

Commodity Futures Trading Commission
CEA CASES

NAME: CORN PRODUCTS REFINING COMPANY

CITATION: 13 Agric. Dec. 1117

DOCKET NUMBER: 55

DATE: DECEMBER 8, 1954

DOCUMENT TYPE: DECISION AND ORDER

AGRICULTURE DECISIONS

BEFORE THE SECRETARY OF AGRICULTURE

UNITED STATES DEPARTMENT OF AGRICULTURE

(No. 4118)

In re CORN PRODUCTS REFINING COMPANY. CEA Docket No. 55. Decided December 8, 1954.

Non-exempt Hedging -- Estimated or Anticipated Sales -- Trading Limit

Where corn futures purchases are made against estimated or anticipated sales of corn products and by-products, which sales are not covered by contracts to sell, it is *held*, such estimated or anticipated sales are not commitments that qualify futures purchases of the commodity as hedges exempt from trading limits under the act.

Exempt Hedging -- Trading Limit

Bona fide hedging transactions exempted from trading limits under the act are sales of futures to the extent that such sales are offset in quantity by purchases of the same cash commodity and purchases of futures to the extent that such purchases are offset by sales of the same cash commodity.

Hedging in Sales to Subsidiary -- Trading Limit

Where respondent sells its product at a fixed price to a wholly owned subsidiary, there is no risk of price fluctuations which would qualify the contracts as the basis for hedging operations exempted from trading limits under the act.

Hedging in Sale of Products and By-Products -- Trading Limit

Where futures are purchased as hedges against a sale of the commodity itself, they may be for the full amount, but futures purchased as hedges against the sale of products or byproducts shall be reasonably related to the market risk to qualify as bona fide hedges exempt from the trading limit.

Due Process -- Unlawful Discrimination -- Constitutional Law

Where respondent claimed that the act is unconstitutional as the order is discriminating and deprived respondent of property without due process of law in that the limitations favored respondents competitors, *held*, it

is not appropriate for an agency charged with the administration of a statute to declare it unconstitutional, and the fact that a regulation may bear more heavily upon one person than another does not make it unlawful.

Speculation in Bona Fide Hedging -- Spreads or Straddles -- Trading Limit

The Commodity Exchange Act makes the futures transactions of any person subject to the trading limit orders of the Commodity Exchange Commission regardless of the degree of speculation involved in such transactions, unless the transactions are exempt as "bona fide hedging" under the act, or are exempt by the Commission as spreads or straddles.

Term "Reasonable" Hedging

Paragraph (B) of section 4a(3) of the Commodity Exchange Act classifies as a hedge the purchase or sale of a commodity for future delivery in such amount as would be a reasonable hedge against the products or by-products of such commodity, and the term "Reasonable" refers to such items as conversion factors, and this paragraph does not expand the term beyond the definition of "bona fide hedging transactions" in section 4a(3).

Price Commitment in Bona Fide Hedging

An essential characteristic of true hedging is a price commitment with respect to the cash commodity or product which is protected by a futures transaction.

Mr. Benj. M. Holstein for Commodity Exchange Authority. *Mr. Samuel A. McCain* of New York, New York, and *Mr. Woodson D. Scott* of *Lord, Day & Lord* of New York, for respondent. *Mr. Jack W. Bain*, Referee.

Decision by Thomas J. Flavin, Judicial Officer

PRELIMINARY STATEMENT

This is a disciplinary proceeding under the Commodity Exchange Act (7 U.S.C. Chapter 1), instituted by a complaint issued under section 6(b) of the act (7 U.S.C. 9) on July 22, 1952, by K. T. Hutchinson, Acting Secretary of Agriculture. The respondent, Corn Products Refining Company, is a corporation whose principal place of business is New York, New York. It is engaged in the business of manufacturing and selling various products and by-products of corn. The complaint charges that the respondent traded in corn futures in excess of the trading limit of 2,000,000 bushels fixed by the order of the Commodity Exchange Commission (17 CFR 150.1) issued under section 4a of the act (7 U.S.C. 6a). The complaint alleges that on April 11,

1952, as the result of transactions theretofore executed on the Chicago Board of Trade for its account, respondent had a net long position in corn futures of approximately 3,650,000 bushels, exclusive of spreading in the same grain between markets, that only 207,000 bushels of this position constituted bona fide hedging transactions exempt from trading limits by the act and the commission's order, and that during a specified period thereafter it held a net long futures position of more than 2,000,000 bushels.

On August 19, 1952, respondent filed an answer admitting that it had a long position in corn futures on the Chicago Board of Trade on the dates and in the quantities specified but denying that such position violated the act or the order. Respondent contends that its long position represented bona fide hedging transactions against outstanding contracts for, and anticipated sales of, corn products and by-products and was, therefore, exempt from the position limit established by the commission. In support of this contention, the answer describes in detail the respondent's operations, its requirements for raw materials, and the contracts which it entered into with its customers. It is also alleged in the answer that the act does not authorize the issuance of the order of the commission and that, if it does, the act is unconstitutional as the order is discriminatory and deprives respondent of property without due process of law in that the limitations contained therein favor respondent's competitors in the corn refining industry and in industries producing competitive products.

Prior to the hearing in this matter, the parties entered into a stipulation of facts which was made a part of the record. The stipulation consists of a

description of the respondent's operations, its requirements for raw materials, and the extent and form of its outstanding contracts. Attached to the stipulation are 22 exhibits containing data with respect to respondent's inventories, prices, products, sales, and futures transactions.

Jack W. Bain, Office of Hearing Examiners, United States Department of Agriculture, presided at a hearing which was held in New York, New York, on October 14 and 15, 1952, and March 3, 1953. The respondent was represented by Samuel A. McCain and Woodson D. Scott, both of New York, New York. Benjamin M. Holstein, Office of the Solicitor, United States Department of Agriculture, appeared as counsel for the complainant. At the hearing, four witnesses testified on behalf of respondent and respondent introduced 19 exhibits in addition to those attached

to the stipulation of facts. The complainant cross-examined respondent's witnesses and offered rebuttal evidence by the testimony of one witness.

