Commodity Futures Trading Commission
CEA CASES

NAME: HOHENBERG BROTHERS COTTON COMPANY AND JULIEN J. HOHENBERG

CITATION: Comm. Fut. L. Rep. (CCH) P20,146; [1975-1977 TRANSFER BINDER]

DOCKET NUMBER: 75-4; 223

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NOTE: FORMERLY CEA DOCKET # 223

[P 20,146] In Re Hohenberg Brothers Cotton Co., et al.

Commodity Futures Trading Commission. March 2, 1976. CFTC Docket No. 75-4 (formerly CEA Dkt. No. 223). Opinion in full text.

Manipulation -- Intent to Manipulate -- Burden of Proof Not Met. -- A trader in futures contracts can not be held liable for manipulation of market prices or attempt to manipulate prices if the trader's mental attitude can not be shown to embody a manipulative intent and this intent can not be shown beyond a reasonable doubt as being clearly exposed by the trader's actions as being the motive for its actions. Here a trader was alleged by the Commodity Exchange Authority to have tendered delivery on a short position on the first day of notices, so as to depress the market and create an opportunity to roll over a long hedge at a price that would outstrip any losses on the delivery currently tendered. The administrative law judge found that no evidence was introduced nor charge made that a manipulation of the price took place. The findings were that the trader's delivery notices were all stopped, thereby not depressing the market. A hypothesis proposed by the expert for the CEA allegedly showing a motive for manipulation was rejected by the administrative law judge for not clearly showing the supposed profit motive. Intent could not be imputed where the facts did not clearly show a profitable motive or a demonstrated capability of realizing a manipulation. Speculation on the trader's thought processes that evaded demonstration was considered by the administrative law judge as being beyond the reach necessary for effective regulatory implementation of the Commodity Exchange Act.

See P 10,025 and 10,310, "Liabilities -- Prohibitions" division.

Preliminary Statement

This is an administrative proceeding under the Commodity Exchange Act (7 U. S. C. §§ 1 *et seq.*, hereinafter referred to as the "Act"), which was instituted by a Complaint and Notice of Hearing filed on February 6, 1974, by the Assistant Secretary of Agriculture. The complaint charges the respondents with attempting to manipulate the price of the December 1971 cotton future on November 23, 1971, in willful violation of 7 U. S. C. 9, 13b and 13(b)). n1

n1 § 9.

"If the Secretary of Agriculture has reason to believe that any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in Interstate commerce, or for future delivery on or subject to the rules of any contract market, or has willfully made any false or misleading statement of a material fact in any registration application or any report filed with the Secretary of Agriculture under this chapter, or willfully omitted to state in any such application or report any material fact which is required to be stated therein, or otherwise is violating or has violated any of the provisions of this chapter or of the rules, regulations, or orders of the Secretary of Agriculture or the commission thereunder, he may serve upon such person a complaint stating his charges in that respect, which complaint shall have attached or shall contain therein a notice of hearing, specifying a day and place not less than three days after the service thereof, requiring such person to show cause why an order should not be made prohibiting him from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Secretary of Agriculture, and to show cause why the registration of such person, if registered as futures commission merchant or as floor broker hereunder, should not be suspended or revoked. Said hearing may be held in Washington, District of Columbia, or elsewhere, before the Secretary of Agriculture, or before a referee designated by the Secretary of Agriculture, which referee shall cause all evidence to be reduced to writing and forthwith transmit the same to the Secretary of Agriculture. Upon evidence received, the Secretary of Agriculture may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant or as floor broker hereunder, may suspend, for a period not to exceed six months, or revoke, the registration of such person. Notice of such order shall be sent forthwith by registered mail or by certified mail or delivered to the offending person and to the governing boards of said contract markets. After the issuance of the order by the Secretary of Agriculture, the person against whom it is issued may obtain a review of such order or such other equitable relief as to the court may seem just by filing in the United States court of appeals of the circuit in which the petitioner is doing business a written petition praying that the order of the Secretary of Agriculture be set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Secretary of Agriculture and thereupon the Secretary of Agriculture shall file in the court the record theretofore made, as provided in section 2112 of Title 28. Upon the filing of the petition the court shall have jurisdiction to affirm, to set aside, or modify the order of the Secretary of Agriculture, and the findings of the Secretary of Agriculture as to the facts, if supported by the weight of evidence, shall in like manner be conclusive.

§ 13.

(a) * * *

(b) It shall be a felony punishable by a fine of not more than $ 10,000 or imprisonment for not more than five years, or both, together with the costs of prosecution, for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any contract market, or to corner or attempt to corner any such commodity, or knowingly to deliver or cause to be delivered for transmission through the mails or in interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.

