



COMMENT

INSTITUTE FOR JUSTICE

February 3, 2000

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**Received CFTC
Records Section**

Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission
3 Lafayette Center -- Suite 9026
1155 21st Street, N.W.
Washington D.C. 20581

Re: EXEMPTION FROM REGISTRATION AS A COMMODITY TRADING ADVISOR,
RIN 3038-AB48, 64 FR 68304 (Dec. 7, 1999)

Dear Ms. Webb:

The Institute for Justice is a nonprofit, public interest legal center dedicated to advancing the liberty of individuals to act as free and responsible members of society. As part of its mission, the Institute seeks to reinvigorate the founding principles of the First Amendment by protecting the free flow of information indispensable to our republican form of government and to our free enterprise economy.

Following the CFTC's interpretation regarding the use of electronic media by Commodity Trading Advisors in 1996 and its enforcement actions and investigations, the Institute for Justice filed a lawsuit on behalf of a group of commodity trading publishers and subscribers, captioned *Taucher v. Born*, 53 F. Supp.2d 464 (D.D.C 1999). This lawsuit alleged that the CTA registration provision could not be constitutionally applied to impersonal publishers. On June 21, 1999, the United States District Court for the District of Columbia agreed, and struck down application of the registration requirement to impersonal publishers. In the course of this litigation, we were frequently exposed to the concerns of commodity trading publishers and their subscribers. This response to the CFTC's proposed exemption reflects those concerns.

The proposed exemption for impersonal publishers is not only an improvement as a matter of policy; it is required by the Constitution. The First Amendment generally prohibits government attempts to subject publishers to licensing requirements, or "prior restraints." While the First Amendment does not prohibit professional licensing schemes in every case where the practice of a profession happens to involve speech, it does prohibit, as the district court held in the *Taucher* case, a federal agency's attempt to license publishers under the guise of regulating professional conduct.

The distinction between professional activity that may be licensed and constitutionally protected publishing was explained in 1985 by Justice White, concurring in *Lowe v. Securities and Exchange Commission*:

One who takes the affairs of a client personally in hand and purports to exercise judgment on behalf of the client in the light of the client's individual needs and circumstances is properly viewed as engaging in the practice of a profession. . . . Where the personal nexus between professional and client does not exist, and a speaker does not purport to be exercising judgment on behalf of any particular individual with whose circumstances he is directly acquainted, government regulation ceases to function as legitimate regulation of professional practice with only incidental impact on speech; it becomes regulation of speaking or publishing as such, subject to the First Amendment's command that "Congress shall make no law . . . abridging the freedom of speech, or of the press.

The Commodity Exchange Act runs afoul of these principles since it subjects many entirely impersonal publishers to a licensing requirement, whether or not they tailor their advice to individual subscribers with whose circumstances they are directly acquainted. While we believe that the Commission's proposed rule does not foreclose all possible unconstitutional applications of the CTA registration requirement, it addresses some of its most flagrant infirmities. For this reason, the proposed rule is a step in the right direction.

With respect to the specific issues on which the CFTC requested comments, we offer the following additional remarks:

Subjection of exempt CTAs to other sections of the Act

Exempt CTAs should not be subject to sections of the Act that apply by their terms only to Registered CTAs. In particular, exempt CTAs should not be subject to the record-keeping and production requirements in Section 4n(3)(A), nor to the ethics training requirements in Section 4p(b).

Both of these requirements are unduly and unreasonably burdensome. The production requirements in Section 4n(3)(A) are of particular concern because they require prospective CTAs to waive their Fourth Amendment rights, allowing the CFTC to investigate or audit them without any showing of actual wrongdoing. This threat is a significant deterrent to prospective publishers. CFTC and National Futures Association audits are particularly acute violations of their privacy for CTAs who publish out of their homes. Furthermore, publishers are extremely wary consenting to release of their subscriber lists to government agencies. When a publisher's subscribers are contacted by a government agency, it has a disastrous effect on customer goodwill, whether or not the CTA is guilty of an offense.

The ethics training requirement is also burdensome, and largely inappropriate for publisher-CTAs. The subject-matter that the CFTC requires ethics training courses to cover, such as "[h]ow to act . . . fairly and with due skill, care, and diligence," and "[o]btaining and assessing the financial situation and investment experience of customers," is plainly designed with traditional, money-managing CTAs in mind—those with an actual fiduciary responsibility for their clients.