Both parties filed briefs and oral argument was held before the referee in Washington, D. C., on June 25, 1953. The referee issued his report on September 29, 1953. The report contained proposed findings of fact, conclusions and an order recommending that respondent be found to have violated the act substantially as charged. Both parties filed exceptions to the referee's report and oral argument upon the exceptions was held before the Judicial Officer in Washington, D. C., on April 13, 1954.

FINDINGS OF FACT

1. The respondent, Corn Products Refining Company, is a New Jersey corporation whose office and principal place of business is located at 17 Battery Place, New York, New York. The respondent is engaged in the business of manufacturing and selling products and by-products of corn and operates factories at Argo and Pekin, Illinois, and North Kansas City, Missouri. Respondent is licensed to do business and does business in the States of New York, New Jersey, Illinois, Missouri, and Texas.

2. The respondent processes over 50,000,000 bushels of corn a year and sells about 77 percent of the products and by-products to its subsidiaries and 23 percent to unaffiliated purchasers. Starch, gluten feed, gluten meal, syrup, and dextrose (corn sugar) are the principal products and by-products obtained from the processing. Respondent's brand name for dextrose is cerelese.

3. Respondent estimates, and the estimate may be accepted as fact for the purpose of this proceeding, that of the corn processed by the nine companies engaged in processing corn by the wet milling process, it processes nearly 44 percent, its nearest competitor in size processes 14 percent, the next two 10 percent each, the fifth in size 9 percent, and the other four less than 5 percent each.

4. Corn Products Sales Company is a wholly owned subsidiary of respondent and is licensed to do business and does business in 42 states and the District of Columbia.

5. The Board of Trade of the City of Chicago, hereinafter referred to as the Chicago Board of Trade, was at all times material to these findings and conclusions a duly designated contract market under the provisions of the Commodity Exchange Act.

6. Section 2(a) of the Commodity Exchange Act (7 U.S.C. 2(a)) defines the term "commission" to mean "the Commodity Exchange Commission, consisting of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General."

7. Section 4a (1) of the act (7 U.S.C. 6a (1)) provides, in pertinent part, as follows:

"Excessive speculation in any commodity under contracts of sale of such commodity for future delivery made on or subject to the rules of contract markets causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity. For the purpose of diminishing, eliminating, or preventing such burden, the commission shall, from time to time, after due notice and opportunity for hearing, by order, proclaim and fix such limits on the amount of *trading* under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market which may be done by any person as the commission finds is necessary to diminish, eliminate, or prevent such burden. Nothing in this section shall be construed to prohibit the commission . . . from exempting transactions commonly known to the trade as 'spreads' or 'straddles' or from fixing *trading* limits applying to such transactions different from *trading* limits fixed for other transactions." [Emphasis supplied.]

8. Section 4a(2) of the act (7 U.S.C. 6a(2)) provides, in pertinent part, as follows:

". . . it shall be unlawful for any person -- * * *

"(B) directly or indirectly to buy or sell, or agree to buy or sell, under contracts of sale of such commodity for future delivery on or subject to the rules of any contract market, any amount of such commodity that shall result in giving such person a net long or net short position at any one time in or with respect to any such commodity in excess of any *trading* limit fixed by the commission for net long or net short position in such order for or with respect to such commodity." [Emphasis supplied.]

9. Section 4a(3) of the act (7 U.S.C. 6a(3)) provides, as follows:

"(3) No order issued under paragraph (1) of this section shall apply to transactions which are shown to be bona fide

hedging transactions. For the purpose of this paragraph, bona fide hedging transactions shall mean sales of any commodity for future delivery on or subject to the rules of any board of trade to the extent that such sales are offset in quantity by the ownership or purchase of the same cash commodity or, conversely, *purchases of any commodity for future delivery on or subject to the rules of any board of trade to the extent that such purchases are offset by sales of the same cash commodity.* There shall be included in the amount of any commodity which may be hedged by any person -- [Emphasis supplied.]

"(A) the amount of such commodity such person is raising, or in good faith intends or expects to raise, within the next twelve months, on land (in the United States or its Territories) which such person owns or leases;

"(B) an amount of such commodity the sale of which for future delivery would be a reasonable hedge against the products or by-products of such commodity owned or purchased by such person, *or the purchase of which for future delivery would be a reasonable hedge against the sale of any product or by-product of such commodity by such person.*" [Emphasis supplied.]

10. On December 22, 1938, the Commodity Exchange Commission, pursuant to authority vested in it by section 4a(1) of the act, issued an order (17 CFR 150.1; 3 F. R. 3145) which provided, in part, as follows:

"As used herein, the word 'grain' includes . . . corn . . . and the word 'person' includes individuals, associations, partnerships, corporations, and trusts.

"Findings of Fact

"Pursuant to the provisions of Section 4a of the Commodity Exchange Act (U.S.C., 1934 ed. and Supp. III, title 7, sec. 6a), the Commodity Exchange Commission, after full consideration of the record made at a public hearing held

in Chicago, Illinois, beginning December 1, 1937, of which due public notice had been given, and at which all persons were given opportunity to hear, present, refute, and comment upon evidence in the premises, does hereby find the following:

"A. Except as otherwise stated herein, trading in any one grain for future delivery on a contract market, by a person who holds or controls a speculative net position of more than

2,000,000 bushels, long or short, in any one future or in all futures combined, in such grain on such contract market, tends to cause sudden and unreasonable fluctuations and changes in the price of such grain not warranted by changes in the conditions of supply or demand, and is not needed to maintain market liquidity or to facilitate hedging on such contract market. * * *

"Upon the foregoing facts, it is concluded that in order to diminish, eliminate, or prevent the undue burden of excessive speculation in grain futures which causes unwarranted price changes, it is necessary to establish limits on the amount of speculative trading, under contracts of sale of grain for future delivery on contract markets, which may be done by any one person; that 2,000,000 bushels is a reasonable limitation on the net long or short position which any person may hold or control and upon the daily purchases or sales which any person may make, in any one grain or any one contract market, in any one future or all futures combined; * * *

IT IS HEREBY ORDERED That the following limits on the amount of trading under contracts of sale of grain for future delivery on or subject to the rules of contract markets which may be done by any person be, and they are hereby, proclaimed and fixed, to be in full force and effect on and after December 31, 1938;

"POSITION LIMITS

"1. The limit on the maximum net long or net short position which any one person may hold or control in any one grain on any one contract market, except as specifically authorized by paragraph 2 hereof, is: 2,000,000 bushels in any one future or in all futures combined.