* * *

§ 13b. Manipulations or other violations; cease and desist orders against persons other than contract markets; punishment; misdemeanor or felony; separate offenses

If any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, or otherwise is violating or has violated any of the provisions of this chapter or of the rules, regulations, or orders of the Secretary of Agriculture or the

> commission thereunder, the Secretary may, upon notice and hearing, and subject to appeal as in other cases provided for in section 9 of this title, make and enter an order directing that such person shall cease and desist therefrom and, if such person thereafter and after the lapse of the period allowed for appeal of such order or after the affirmance of such order, shall fail or refuse to obey or comply with such order, such person shall be guilty of a misdemeanor and, upon conviction thereof, shall be fined not less than $ 500 nor more than $ 10,000, or imprisoned for not less than six months nor more than one year, or both, except that if such failure or refusal to obey or comply with such order involves any offense within paragraph (a) or (b) of section 13 of this title, such person shall be guilty of a felony and, upon conviction thereof, shall be subject to the penalties of said paragraph (a) or (b): Provided, That any such cease and desist order against any respondent in any case of manipulation of, or attempt to manipulate, the price of any commodity shall be issued only in conjunction with an order issued against such respondent under section 9 of this title. Each day during which such failure or refusal to obey or comply with such order continues shall be deemed a separate offense."

Extensions of time for filing an answer having been granted, an answer to the complaint was timely filed on April 5, 1974. A Motion for a Bill of Particulars was filed by respondents on April 5, 1974, followed by briefs of the parties. By written opinion filed on May 8, 1974 the motion was denied. A prehearing conference on the matter was held on July 2, 1974, and a summary of the prehearing conference was filed by the Administrative Law Judge.

Oral hearing on the matter was held in a conference room of the United States Department of Agriculture, Washington, D. C., on September 24, 25, 26 and 27 and October 7, 8, 9, 10 and 11, 1974. Complainant is represented by Richard W. Davis, Jr., Esq., Office of the General Counsel,

United States Department of Agriculture, and respondents are represented by William H. Allen, Esq., Richard L. Dashefsky, Esq., Bingham B. Leverich, Esq., and Michael A. Schlanger, Esq., of Covington & Burling, Washington, D. C., and William W. Goodman, Esq., of Goodman, Glazer, Strauch & Schneider, Memphis, Tennessee. Subsequent to the hearing and transfer of functions from the Commodity Exchange Administration in the United States Department of Agriculture to the Commodity Futures Trading Commission, a new independent agency, complainant is represented by Darrold A. Dandy, Esq., and William R. Schief, Esq., attorneys of the Commodity Futures Trading Commission.

Both parties to the proceeding at various times requested extensions of time for filing briefs and other documents. The final brief in this matter was filed by respondent on November 12, 1975. On November 25, 1975, the parties filed a stipulation covering corrections to the transcript of the hearing. Complainant's counsel filed certain additional corrections to the transcript which were not covered by the stipulation.

On October 23, 1974, following the oral hearing and before submission of briefs, Congress amended the Commodity Exchange Act by enactment of the Commodity Futures Trading Commission Act of 1974 (Pub. Law 93-463, October 23, 1974, 88 Stat. 1389). The amendments were made effective on April 21, 1975. Among the amendments were those which 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.

Section 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."

This case was heard prior to April 21, 1975, and jurisdiction for purposes of this decision is retained in accordance with the cited statutory provisions, together with the necessary inter-agency authorizations.

The Issues

Complainant charges respondent company and its President with violation of § 9 of the Commodity Exchange Act for intent to manipulate the market price of cotton as demonstrated by the manner in which the company traded in cotton futures on the New York Cotton Exchange. Specifically, complainant contends that respondent company's act of tendering cotton for delivery against 357 short contracts of the December 1971 future on first notice day (November 23, 1971) was intended to depress the price of spot cotton and the December future to its advantage. The advantage inferred was that by depressing the price of spot cotton and the December future respondent company would create an opportunity for it to buy spot cotton, or the December future, on the market at a price cheaper than the costs involved in its December future short contracts. It would then be in a position to tender spot cotton or December futures purchased against its short position, transfer its hedge to March or May, 1972 futures at no cost, or at least at a cost less than its paper loss on its short position in the December future. The contention is that such a course of action and events were anticipated to reduce respondent company's paper loss on its December short contracts, while at the same time retaining its hedge against its inventory or long position.

