to reach a conclusion concerning the scope of the regulation at issue. Rather, the Commission relied on Federal Register language that "made plain" the regulation's scope. Cantor Release, 1998 CFTC LEXIS 130, at *28.

[6] The futures industry also appears to treat the language as ineffectual if it even considers it in the first place. The Commission has defined the scope of its regulations in terms that it has defined in Rule 1.3. Thus, legality of futures industry transactions and practices often cannot be determined without carefully reviewing the definitions contained in the regulation. Moreover, the industry members and the bar are acutely aware of this. Thus, it is reasonably expected that, if the industry and bar concluded there was a substantial probability that the Commission might reinterpret the defined terms on an ad hoc basis, they would regularly petition for no action or interpretative relief in order to determine whether, in their specific circumstances, the definitions would hold. A cursory review of submitted letters indicates that the industry generally does not seek such relief. This fact would seem to support one of two conclusions: (1) the industry and bar take no notice of the language or (2) the industry and bar do not expect the Commission to rely upon the language.

[7] I do not mean to suggest that the Commission, as currently comprised, would overstep unambiguous congressionally-imposed limits. However, there is at least one incarnation of the Commission that did precisely that. Thus, eliminating the language at question would serve to ensure that future Commissions do not give into the same temptation when the ends pursued seem laudable.

[8] Unlike 15 U.S.C. § 78c(a), 7 U.S.C. § 1a does not contain "unless the context otherwise requires" language.

the Commission has accorded itself that discretion.[9] The Commission[10] may have unintentionally bolstered this impression in a 1998 quasi-judicial rulemaking and its defense of that decision.[11] This raises questions of authority.

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[9] A reader could observe that the Commission often defines terms with language that is identical or virtually identical to that used by Congress. Compare 7 U.S.C. § 1a with 17 C.F.R. § 1.3. In circumstances where the statutory and regulatory language are identical, a reader could interpret the introductory language as indicating that a statutory term means the definition that Congress assigned unless the Commission determines that circumstances require otherwise. The conclusion does not follow the observation as a matter of logic. However, as discussed in footnote 11, infra, it could be viewed as resting on a historical basis.

[10] This was, of course, a Commission under different leadership.

[11] Among other things, New York Currency Research, [1996-1998 Transfer Binder] ¶ 27,223 at 45,914-15, considered the issue of whether the definition of "commodity trading advisor" that Congress placed in Section 1a of the CEA applied when the term "commodity trading advisor" appeared in Section 4n(3)(A) of the CEA. To be more precise, the Commission considered whether the phrase "commodity trading advisor . . . registered under this Act" applied only to those persons that (1) met the congressionally-mandated definition of "commodity trading advisor and (2) happened to be registered under the CEA. [1996-1998 Transfer Binder] ¶ 27,223 at 45,914-15. The Commission held that Congress' definition of "commodity trading advisor" did not limit the scope of the term as it appeared in Section 4n(3)(A). Rather, it held that any person registered as a commodity trading advisor qualified as a commodity trading advisor who was registered. Id. In other words, the Commission ruled that, under certain circumstances, the Section 1a definition of "commodity trading advisor" did not characterize the term as it appeared in other sections of the CEA.

Rather than holding that congressional terms mean the definitions to which Congress assigned them, the Commission took the approach that policy imperatives sometimes provide a foundation for disregarding language that the Commission's administrative law judge and the Second Circuit both found to be unambiguous. New York Currency Research, 180 F.3d at 92-93; [1996-1998 Transfer Binder] ¶ 27,223 at 45,914-15. Thus, without expressly relying on the introductory language of Rule 1.3, the Commission seems to have exercised the most extreme version of this self-granted authority to disregard definitions when circumstances seem to require otherwise. For reasons discussed elsewhere, such ad hoc decisions impose inefficiencies that may even violate due process.