"2. To the extent that the net position held or controlled by any one person in all futures combined in any one grain on any one contract market is shown to represent spreading in the same grain between markets, the limit on net position in all futures combined set forth in paragraph 1 hereof may be exceeded on such contract market, but in no case shall the excess result in a net position of more than 3,000,000 bushels in all futures combined nor more than 2,000,000 bushels in any one future. * * *

"The foregoing limits upon position and upon daily trading shall not be construed to apply to bona fide hedging transactions

as defined in paragraph (3) of section 4a of the Commodity Exchange Act."

The position limits established in said order of the Commodity Exchange Commission were in full force and effect at the time of the transactions involved herein.

11. On April 11, 1952, as the result of transactions theretofore executed for its account on the Chicago Board of Trade, the respondent held the following net long open contract position in corn futures:

Future	Quantity
May 1952	1,640,000 bushels
July 1952	1,500,000 bushels
December 1952	510,000 bushels
Total	3,650,000 bushels

No part of this long position in corn futures represented spreading in the same grain between markets. On the same date, as the result of transactions theretofore executed for its account on other boards of trade, respondent held a short open contract position in September raw sugar futures of 7,000 long tons and in October cottonseed oil futures of 840,000 pounds.

12. As of April 11, 1952, respondent had the following outstanding contracts for the sale of corn products and by-products to its subsidiaries and to unaffiliated purchasers:

(a) Contracts with various purchasers, including its subsidiaries, for the sale of starch, syrup and dextrin for delivery within 30 days at the market price on the day of shipment, the manufacture of which would require 1,059,000 bushels of corn.

(b) Contracts with unaffiliated purchasers for the sale of dextrose for delivery within 30 days at the market price on the day of shipment, the manufacture of which would require 547,000 bushels of corn.

(c) Contracts with Corn Products Sales Company, a wholly owned sales subsidiary, for the sale of dextrose for delivery within 30 days at fixed prices, the manufacture of which would require 2,007,000 bushels of corn.

(d) Contracts with unaffiliated foreign purchasers for the sale of starch, syrup and dextrose at fixed prices, the manufacture of which would require 207,000 bushels of corn.

(e) Contracts with unaffiliated purchasers for the sale of 41,000,000 pounds of gluten feed and meal for delivery within 30 days at fixed prices, the manufacture of which would require approximately 3,090,000 bushels of corn, which would, at the same time, yield 105,000,000 pounds of starch or 130,000,000 pounds of syrup.

13. Dextrose sells in competition with cane sugar. Historically, the market price of dextrose follows the price of refined cane sugar and dextrose sells at a fixed differential of 15 or 16 percent below the market price of refined cane sugar. Cane sugar is sold at a firm price for 30 days ahead. A change in the price of refined cane sugar will not take effect until 30 days after the change is announced. The maximum market price of dextrose is predictable and, as a practical matter, is fixed for at least 30 days.

14. By experimenting for some years, respondent has developed a method of using futures markets by which it assures itself of a profit in what it calls its cerelese operations. Following this method in connection with 15,225,000 pounds of dextrose it expected to sell to customers the latter part of 1952, on April 11, 1952, it had purchased 510,000 bushels of December corn futures, and had sold 7,000 long tons of raw sugar futures and 840,000 pounds of cottonseed oil futures.

15. Respondent forecasts what its sales will be for months ahead, and the error in its forecasts has proved to be small. Based on such forecasts, it schedules the amounts of corn it will process 60 days ahead. It considers the future demand of its customers (what it forecasts it will sell) to be an obligation, whether or not covered by contract.

16. Respondent's trading in futures is not done for the purpose of speculating in price differences, but in good faith for the purpose of offsetting risks and reducing costs in its business. It regards such trading as proper and legitimate hedging.

CONCLUSIONS

I

Section 4a(1) of the act (7 U.S.C. 6a(1)), quoted above in Finding of Fact 7, finds that excessive speculation in futures of any commodity on or subject to the rules of contract markets is an undue and unnecessary burden upon interstate commerce and

provides that the Commodity Exchange Commission for the purpose of diminishing, eliminating or preventing such burden shall, from time to time, after notice, hearing, etc., ". . . proclaim and fix such limits on the amount of *trading* under contracts of sale . . . for future delivery on or subject to the rules of any contract market which may be done by any person as the commission finds is necessary to diminish, eliminate, or prevent such burden." [Emphasis supplied.] Section 4a(2), as seen from Finding of Fact 8, makes it unlawful for any person to buy or sell any amount of a commodity for such future delivery in excess of any daily *trading* limit fixed by the commission or which will give a person a position in excess of any *trading* limit for net long or short positions fixed by the commission. The only exceptions to the trading restrictions contained in the act are (1) the authorization in section 4a(1) to the commission to exempt "spreads" or "straddles" and (2) the exemption for bona fide hedging transactions in section 4a(3).

It is seen, then, that the act provides for orders by the commission fixing *trading* position limits for any person, that a position in excess of such limit is unlawful, and that the only transactions exempted by the act from *trading* limits are those specified. Therefore, *whatever the degree of speculation involved in the futures transactions of a person*, the act makes them subject to the trading limit orders of the commission unless the transactions are exempt as bona fide hedging transactions under the act or are exempt by the commission as spreads or straddles.