Complainant contends that the first step in this intended course of action was taken by respondent company's tenders on November 23, but that the planned course of action, and its hoped for results, were frustrated by Plains Cotton Cooperative's action in promptly stopping all of the notices. Complainant does not contend that respondents actually manipulated the price of cotton -- only that they intended to do so, which is a violation of the Act.

Respondent alleges that the actions taken by respondent company on November 23 were not intended to depress the price of cotton or the December future to its advantage as alleged, and avers that its actions were consistent with good market practices of a large cotton merchant in response

to prevailing market conditions and its overall position in the market.

Findings of Fact

1. Hohenberg Bros. Company (misnamed in the complaint as Hohenberg Bros. Cotton Company), a corporation with its principal office and place of business at 266 South Front Street, Memphis, Tennessee, is now and was at all times material herein operating as a cotton merchant.

Julien J. Hohenberg, an individual whose business address is the same as that of Hohenberg Bros. Company, was at all times material herein the president of Hohenberg Bros. Company and a member of the New York Cotton Exchange. At all times material herein, respondent Hohenberg held more common, voting, stock of the Company than any other person.

2. The New York Cotton Exchange is now and was at all times material herein a duly designated contract market under the Commodity Exchange Act.

3. The actions of the respondents in these proceedings relate to the purchase and sale of December 1971 cotton futures contracts on, and subject to, the rules of the New York Cotton Exchange. The type cotton contract referred to in this proceeding is the No. 2 contract. The first day that this future was open for trading was August 10, 1970. Trading in this future began on October 2, 1970. The first day on which notice could be given of intent to deliver spot cotton in

satisfaction of contracts in this future (first notice day) was November 23, 1971. The last day on which trading in this future was conducted (last trading day), was December 9, 1971. The last day on which spot cotton could be delivered in satisfaction of contracts in this future (last day to deliver) was December 23, 1971.

4.(a) The basis of the No. 2 contract is Middling 1-1/16 inch cotton with premiums and discounts allowed between deliverable grades (Good Middling down through Low Middling White and Good Middling through Middling Light Spotted) and staples (1-1/32 to 1-3/32 and up). The price differences for deliverable grades and staples above and below Middling 1-1/16 cotton are based on the average of the commercial differences for corresponding grades and staples quoted by the USDA for Greenville, South Carolina; Greenwood, Mississippi; Memphis, Tennessee; Dallas, Texas; and Phoenix, Arizona. Tenderable cotton must have a micronaire of between 3.5 and 4.9 and must be of United States growth.

(b) Rain-grown and nonrain-grown cotton are both tenderable on the No. 2 contract.

(c) The size of each contract is 100 bales with a total weight of 50,000 pounds (net). Exchange rules permit a one percent weight variance, thus making the minimum deliverable weight 49,500 pounds and maximum weight 50,500 pounds.

(d) All cotton futures price quotations are in cents and hundredths of a cent per pound. Minimum fluctuation is 1/100 of a cent, which is equal to $ 5 per contract. No trades may be made at more than 2 cents per pound above or below the previous day's close and the range during any one day must not exceed 2 cents per pound, except on or after the first notice day of the current delivery month.

(e) All trading in the current delivery month ceases two hours after the opening on the tenth business day prior to the last delivery day of the calendar month (sixteenth business day prior to end of calendar month).

(f) In reference to delivery months, Exchange rules state that "trading can be made for the current month and one or more of the 17 succeeding months, or, if so ordered by the Board of Managers, for one or more of the six months next succeeding the 17 months." The Exchange, however, currently trades in the October, December, March, May, and July delivery months.

(g) Certificated cotton is cotton inspected, weighed, and sampled under New York Cotton Exchange supervision, and is determined deliverable on futures contracts upon classification, review, and micronaire test under USDA regulations.

(h) Exchange rules aso provide for issuing notices based on deliverer's class. Under this provision, the notice issuer may state his "own classification" on last notice day if government certificates have not been issued. Samples of the cotton, however, must be delivered to the USDA in readiness for classification not later than 8 p.m. on the second business day preceding the last delivery day. If the contract is short in weight, due to untenderable cotton when the cotton is finally delivered, then the deliverer has no right of replacement and is

in default to the extent of the deficiency of tenderable cotton.

(i) Cotton remaining under certification for a period exceeding 6 months incurs the following weight reduction penalties when delivered:

(1) 3 pounds per bale per month for the seventh through the twelfth month;

(2) 4 pounds per bale per month for the thirteenth through the eighteenth month;

(3) 5 pounds per bale per month for the nineteenth through the twenty-fourth month;

(4) 6 pounds per bale per month for the twenty-fifth month and each month thereafter.