The burdens that these requirements create are likely to cause some publishers to exit the commodity publishing industry, and dissuade others from entering it at all. This risk must be evaluated in light of the fact that the SEC does not currently regulate securities publications in this fashion. In fact, one of our clients in the *Taucher* case informed us that he would rather switch his commentary to the securities markets than be subject to burdensome CTA regulations. If the CFTC imposes burdens on commodity publishers that the SEC does not impose on securities publishers, a decrease in the available sources of commodity information should be expected.

Applying burdensome regulations to publishers in this fashion is not only unfair to those publishers and to their subscribers (who are deprived of the benefits of their research), it raises significant constitutional issues. Burdensome regulatory schemes for speakers, even in the absence of a licensing requirement, have been struck down by the courts on First Amendment grounds. The inclusion of these requirements is therefore likely to lead to future constitutional litigation. Subjecting publisher-CTAs to these burdensome requirements would hinder not only the CFTC's stated policy goal of minimizing the impact on speech, but also its goal of avoiding future litigation.

Categories of CTAs that are not included in the exemption but should be

The CFTC's stated policy goals of minimizing burdens on speech and avoiding future litigation would best be met if the proposed exemption were at least co-extensive with Justice White's view of the scope of First Amendment protection for publishers. Certain Commodity Trading Advisors fail to qualify for the proposed exemption (or the exemption is unclear as to their activities), but would nevertheless be considered publishers under Justice White's "personal nexus" test.

Subsection (a)(9)(i) reserves authority over CTAs who "direct client accounts." We agree with the CFTC's position that this reservation does not raise First Amendment concerns.

Subsection (a)(9)(ii) reserves authority over CTAs who "provide commodity trading advice based on, or tailored to, the . . . circumstances or characteristics of particular clients." We believe that this reservation is consistent with the First Amendment as applied to CTAs who have actual direct knowledge of their client's circumstances or characteristics. However, it is unclear whether this reservation is intended to apply to a CTA that publishes a printed trading system or a computer software program that allows a user to receive a recommendation appropriate to his circumstances by supplying personal information.

For example, suppose a CTA publishes a book containing printed instructions for a trading strategy. At one point in the instructions, the user is required to insert his or her net available capital into a formula to determine the number of contracts he or she should trade. Is the publisher of this book exempt under Subsection (a)(9)(ii)? As a second example, consider a software program that requires the user to input his or her current positions in various contracts. The program then makes a different recommendation depending on whether the user has a pre-existing long or short position. Would the publisher of this software be exempt under Subsection (a)(9)(ii)?

As long as these two publications were not designed with the needs of a particular user in mind, *Lowe* does not permit their licensure. Neither publisher is “directly acquainted” with the needs and circumstances of the person to whom the advice is given, and no sort of “personal nexus” exists between publisher and subscriber. The CFTC should clarify that the reservation in (a)(9)(ii) is not intended to apply to cases such as this, or in the alternative, clarify that it intends to assert authority over such publishers notwithstanding *Lowe*. We suggest the following language for Subsection (ii):

- (ii) Provide commodity interest trading advice based on, or tailored to, the commodity interest or cash market positions or other circumstances or characteristics of particular clients with whose circumstances or characteristics the CTA is directly acquainted.

This formulation would clarify the above ambiguities and also advance the CFTC’s interest in avoiding litigation by tracking the *Lowe* standard more closely.

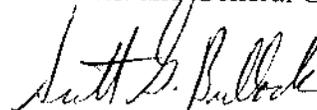
Finally, Subsection (a)(9)(iii) reserves authority over CTAs who “provide commodity interest trading advice through interactive communications with individual clients, such as face-to-face or telephone conversations or electronic mail exchanges between individuals.” We believe that this reservation is inconsistent with the First Amendment except in cases where the advice is actually given “in the light of the client’s individual needs and circumstances.” Since such cases would already be reserved by Subsection (a)(9)(ii), we believe that Subsection (a)(9)(iii) should be removed.

While the CFTC’s proposal could be further improved in this fashion, we welcome any rule change that increases the free flow of information in the commodity publishing industry and ameliorates the constitutional infirmities of the CEA. Thank you for your attention to this matter. If we can provide additional information or suggestions, please do not hesitate to contact us.

Very truly yours,



William H. Mellor
President and General Counsel



Scott G. Bullock
Senior Attorney

Robert Kry
Clerk