The respondent argues that the trading limit provisions of the act apply only to *speculative* trading, that the commission's order can only do likewise, that the respondent's corn futures trading is *not speculative* because it is done to stabilize the cost of corn to it and to assure a continuing source of supply of corn for the respondent's manufacturing and selling needs and that, therefore, whether or not its futures transactions are exempt as hedging, the trading limit provisions of the act and the order are inapplicable to it. Of course, the respondent's futures transactions are carried on in connection with its business and do not represent the kind of trading engaged in by those who trade *only* in price differences. As we have seen, however, the act provides for fixing *trading* limits, makes it unlawful to exceed the *trading* limit and exempts only bona fide hedging transactions and spreads or straddles when so provided by the commission. Whether or not the kind of trading done by the respondent should

have been treated the same for the trading limit purposes of the act as the trading of a speculator trading only in price differences was a matter for decision by Congress. The act appears to make no distinction among types of trading except for the exemption for bona fide hedging transactions. The statutory provisions have the effect of throwing into the broad category of speculative trading, transactions which are not bona fide hedging transactions. The commission's order fixing 2,000,000 bushels as the position limit for corn futures exempts bona fide hedging transactions and provides higher limits where spreads between markets in corn futures are involved. The order follows the act. There is no question of spreads involved so that we come down to the main issue in this proceeding, namely, whether the respondent's net long futures position of 3,650,000 bushels on April 11, 1952, was in violation of section 4a of the act and of the commission's order or whether its corn futures purchases were bona fide hedging transactions exempt by the act and the order at least to the extent that the respondent's position exceeded 2,000,000 bushels.

II

The respondent contends that its entire long futures position of 3,650,000 bushels constituted hedges exempt under the act and the order. The basic reasoning in support of this contention is that the respondent is entitled under section 4a(3) (B) of the act to have considered as hedges the amount of corn

futures purchases which would be a *reasonable* hedge against future sales of corn products and by-products by the respondent. The respondent argues that "sale" in section 4a(3) (B) extends to sales of products and by-products to take place in the future without the existence of contracts of sale at the time of the futures purchase, that unquestionably its business necessitates the grinding of corn for sales of products and by-products and that corn futures purchases against such future sales of products and byproducts are hedges under the act subject only to whatever limits on amounts of such purchases are set by the word "reasonable." The respondent ventures an opinion that an amount of purchases to cover its "nearby needs," for example, a sixty-day supply (amounting to 10 to 12 million bushels) would not be unreasonable.

As part of its case on this phase of the problem, the respondent points out that its futures trading is done for protective purposes rather than speculation, that is, that its futures purchases

tend to assure it supplies of cash corn as well as to stabilize the costs of corn to it. In this latter connection the respondent adverts to the fact that prices for corn products and by-products are relatively more stable than corn prices and that trading in futures as the respondent does, that is, by treating account-wise the profit or loss on its futures transactions as part of the cost of corn purchased, tends to smooth out fluctuations in its cost of corn. The respondent urges that it forecasts with great accuracy its needs for corn and the prices at which it will sell corn products and by-products in the future and that, therefore, these forecasts which it regards as commitments, supply a legitimate basis for regarding futures purchases against such forecast sales as hedging exempt from trading limits by the act.

The respondent seemingly makes use of the word "reasonable" in section 4a(3) (B) of the act as though it confers a completely different and much wider immunity from trading limits than section 4a(3) prescribes. We do not believe this to be the case. Section 4a(3) lays down a definition of "bona fide hedging transactions" which requires a futures purchase to be balanced by a sale of the cash commodity and *vice versa*. Paragraph (B), dealing in hedging with respect to *products or by-products of a commodity* as distinguished from the commodity itself, permits the addition of what would be a *reasonable* hedge in such cases. Obviously paragraph (B), in using the word "reasonable," refers to such items as conversion factors and is not an indefinite expansion of the word "reasonable" in the case of products or by-products of a commodity beyond the definition of "bona fide hedging transactions" in section 4a(3). Obviously, too, the word "hedge" in paragraph (B) does not have a meaning different from that in section 4a(3). There is no indication in the legislative history that Congress intended to enlarge exemptions for trading *with respect to products and by-products*, as distinguished from commodities themselves, to anything reasonable or commercially advantageous to the trader without reference to the definition of bona fide hedging transactions. In other words, if anticipated sales of a *cash commodity itself* without fixed price commitments would not qualify futures purchases as a bona fide hedging transaction under section 4a(3), anticipated sales of the *product* of a commodity would not make futures purchases against such sales a hedge under section 4a(3) (B).

In essence, a hedge is the assumption of a new risk in order to offset an opposite risk to which the hedger is subject. Webster's

New International Dictionary (2d ed. 1950). n1 In the futures market, the traditional function of hedging is to supply a form of insurance against price fluctuations n2 in connection with transactions in the cash or "spot" commodity or products of such commodity and is based upon the assumption that price movements in the cash commodity market will parallel those in the futures market. Hedging is employed by buyers or owners of the cash, that is the physical, commodity and those dealers or processors who have entered into

contracts for the forward sale of the commodity or product thereof and who at the time of making the contracts for forward sale do not own the commodity to be delivered or processed.

n1 The Oxford New English Dictionary (1901), giving usage illustrations as far back as 1672, defines "hedge" to mean: "8. To secure oneself against loss on (a bet or other speculation) by making transactions on the other side so as to compensate more or less for possible loss on the first."

n2 The value of futures trading for such purpose has been the historical defense against eliminating or curtailing futures trading.