(j) Delivery points for the No. 2 contract are New Orleans, Louisiana; Houston, Texas; Galveston, Texas; Memphis, Tennessee; and Greenville, South Carolina.

5. At the beginning of trading on May 5, 1971, the respondent company's short futures position was 376 contracts, 6.6 percent of the short open interest. The monetary value of an equivalent amount of spot cotton would have been approximately $ 5,-750,000. At the beginning of trading on June 9, 1971, respondent company's short futures position was 914 contracts, 9.8 percent of the short open interest. The monetary value of an equivalent amount of spot cotton would have been approximately $ 13,900,000. At the beginning of trading on October 21, 1971, respondent company's short futures position was 735 contracts, 13.9 percent of the short open interest. The monetary value of an equivalent amount of spot cotton would have been approximately $ 11,600,000. At the beginning of trading on November 23, 1971, first notice day, respondent company's short futures position was 936 contracts, 46.3 percent of the short open interest. The monetary value of an equivalent amount of spot cotton would have been approximately $ 14,500,000.

6. On October 15, 1971, respondent company's short position was 795 contracts, 14.4 percent of the short open interest. The position of the other largest short reporting trader was 1,042 contracts, 18.9 percent of the short open interest. On October 22, 1971, respondent company's short position was 780 contracts, 15.5 percent of the short open interest. The position of the other largest short reporting trader was 886 contracts, 17.6 percent of the short open interest. On October 29, 1971, respondent company's short position was 936 contracts, 19.4 percent of the short open interest. The position of the other largest short reporting trader was 836 contracts, 17.4 percent of the short open interest. On November 5, 1971, respondent company's short position was 987 contracts, 23.0 percent of the short open interest. The position of the other largest short reporting trader was 654 contracts, 15.2 percent of the short open interest. On November 12, 1971, respondent company's short position was 973 contracts, 29.2 percent of the short open interest. The position of the other largest short reporting trader was 407 contracts, 12.2 percent of the short open interest. On November 19, 1971, respondent company's short position was 915 contracts, 40.3 percent of the short open interest. The position of the other largest short reporting trader was 120 contracts, 5.3 percent of the short open interest. On November 22, 1971, respondent company's short position was 936 contracts, 46.3 percent of the short open interest in the December future. The position of the other largest short reporting trader was 120 contracts, 5.9 percent of the short open interest.

7. In addition to its open short future position, respondent company on November 19, 1971 (the last date before first notice day of the December 1971 future for which accurate information is available), owned approximately 48,000 bales of *certificated* cotton, or approximately *58 percent* of the total certificated stock. This contrasts with the company's total open short position on November 22, 1971, of 936 contracts, or approximately 93,600 bales. The evidence discloses that respondent company's total open short position of 93,600 bales represented only a fraction of the free supply of approximately 8,000,000 bales that had been ginned and could have been certified, or could have been tendered without certification through the deliverer's class procedure.

8. The evidence discloses that throughout the period from early May through December 1971 the overall position of respondent company was that of maintaining a long position which was never completely hedged by its short position in the futures market. Respondent company is a very large cotton merchant and, as such, uses the futures market to hedge its transactions. The evidence establishes that respondent company hedged its long position to the extent its management thought reasonable and

prudent to do so in the light of its cotton supply for resale. n2 During the period May through November 1971, respondent company's principal short hedge was in the December 1971 future. This is the usual hedge because the cotton contracted for from suppliers would come to market in October and November, and, also, because December was the most liquid month in relation to cotton suppliers. This fact is evidenced by the larger amount of trading and the open interest in the December future over the futures of other months.

n2 On November 19, 1971 (the last date for which statistics are available), respondent company had 162,100 bales of raw cotton on hand, or the equivalent of 1,620 contracts valued at approximately 25 1/2 million dollars.

Mr. Julien Hohenberg testified that during the period October 1, 1971, and November 22, 1971, the company increased its short position in the December future because it was receiving a large amount of cotton during this period under contracts and commitments with farmers which had been made previously. This new supply, in addition to what was already held, made it prudent for the company to increase its short position to hedge its increasing supply position. He further testified that the quality of the cotton being produced to fill the company's commitments with farmers was fairly short staple and readily marketable to its customers.

9. The evidence discloses that during the period from October 1, 1971, to November 23, 1971 (first notice day), there was a downward trend in the price of the December 1971 future.