Administrative agencies are creatures of Congress and may exercise only that authority that the legislature provides. Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374 (1986); INS v. Chada, 462 U.S. 919, 955 (1983). Congress has not expressly authorized the CFTC to disregard the definitions set forth in Section 1a of the CEA.[12] In addition, Congress has not explicitly or by use of ambiguous language implicitly granted the authority to expand a definition's scope. Thus, a self-authorization to disregard congressional definitions may amount to an ultra-vires act. The New York Currency Research episode aside, there in no indication that the Commission has assumed the authority to disregard Section 1a definitions. Thus, as drafted, the introductory language creates the potential for mischief and introduces uncertainty.

Even if the Commission exercised the authority to disregard definitional language in a manner that did not overstep its congressionally-imposed bounds, it could still do so unlawfully. The Commission often acts in a manner that implicates the due process rights of those subject to its authority. For example, when the Commission seeks to impose sanctions upon a person based on alleged violations of the law, Fifth Amendment due process applies. In re First Guaranty Metals, Co., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,074 at 24,340-41 (CFTC July 2, 1980). The Fifth Amendment's due process clause generally prohibits a federal agency from imposing sanctions when the person sanctioned did not receive fair notice of the behavior required or prohibited. Blount v. SEC, 61 F.3d 938, 948-49 (D.C. Cir. 1995) (citing General Elec. Co. v. EPA, 53 F.3d 1324, 1328-29 (D.C. Cir. 1995)). Thus, if the Commission employed Rule 1.3's introductory language in a quasi-judicial proceeding and, on the basis of that change, imposed sanctions, there is a substantial probability that the decision would run afoul of the Fifth Amendment's due process clause. In short, if the Commission made use of the introductory language at issue, such use could be unlawful.[13]

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[12] In certain instances, Congress has granted the authority to prescribe exceptions to defined categories. 7 U.S.C. § 1a(5)(B)(vii). However, this comes nowhere close to the plenary authority that the introductory paragraph of Rule 1.3 may be read as wielding. After all, the ability to exclude persons from definitions and, thereby, from the regulatory requirements that define their scope in defined terms would not seem to include the authority to expand the definitions and, thereby, the coverage of regulations.

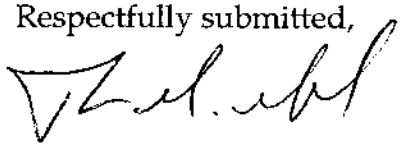
[13] If the Commission sought to employ the introductory language to expand the scope of another substantive provision, it could be viewed as having enacted a de facto rule change. Such a rule change could implicate the Administrative Procedure Act. See American Telephone and Telegraph Co. v. FCC, 978 F.2d 727, 732-33 (D.C. Cir. 1992).

The Commission apparently does not rely upon the regulatory language that permits it to disregard its regulations (and possibly those of Congress). The industry and bar apparently do not believe that the Commission is likely to do so. Thus, the language appears to serve no useful purpose other than to preserve flexibility.[14] Most people prefer to preserve options. However, in the case of agencies, this practice may lead to unlawful acts as set forth above. In addition, it is generally bad policy.

As touched on above, laws and regulations serve an institutional purpose. Private and public actors depend on their existence and meaning when ordering their affairs. In other words, law has an institutional value in form of setting up guideposts and warning signs.[15] An exercise of self-imposed latitude that throws the substance of these guides into doubt creates uncertainty that makes decision making less efficient and increases the likelihood of action that serves not purpose other than to address the new uncertainties. In other words, it reduces the institutional value of federal law.

For the reasons set forth above, I would suggest that the Commission consider deleting the words "unless the context otherwise requires" from the introductory language of Rule 1.3. The language is almost never used, often cannot be used lawfully and, when used, may cause more harm than good. In short, this regulatory white elephant should be discarded.

Respectfully submitted,



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[14] There may be instances under which the ability to expand definitions to increase regulatory coverage is necessary. However, the self-grant of such authority should be narrowly targeted as well as consistent with the Administrative Procedure Act and due process.

[15] For example, when the Commission uses clear language to express the law – as it often does -- a private actor may be able to resolve a regulatory question in a matter of minutes. When, on he other hand, the law lacks clarity or is somehow thrown into doubt, careful private actors will secure legal advice that may involve expensive inquiries as well as requests for some form of relief granted by the Division of Trading and Markets. Thus, uncertainty drains private and public resources that could have been otherwise applied.