A typical illustration of hedging by futures purchasers follows. A flour miller contracts in midsummer to deliver 5,000 barrels of flour in the late fall at a price based upon prevailing prices for wheat. The contract price is sufficient to cover costs and insure a milling profit. The month of November arrives and the miller, by reason of an advance in the price of wheat, may be compelled to pay a higher price per bushel than the price on which he based his estimate when he contracted to mill the flour at the fixed price. The advance in wheat prices may well destroy any anticipated milling profits. In order to eliminate the risk of a change in the price of the raw material, the miller will buy December wheat futures contracts at the time he makes the contract for the sale of the flour. In the interval between the time when the contract for the sale of the flour is made and November when he will need the wheat to manufacture the flour, the price of wheat may rise or fall. When November arrives, he purchases wheat of the quality and grade he desires. If the price of wheat has advanced, he loses the amount of the advance since he has to pay more for the wheat than the price of wheat at the time he made his contract to sell flour, but at the time he obtains the actual cash wheat, he simultaneously closes out his hedge transaction by selling the December futures contracts. He makes a profit on his futures transaction which balances his loss on the purchase of the cash wheat and insures to him his normal milling profit on the manufacture and sale of the flour at a small

cost in commissions. If the price of wheat has declined between the time of making the contract to sell the flour and the purchase of the necessary wheat, the profit on the purchase of the wheat is balanced by a corresponding loss on the futures transaction.

As can be seen from the illustration, the hedge is used to insure processors against loss *due to price changes in commodities*. Its purpose is to insure processing profit. Its object is not to return a speculative profit, for the reason that any profit derived on the futures merely equalizes or offsets a loss which has been incurred on a transaction or market position in the cash commodity market. The cash market transaction and the exchange transaction are complementary. By means of the futures-trading, the hedger passes on to others a market risk, that is, the risk of price change in the commodity. Accordingly, an essential characteristic of true hedging is a price commitment with respect to the cash commodity or product which is protected by a futures transaction. In other words, a futures sale is a hedge to the extent that the trader owns or purchases an equivalent amount of the cash commodity or products or by-products thereof and a futures purchase is a hedge to the extent that the trader has contracts for forward sales of the cash commodity or products or by-products of the commodity at fixed prices. See testimony of Dr. W. E. Beach, tr. pp. 178-180; article on "Hedging," *Encyclopedia Britannica* (1942 ed.); n3 Hoffman, *Future Trading Upon Organized Commodity Markets* (U. of Pa. Press, 1932), pp. 377-418; Hoffman, *Hedging by Dealing in Grain Futures* (1925), pp. 114, 123-124; Vol. VII, Report of the Federal Trade Commission on the Grain Trade (1926) pp. 33-47; Hoffman, *Future Trading and the Cash-Grain Markets* (U. S. Dep't of Agriculture, Circular No. 201, 1932) p. 22; Baer and Woodruff, *Commodity Exchanges* (Harper, 3d ed., 1935) pp. 83-88, 118-120; Emery, *Speculation on the Stock and Produce Exchanges of the United States* (Columbia University, 1896) p.

160; Baer and Saxon, *Commodity Exchanges and Futures Trading* (Harper, 1949) pp. 197-218.

n3 The first paragraph of this article states: "Hedging, a method by which traders in commodities may partially or entirely insure themselves against loss from price fluctuations. The technique of hedging is the making at about the same time of two contracts of opposite though corresponding nature; one a genuine trade contract with a view to obtaining a dealer's ordinary trade profit, the other an insurance or protective contract in the speculative or 'futures' market which counteracts loss (and profit) on the first transaction through price fluctuations"

There are many reported court decisions dealing with hedging and these, too, generally regard hedging to be a form of protection

from price fluctuations and expressly or impliedly consider as an essential element of a true hedge a price commitment with respect to the cash commodity or product thereof that is hedged. n4

n4 E.g., *United States v. New York Coffee and Sugar Exchange*, 263 U.S. 611, 619 (1924); *Board of Trade v. Christie Grain and Stock Company*, 198 U.S. 236, 249 (1905); *Commissioner v. Farmers and Ginners Cotton Oil Company*, 120 F. (2d), 772, 774 (C.C.A. 5th, 1941); *Borllin-Harrison Company v. Lewis Company*, 182 Tenn. 342, 187 S.W. (2d) 17, 23 (1945); *Lyons Milling Company v. Goffe & Gardener*, 46 F. (2d) 241, 247 (C.C.A. 10th, 1931). In *Commissioner v. Farmers and Ginners Cotton Oil Company*, *supra*, the general principles are given as follows (p. 774):

"A hedge is a form of price insurance; it is resorted to by business men to avoid the risk of changes in the market price of a commodity. The basic principle of hedging is the maintenance of an even or balanced market position. To exercise a choice, of risks, to sell one commodity and buy another, is not a hedge; it is merely continuing the risk in a different form. That is what the taxpayer did in this case. It did not retain its crude oil and sell refined; it sold crude and bought refined when it had no actual commodity on hand or future commitments to be protected from price variations. [Emphasis supplied.]

While one may run across an occasional use of the term "hedging" in a broader sense than its traditional meaning, and while there may be, as claimed by the respondent, an opinion in some quarters of the trade n5 that the term encompasses trading done for protective purposes but without price commitments, there seems little doubt as to the legislative intent of the *Commodity Exchange Act* which is necessarily what we are concerned about in this proceeding. Section 4a(3) exempts "bona fide hedging transactions" from trading limit orders and defines bona fide hedging transactions as *sales of futures to the extent that such sales are offset in quantity by purchases of the same cash commodity and purchases of futures to the extent that such purchases are offset by sales of the same cash commodity*. This is the definition of traditional hedging. Paragraphs (A) and (B) add amounts which can be considered as "hedging transactions" under the act, (A) being amounts of a commodity which the trader expects to raise and (B) amounts of futures sales of a commodity which would be a *reasonable hedge* against ownership or purchase of the *products* or *by-products* of the commodity and amounts of futures purchases of a commodity which would be a *reasonable hedge* against sales of *products* or *by-products* of the commodity. As we have pointed out above, "reasonable hedge" in the case of products or by-products of commodities is subject to and governed by the definition of "bona fide hedging transactions" given in section 4a (3).

n5 The respondent, e.g., cites a current rule of Commodity Exchange, Inc., of New York to the effect that (for margin purposes) a hedge shall

include a futures purchase against the sale of a product from the commodity or a related commodity or any amount of such commodity or related commodity which a person in good faith intends to consume as manufacturer, etc.