10. The evidence discloses that the 48,000 bales of *certified* cotton which respondent company held on November 19, 1971, was the remainder of a larger amount acquired in May 1971, when respondent company was a successful bidder on 102,000 bales of cotton offered by the Commodity Credit Corporation. Respondent company's purchase was a part of a 540,000 bale sale by the CCC. At the time the price was attractive, but subsequently, the December future price fell sharply because of increased potential supplies then in the fields. As a result of a combination of circumstances, respondent company held this CCC cotton at a substantial loss vis-a-vis its replacement value in spot cotton during the summer months of 1971. Respondent company promptly disposed of as much of this CCC cotton as it could to the trade, but its sales of cotton during the period May through November were substantially lower grades and shorter staple length, whereas the CCC cotton was in a range of grades and staple lengths.

Between July and September 1971 all of the CCC cotton purchased by respondent company was certified. Mr. Julien Hohenberg testified that the reason for having this cotton certified at that time was that certification at the time of settling with the CCC for the cotton saved money. The same procedures, such as classifying, weighing, etc., served a dual purpose, so that simultaneous certification with settlement could be accomplished by use of the same documents. Certification also gave the company the protection of greater flexibility in handling this cotton by making it available for tender against its short position, while at the same time preparing it for sale.

11. The evidence discloses that sometime in October the respondent company had on hand a substantial amount of certified CCC cotton which it had not disposed of. This was sorted in terms of grades, with the result that it had approximately 48,000 bales of certified CCC cotton in grades that were not currently selling very well. This was the certified cotton on hand on November 19, 1971, referred to *supra.*

12. Sometime prior to November 23, 1971, Mr. Joseph P. McMahon, a floor broker on the New York Cotton Exchange and the managing partner of an affiliate of the respondent company herein, and the person who handled the futures trading of the respondent company during October and November 1971, testified that he did not think that there were any large long positions in the December 1971 future. He had previously communicated this view to Mr. Julien Hohenberg. The evidence (Exhibit 14) is that the November 22, 1971 Daily Market Report of the

Cotton Exchange shows that on November 19 there was an open interest in the December 1971 future of 227,700 bales. This same report showed 83,000 bales of certified cotton available for delivery (or tender).

13. Shortly before November 23, Mr. Preston Davis, a cotton buyer with long experience in spot cotton and cotton futures trading, informed Mr. Julien Hohenberg that he believed that Plains Cotton Cooperative Association held a large long

position in the December 1971 cotton future. He, also, informed Mr. Julien Hohenberg that he believed that Plains Cooperative would take delivery of spot cotton offered in satisfaction of December future contracts.

14. On November 22, 1971, the day before first notice day of the December 1971 future, Mr. Julien Hohenberg telephoned Mr. Henry C. Patton, sales manager of Plains Cotton Cooperative Association. During the course of the telephone conversation, Mr. Hohenberg stated that he intended to tender cotton in satisfaction of respondent company's short futures position. He further stated that some of the cotton to be tendered would be penalty cotton and was of grades and staples not then in great demand by his company's customers.

Mr. Dan W. Davis, general manager and executive vice-president of Plains Cotton Cooperative Association, listened in on the telephone conversation between Mr. Patton and Mr. Hohenberg. He testified that he concluded as a result of the conversation that Mr. Hohenberg would probably tender cotton the following day.

Although the conversation indicated that Mr. Hohenberg was seeking to ascertain Plains Cotton Cooperative's probable response to tenders, Mr. Patton did not commit himself as to whether or not he would stop the cotton if tendered, n8 nor did he state the extent of Plains long position. The officials of Plains Cooperative testified that they understood Hohenberg was trying to get information from them, but did not tell them anything about the cotton they didn't already know. The quality, grade, etc. is shown on the certificates. After Hohenberg's call the two Plains officials speculated as to the purpose of the call. They inferred that Mr. Hohenberg would have preferred that Plains not stop the cotton if tendered. However, their own views of the situation, and their position in the market made them bullish on the prospects. On cross-examination the officials stated that, while at the time of the call they thought the call was unusual, this was the first experience they had in such a situation. Subsequent experience caused them to conclude that there was nothing unusual in Hohenberg's call or the nature of the conversation.

n8 "Stop the action" means accept delivery of the cotton tendered against respondent company's short position.

15. On November 23, 1971, first notice day, respondent company tendered 357 transferable notices of delivery of spot cotton in satisfaction of that much of its 936 open short December future contracts. The evidence discloses that Plains Cooperative had a long position in December futures and promptly commenced stopping the respondent company's 357 notices shortly after opening of trading at 10:30 a.m. All of the notices had been stopped by noon.