The legislative history of the act confirms our conclusion that the intent was to exempt from trading limits what was considered to be "legitimate" or "bona fide" hedging, namely, the futures trading supplying protection from price fluctuations to traders in cash commodities and processors having price commitments with respect to the cash commodities or products thereof. See section 3 of the act which contains a legislative finding that futures trading transactions ". . . are utilized by shippers, dealers, millers and others engaged in handling commodities and the products and by-products thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price" [Emphasis supplied.] *Hearings before Committee on Agriculture on H.R. 3009*, 74th Cong., 1st Sess. 104-105, 108 (1935); *Hearings before Committee on Agriculture and Forestry on H.R. 6772*, 74th Cong., 2d Sess. 10-18, 38-46, 231-235, 255 (1936). See also the discussion in the Senate, 80 Cong. Rec. 6161, 7853, 7855, 7909, 7912, 7918, 8012, 8014, 8015, 8086, 8087, 8089 (1936).

Accordingly, it is seen that whatever assurance from the standpoint of getting supplies of corn to process may be afforded the respondent by its purchases of corn futures, such a reason for futures purchases does not make them hedges *under the act*. We come down, then, to the bare question as to whether future, expected, or anticipated sales of corn products and by-products qualify corn futures purchases against such sales as hedges under the act when such sales are not covered by contracts to sell but are forecast or estimated with a high degree of accuracy both as to volume and price.

Anticipated sales of a commodity or its products or by-products are not commitments that qualify futures purchases of the commodity as hedges exempt from trading limits under the act. Regardless of the accuracy of its forecasts, the respondent is under no binding obligation to sell its corn products in any particular amounts at fixed prices. The prices at which it sells its products are not tied down but are free to reflect any changes in the price of corn during the interval between the purchases of the corn futures and the sales of the products. As a matter of economics, then, it would seem that no matter how the respondent keeps its accounts, the respondent is not passing on to others a

market risk when it purchases corn futures but is itself assuming a risk of change in the price of corn. n6 But, at any rate, an examination of the act shows that paragraph (A) of section 4a(3) specifically provides that the amount of a commodity a person is raising or in good faith *expects to raise* may be hedged. This, of course, means that the hedging authorized by paragraph (A) was not allowed by section 4a(3) without paragraph (A) and, since *anticipated ownership* by the raising of a commodity was specifically added to 4a(3) and *anticipated sales of a commodity or products* were not, the inference is obvious that anticipated sales do not afford a basis for hedging under section 4a(3). It is clear, too, that the intention of Congress was to write a tight definition of hedging which would leave little room for broadening by administrative interpretation. n7

n6 See p. 399 of Hoffman, *Future Trading Upon Organized Commodity Markets* (U. of Pa. Press, 1932). Hoffman describes as "open speculation," but commonly associated with hedging, the situation in which a cotton merchant sells futures before he purchases actual cotton although the operation might prove to be a wise policy in view of the type of business anticipated during the forthcoming season.

n7 Senator Pope of Idaho, apparently the floor manager of the bill in the Senate, stated as follows: ". . . the definition of bona fide hedging,

which appears in the first part of the bill, is so specific that no regulation could be made by the Secretary of Agriculture contrary to it or expanding it. I think the definition of hedging is very specific, and is limited strictly to the amount of cash grain, either bought or sold, plus the amount of grain that may be raised for a period of 1 year by one who owns or has rented land or the products and by-products of the commodity. That is so specific and is so definite that, in my opinion, and in the opinion of others who appeared before the committee, there would be no reason to say that the Secretary could go beyond that definition or extend the definition of hedging." 80 Cong. Rec. 7854 (1936).

Any lingering doubts about the act's meaning in this respect are dispelled by the defeat in the Senate of a proposed amendment to the bill that became the act which sought to qualify as hedging under the act futures purchases of a commodity against anticipated sales of the products of the commodity. n8 80 Con. Rec. 7910 (1936). The defeat was due to disapproval of the amendment's objectives rather than, as urged by the respondent, a belief that the amendment was unnecessary because such purchases were treated as hedges by the bill without the proposed amendment.

n8 The proposed amendment was offered by Senator Murphy of Iowa and admittedly sought to enlarge the definition of hedging in the bill to permit large manufacturers of grain to purchase grain futures against anticipated sales of grain products. The justification advanced for the proposed amendment is much the same as that supplied by the respondent in this proceeding. (80 Cong. Rec. 7908 (1936)).

In the light of the foregoing considerations, we disagree with the respondent's claim that its estimated or anticipated sales of

corn products exempt its corn futures purchases as hedges under the act. No part of the corn futures purchases in issue should be classified as hedges under the act due to such anticipated sales of corn products.

III

Next there are for consideration the sales contracts for corn products listed in Finding of Fact 12. As shown by Finding of Fact 12 (a), the respondent had outstanding contracts as of April 11, 1952, with various purchasers, including its subsidiaries, for the sale of starch, syrup and dextrin for delivery within 30 days *at the market price on the day of shipment*, the manufacture of which would require 1,059,000 bushels of corn. Under the pricing provisions of these contracts, there were present no fixed commitments by the respondent as to price. The market prices for the products could reflect any intervening changes in the price of corn between the dates of the sales contracts and the deliveries under the contracts. There was no risk of price fluctuations incurred by the respondent and therefore, any corn futures purchases against such contracts would not be needed to protect against the risk of price fluctuations. We have concluded above that hedging exempted by the act involves the essential characteristic of a price commitment (except in connection with the raising of commodity) with respect to the cash commodity or product and, since such commitment is absent in connection with these contracts, nothing should be deducted as hedges from the respondent's long futures position of 3,650,000 bushels because of these contracts. The contracts with the respondent's subsidiaries, as explained below with respect to the respondent's fixed price contracts with Corn Products Sales Company, are subject to an additional disqualifying factor.

IV

Finding of Fact 12 (b) recites that the respondent had outstanding contracts as of April 11, 1952, with unaffiliated purchasers for the sale by respondent of dextrose, or refined corn sugar, for delivery within 30 days at the market price

on the day of shipment, the manufacture of which would require 547,000 bushels of corn. On the surface, it would appear that the conclusion expressed with respect to the contracts for the sale of starch, syrup, and dextrin also applies to the contracts for the sale of dextrose since the pricing provisions are identical. However, although these contracts provide for the sale of dextrose

for delivery within 30 days at the market price on the day of shipment, it appears from the evidence that the interrelationship between the price of cane sugar and dextrose and the pricing peculiarities of the cane sugar industry operate to result in fixed-price dextrose contracts. The testimony in this proceeding indicates that the market price of dextrose is predictable and is, in actuality, fixed for a period of 30 days because dextrose sells at a fixed differential below the sugar price and sugar prices are fixed for 30 days ahead. While the testimony is not clear as to what happens when sugar prices are reduced rather than advanced, *upon the evidence in this proceeding*, the recommendation of the referee that futures purchases against these contracts be considered hedges under the act is adopted. The amount of such futures purchases to be so considered is determined below.

V

From Finding of Fact 12 (c) it appears that, on April 11, 1952, the respondent had outstanding contracts with its wholly owned subsidiary, Corn Products Sales Company, for the sale by respondent to its subsidiary of dextrose at a fixed price, the manufacture of which would require 2,007,000 bushels of corn. It is complainant's position that the respondent corporation does not subject itself to a market risk or hazard when it sells its products at fixed prices to a wholly owned subsidiary and that, therefore, such contracts could not be the bases for hedges under the act. In the usual case where a processor makes a forward sale based upon then existing prices for the commodity, a market risk is present because a rise in the price of the raw material after the contract is entered into and before the raw material is procured will result in a loss to the seller and a gain to the buyer.

Since the subsidiary is *wholly owned* by the respondent, the subsidiary's profits and losses are those of the respondent. If the price moves against the seller, respondent loses, but as the owner of the buyer, it also gains and *vice versa*. There is, then, no risk of price fluctuations which would qualify the contracts as the bases for hedging operations exempted from trading limits by the act. If this be disregard of the corporate separateness of the sales subsidiary, we think it justified. If large companies having wholly owned sales subsidiaries can make fixed price contracts with their subsidiaries the grounds for hedging, the act's provisions for trading limits would be frustrated by such companies. In the field of public law, corporate separateness is often ignored

where recognition of the separate entity in a particular instance would enable evasion or circumvention of public law. "It is well settled, however, that the corporate entity may be disregarded when failure to do so would enable the corporate device to be used to circumvent a statute." *Alabama Power Co. v. McNinch et al.*, 94 F. (2d) 601, 618 (App. D.C. 1939). See also the numerous cases cited in Fletcher, *Cyclopedia of the Law of Private Corporations*, § 45.

VI

The respondent had outstanding contracts on April 11, 1952, as shown by Finding of Fact 12 (d), for the sale by respondent to unaffiliated foreign purchasers of starch, syrup, and dextrose at fixed prices, the manufacture of which would require 207,000 bushels of corn. The complainant concedes that futures purchases against such contracts are hedges under the act. These contracts provide for the sale of corn products at fixed prices and consequently create a market risk. Therefore, respondent's long futures position should be reduced because of such contracts, the amount to be computed below, in

determining whether respondent's long position exceeded the trading limit established by the commission.

VII

Finding of Fact 12 (e) discloses that the respondent, on April 11, 1952, also had outstanding contracts for the sale by respondent to unaffiliated purchasers of 41,000,000 pounds of gluten feed and meal for delivery within 30 days at fixed prices which would require 3,090,000 bushels of corn to manufacture. These sales would appear to be items against which the purchase of corn futures would be a hedge under the act. The question remains, however, as to the amount of corn futures that may be purchased as a hedge thereon. The respondent contends that it should be permitted to classify the entire 3,090,000 bushels of corn futures as hedges. The complainant, on the other hand, contends that only about 770,000 bushels of corn futures may be so classified because feed and meal are corn by-products and represent only about one-fourth of the total products derived from the milling of corn.

The respondent does not claim that it has fixed price commitments for the sale of the starch or starch products, but only for the by-products, feed and meal, which represent approximately one-fourth of the yield from a bushel of corn. Section 4a(3)(B) of the act provides that "there shall be included in the amount of any commodity which may be hedged . . . an amount

of such commodity . . . the purchase of which for future delivery would be a reasonable hedge against the sale of any product or byproduct of such commodity" [Emphasis supplied.] Where futures are purchased as a hedge against a sale of the commodity itself, there is no problem as to quantity. Section 4a(3) of the act provides that bona fide hedging means the purchase of any commodity for future delivery to the extent such purchases are offset by sales of the same cash commodity. n9 However, when dealing with the purchase of futures against the sale of products or by-products of a regulated commodity, the statute contains the qualification as to reasonableness of amount of futures that may be purchased as a hedge. The purchase of a given amount of corn futures would be a reasonable hedge against the forward sale at fixed prices of all the products of such amount of corn, but it is not believed that it would be a reasonable hedge against the sale of only a fourth of such products. Where the commodity yields different processed products, there would be considerable duplication if each product were hedged as if it were the total yield of the commodity processed. *Since the respondent has a market risk only with respect to one-fourth of the 3,090,000 bushels of corn, the purchase of corn futures beyond 770,000 bushels because of such risk could not be considered a reasonable hedge.* This is especially so in view of the legislative intent to restrict and define the amount of futures that may be purchased as a hedge. The amount of futures purchases to be deducted from the respondent's position as hedges because of these contracts is computed below.

n9 Senator Pope, when explaining the bill in the Senate, stated: "The important thing in that connection is that on one side or the other of these transactions exists a cash commodity, and as the cash commodity is necessarily limited in amount, the future trading would be limited to the amount of the cash commodity." 80 Cong. Rec. 6161 (1936). See also Hearing Before Committee on Agriculture and Forestry on H.R. 6772, 74th Cong., 2d Sess., 201 (1936).