16. The price of the December 1971 future rose continuously from 31.15 on November 22, 1971, to 33.45 on December 2, 1971, after which it fluctuated in a narrow range until it closed on December 9, 1971, at approximately 33.44. Beginning on November 23, first notice day of the December future, the price of the March 1972 future rose through December 31, 1971. The spot price quotation also rose from 30.25 on November 22, 1971, to 33.67 on December 31, 1971.

17. On November 30, 1971, respondent company tendered an additional 105 transferable notices of delivery against its remaining open short December future contracts. On December 1, 1971, it made a further tender of 25 notices against its remaining open short December future contracts. These also were

stopped. As a result of these actions respondent company moved its remaining inventory of 48,000 bales of certified CCC cotton purchased in May. It transferred forward to the March future the remainder of its short position in the December 1971 future.

18. The evidence discloses that Plains Cooperative took approximately a total of 70,000 bales of cotton tendered, and retendered, against December 1971 short contracts by the market as a whole. The testimony of Plains officials and their action in the market disclosed that on November 23 Plains had a long position in both December and March futures of over 200,000 bales, or 2,000 contracts. These were substantially all in December futures. There is no official government publication which identified a person's, or company's, long position, so that respondent company's officials and the market did not know the extent of Plains' position on November 23. Only the

total long and short positions in a particular future are published periodically.

19. In substantial part, complainant's contention is based on a calculation made by Dr. Wayne L. Olson, Director, Trading Division of CEA that on November 23, 1971, respondent company had a paper, or potential, loss in its short position of $ 270,000. This sum, according to Dr. Olson's testimony was calculated by taking the *average* price of respondent company's short position in the December 1971 future on November 22 and the closing price of the future on that day. As a result of this calculation he concluded that respondent company could probably have transferred its total hedge of the December future into March, or May, futures and maintained its same relative dollar position. He further contends that respondent company's failure to do so was so irregular as to impute a specific illegal motive or intent to the actions taken by it. However, all of the testimony of experts, together with that of respondent company officials, is to the effect that a *cotton merchant* does not make, and is not interested in the sort of day to day computations made by Dr. Olson. Respondent company didn't make this kind of computation, because it was meaningless. It does not conduct its trading activities on the basis of any such computation. The substantial reason for this is that a cotton merchant uses the commodity exchange for hedging against inventory positions and commitments to purchase or sell cotton to its customers. The taking of the short position by respondent company, as shown by the facts, was solely for the purpose of hedging. Dr. Olson freely admits this.

The evidence further discloses that on November 22, respondent company had a long position of 162,000 bales and a short position in the December future of 96,000 bales, so that it was less than 60% hedged on that date in this future. In this kind of situation it is obvious that, to the extent of its hedge, day-to-day calculations of the dollar value of its position based on cost were meaningless, because what it stood to lose on its short position was balanced by its long position. This was respondent company's situation on November 23, 1971. Respondent company's short position was far from being greater than its counterbalancing long position. Thus it had no primary concern about the vulnerability of its short position as such.

While it is true that a cotton merchant is not disinterested in taking profits in trading on the exchange when it can be done to advantage, it is equally true, as admitted by Dr. Olson, that it is risky to do so. A hedged position for a cotton trader is entirely different from a purely *speculative* trader's position. Dr. Olson's calculation and the observation he made based upon it, has little significance to a hedged cotton merchant, whose principal business is buying and selling cotton. It may have significance to a pure *speculator,* whose sole objective is to trade in the fluctuations of the market, i. e., the difference between the costs of a contract in which a position is taken and the current values of a similar, or identical, contract at any specific time in the market. No evidence was adduced to show that the nature of respondent company's position, or attitude, had changed on November 23 from that of a cotton merchant to that of a speculator. The evidence is all to the contrary. In the circumstances of this case Dr. Olson's calculation can provide no realistic basis from which to project his conclusion that the specific *intention* of respondent company's officials was to speculate in short positions in the December future rather than continuously act as a cotton merchant and maintain a hedged position and attitude.