VIII

We come next to the respondent's "cerelose operations" described in Finding of Fact 14. Cerelose is the respondent's brand name for dextrose. These operations consist of the purchase of corn futures against the simultaneous sale of raw sugar futures and cottonseed oil futures. It is respondent's position that this operation is a reasonable hedge under the act because it insures the

profit which it expects to realize from its anticipated dextrose production. On April 11, 1952, respondent was long 510,000

bushels of December corn futures as against a short September and October futures position of 7,000 long tons of raw sugar and 840,000 pounds of cottonseed oil, respectively. Respondent's explanation of this transaction is that the cost of production of dextrose is determined by the cost of corn, but its selling price is determined by the price of refined cane sugar with which it competes. In planning future production and sales of dextrose, the respondent observes the relationship between the price of cane sugar and the price of corn and determines when this relationship is such that if cash corn were obtained and manufactured into dextrose, the dextrose could be sold at a fair profit. It then buys corn futures in an amount equivalent to its expected dextrose production. In the course of producing dextrose, corn oil is derived as a by-product. There is no corn oil futures market, but corn oil competes with cottonseed oil and its price is related to the price of cottonseed oil. Accordingly, in order to fix the selling price of corn oil which will be produced together with the dextrose, the respondent sells cottonseed oil futures in an amount equivalent to its expected corn oil production. All these futures operations are conducted simultaneously.

Respondent appears to be contending that the purchase of the 510,000 bushels of corn futures is a reasonable hedge against the anticipated production and sale of dextrose and that "the fact that in the dextrose price insurance operation other commodities are used does not affect the validity of the purchase of corn futures against the sale of corn products as a hedge under the Act." Anticipated sales of dextrose, as we have concluded above, do not afford a valid basis under the act for classifying futures purchases against such sales as hedges. The purchase of corn futures against sales of cottonseed oil futures and sugar futures is a straddle and not a hedge. Under section 4 of the act a futures purchase of a commodity can be a hedge only against the sale of such commodity or a product or by-product thereof. Sales of sugar and cottonseed oil futures are not sales of the commodity, corn, or products or by-products thereof, with respect to which the futures purchases are made.

IX

We have determined, then, that there exists bona fide hedging under the act for corn futures purchases by the respondent (1) against the respondent's sales contracts for dextrose described in Finding of Fact 12 (b), (2) against the respondent's fixed price sales contracts for starch, syrup and dextrose to foreign purchasers

described in Finding of Fact 12 (d), and (3) against the respondent's sales contracts for meal and feed described in Finding of Fact 12 (e). Regarding 547,000 bushels of corn futures purchases as a hedge for the dextrose contracts mentioned in Finding of Fact 12 (b) and 207,000 bushels of corn futures purchases as a hedge for the contracts mentioned in Finding of Fact 12 (d), there is available a total of 754,000 bushels as a hedge against these contracts. About one-fourth of the production from a bushel of corn is feed and meal so that in addition to serving as hedges for the sales contracts for dextrose, starch and syrup, one-fourth of the 754,000 bushels, or 188,500 bushels, should also serve as a hedge against the respondent's feed and meal sales contracts referred to in Finding 12 (e). Deducting these 188,500 bushels from 770,000 bushels which is a reasonable hedge for the 41,000,000 pounds of feed and meal contracts, leaves 581,500 bushels of futures to be added to the 754,000 bushels to get the total bushels of corn futures purchases exempt from trading limits as hedges. The total is 1,335,500 bushels. Subtracting this total from the respondent's net long position on April 11, 1952, of 3,650,000 bushels gives a result of 2,314,500 bushels or a net long position in excess of the trading limit of 2,000,000 bushels. Accordingly as alleged in the

complaint, the respondent by virtue of its net long position in corn futures on April 11, 1952, and thereafter violated section 4a of the act and the order of the commission.

Respondent contends that because the 2,000,000 bushels limit, as here interpreted, is the equivalent of the corn requirements of its competitors for from 60 days to a year, but of respondent's requirements for less than two weeks, the limit discriminates against respondent in violation of the due process clause of the Fifth Amendment. It also alleges that because the law prescribes no trading limits for sugar futures, limits on corn futures unlawfully discriminate against respondent by restricting it while not restricting its competitors who sell cane sugar. Even if it were appropriate for an agency charged with administering a statute to declare it unconstitutional, we would not do so on these grounds. A regulation is not unlawful because it may bear more heavily upon one than upon another. *Bowles v. Willingham*, 321 U.S. 503, 518 (1944); *Secretary of Agriculture v. Central Roig Refining Company*, 338 U.S. 604, 618-619 (1950). "Congress may choose the commodities and places to which its regulation shall apply." *Currin v. Wallace*, 306 U.S. 1, 14 (1939).

All exceptions, suggestions, objections, arguments, etc., of the respondent inconsistent with this decision and order are overruled.

The sanction authorized by section 6(b) of the act is an order to the contract markets requiring such markets to refuse for a specified period all trading privileges thereon to a person who has been found to have violated the act or any of the rules and regulations thereunder. The act provides for a court review of such an order to refuse trading privileges. The matters involved in this proceeding present issues upon which honest differences of opinion may exist and which have not been settled by court decisions under the act. Any sanction, therefore, should be a minimum one. In the light of all the circumstances, it is concluded that an order should be issued requiring the contract markets to refuse all trading privileges to the respondent for a period of one day.

ORDER

Beginning on the 30th day after the date of this order, all contract markets shall refuse all trading privileges thereon to the respondent, Corn Products Refining Company, for a period of one day.

A copy of this decision and order shall be served upon the respondent and upon each contract market.

LOAD-DATE: June 8, 2008