20. Underlying complainant's charge is an implication that there was something suspicious and illegal about respondent company's tender of cotton on first notice day, which caused it deliberately to risk taking an alleged $ 270,000 loss, when it allegedly could have transferred its short future position to March, or May, futures and at probably no great cost, if any, due to the spread between the futures. The fact is that between first notice day until last day of trading in the December future respondent company had to do something -- either tender cotton against its short position, or transfer forward its short position. A business decision had to be made. The evidence discloses that at no time prior to November 23 was the spread between the December 1971 future and the March 1972 future equal to the carrying charge. Further, not to tender cotton against its December short position would have required respondent company to carry its present investment in inventory over entirely, as well as pay the necessary additional carrying charges incident to transferring its short position forward. Such an action would have included the necessity of carrying the 48,000 bales of certified CCC cotton in inventory, for which it had no present or immediately foreseeable demand due to the staple length of this particular cotton. The respondent company had over $ 7,000,000 of working capital tied up in this particular 48,000 bales. n4

n4 It is this cotton which was tendered by respondent company on November 23, November 30 and December 1. (Findings of Fact 15, 17.)

Assuming for the sake of demonstration that the spread between the shorts of the December and March futures were such that they could have been interchanged without cost, the respondent company would have had to carry over 48,000 bales of certified cotton in slow-moving inventory. The cost of storage on this cotton, the amount of penalties that would be incurred at a future delivery date, commissions on sale, insurance, the value of interest on this $ 7,000,000 inventory represented by it, together with other economic and marketing conditions, had to be weighed against the alleged $ 270,000 paper loss on respondent company's short position. All of the expert witnesses who were experienced in marketing activities testified that respondent company's decision to tender cotton in the circumstances was prudent and sound. Only Dr. Olson disagreed. However, it was admitted that Dr. Olson's experience in marketing cotton in vicarious only, so his judgment in the matter is somewhat academic. We consider the testimony of the expert witnesses in this matter to be more credible. Moreover, it is highly unlikely that respondent company would have made the additional tenders of the remainder of the 48,000 bales on November 30 and December 1 on a rising market if it were not seriously interested in switching this part of its inventory into more marketable qualities of cotton, and doing it in the least expensive manner consistent with the company's total business activities and objectives.

The *total* cost of carrying over this 48,000 bales was not computed or considered by Dr. Olson. Although this total cost was not computed, and is not in evidence, it would definitely have exceeded the spread between the futures and (possibly) would have exceeded $ 270,000. Respondent company officials had to consider these additional costs in coming to a conclusion of whether or not to tender cotton on November 23. They testified that they decided the best course of action was to tender the cotton -- and they did. Since Dr. Olson's theory considered primarily the one element of spread between the December 1971 and the March 1972 futures on November 23, his computation is patently deficient to serve as a realistic basis for construction of the intent behind respondent company's actions. It is not scientifically feasible to use what one does not know as support for the validity of a deduction or conclusion that cannot otherwise stand.

21. Complainant assumes that respondent company issued notices of tender against 357 short contracts on first notice day for the sole purpose of, and with the intent of, driving the spot market and/or the December future down. In support of this assumption of intent complainant relies almost entirely on the history of market price movements on first notice day as demonstrated in its Exhibit No. 26, which is set forth below:

"TABLE OF TENDERS ON CONTRACT ON FIRST NOTICE DAY IN RELATION TO OPEN INTEREST ON THAT DATE

	Tenders Issued On First Notice Day	Passes	Open Interest On First Notice Day	Percentage Of Open Interest	Price Change
December 1967	170	95	380	45%	Plus .32
March 1968	116	144	779	15%	Plus .11
May	24	53	1304	2%	Plus .11
July	24	76	806	3%	Plus .17
October	107	316	829	13%	Minus .82
December	37	74	641	6%	Plus .13
March 1969	259	283	728	36%	Minus .04
May	135	118	508	27%	Plus .20

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	Tenders Issued On First Notice Day	Passes	Open Interest On First Notice Day	Percentage Of Open Interest	Price Change
July	321	570	730	44%	Minus .89
October	67	34	182	37%	Minus .02
December	400	283	740	54%	Plus .13
March 1970	210	310	558	38%	Minus .04
May	59	23	146	40%	Plus .12
July	19	7	492	4%	--
October	60	92	106	57%	Minus .45
December	6	13	266	2%	Minus .18
March 1971	72	74	409	18%	Minus .10
May	14	15	232	6%	Plus .60
July	90	260	582	15%	Minus .69
October	50	33	476	11%	Plus .80
December	358	132	2025	18%	Plus .82"

All of the testimony adduced agrees in principle that large tenders on first notice day do tend to drive the market down -- *providing that other factors were present.* These factors are (a) that notices of tenders circulate for an extended period before being stopped out; (b) that the tenders are inordinately large with respect to the percentage of open interests; and (c) that a supply of spot cotton is available at an attractive price.

Dr. Olson pointed out that only once in recent years has the volume of tenders on first notice day exceeded the 357 notices by respondent company, and that was in connection with the December 1969 future when 400 tenders were made on first notice day. Dr. Olson apparently arrived at his assumption of intent without considering the other factors necessarily involved in his hypothesis, although he acknowledged their significance. He concluded simply that, because the respondent company's tender was historically large in terms of volume, it *must* have been made with the intention to drive the market down. That it did not succeeed was solely because Plains Cooperative stopped the notices. This is a pertinent factor. To avoid the disturbance this factor has on his assumption of intent, Dr. Olson made a mental flip-flop and blandly stated that respondent company did not know Plains was in a position to, and would, stop the notices -- otherwise the market would have gone down! In plain words, Dr. Olson contends that respondent company's officials were very knowledgeable about how to drive the market down, and fully capable of formulating, and did formulate, an illegal intent to do so, but were completely ignorant of the hidden dangers to the success of the endeavor -- namely, the ever real possibility that the notices would be stopped. The evidence of the competence and knowledge of the officials of one of the largest cotton firms in the country does not support such an inference.

A glance at Exhibit No. 26, *supra,* discloses that large tenders alone on first notice day do not always drive the market down. In fact, it is obvious from the Exhibit that other present factors may cause the market *to rise,* regardless of a large volume of tenders. The very illustration of the action of the December 1969 future on first notice day cited by Dr. Olson discloses that the market actually rose in spite of the larger volume of tenders, in spite of a larger number of passes, and in spite of the much smaller percentage of open long interest. The point need not be laboured. How Dr. Olson could realistically hold to his conclusion in the face of the historical facts in complainant's own exhibit is not clear. His conclusion absent other information is obviously unsupported by history alone. Yet, that is what he advances.

The evidence discloses that the statistics presented in Exhibit No. 26 were never published, but were assembled and made available by complainant only after this hearing had opened. Thus, even if they are viable as historical data to support Dr. Olson's theory, there is just no way to impute knowledge of these statistics to respondent company's officials, which is the minimum necessary to support a finding of intent on this basis. The statistics were available only in unassembled form in the

records of the CEA. Even so, as noted previously, a careful study and analysis of the data had it been available just does not impel Dr. Olson's conclusion.

22. It is of some significance, also, to note that the evidence discloses that the market in the December 1971 cotton future was different from that of the preceding years covered by Exhibit No. 26. The testimony of Mr. F. Marion Rhodes, President of the New York Cotton Exchange, was that, as a result of the passage of the Agricultural Act of 1970, the volume of trading on the Cotton Exchange increased from very low levels of a little over 3 million bales in 1970 to 36 million bales in 1971. This was due to the change in its program and the dropping of the support level for cotton by the federal government. The impact of this program shift makes statistics on volume of trading on the Exchange, as demonstrated by Exhibit No. 26, for the immediately preceding years of doubtful value for the comparison relied upon by Dr. Olson. Marketing conditions and decisions based thereon, coupled with the large sale of CCC cotton in May had a substantial impact on the 1971 market. Yet this fact was not even referred to or apparently considered by Dr. Olson. Why it was not considered leads to the conclusion that Dr. Olson's investigation of the facts was superficial and his conclusion based upon his analysis of Exhibit No. 26 and historical market data additionally without solid foundation.

23. The Cotton Exchange, as a licensed contract market, has a primary responsibility for policing trading activities on the Exchange. Mr. Rhodes testified that he, as president of the Exchange, found nothing irregular or illegal in the actions of respondent company on November 23, 1971. Nor had anyone complained of respondent company's action. Moreover, he further testified that no regulation of the Exchange had been violated by respondent company's action.

Complainant has not cited any specific regulation or directive of the Commodity Exchange Authority which was violated by respondent company's action. Our review of the regulations issued by the agency discloses that there is no regulation putting limits on the number of tenders which may be made against short contracts on first notice day. Nor is there any regulation which specifies when a holder may not tender cotton against a short contract. Nor is there any regulation which compels a holder to transfer a present short future to a later one -- regardless of the spread between the futures. We find, therefore, that respondent company's action on November 23, 1971, was not in violation of any known regulation or specific policy directive issued by the Commodity Exchange Authority.

Conclusions

This is a case without precedent under the Act. In those instances where charges of intent to manipulate prices of commodities on designated contract markets have been brought they have been coupled with charges of manipulation. Here we are not dealing with a charge of manipulation -- only a charge of intent to manipulate. The facts are that no actual manipulation took place. Complainant has the burden of constructing an intent to manipulate the price of cotton from the facts presented in evidence.

Complainant does not propose that the charge is grounded upon a presumption arising from the facts. The statute and the case law have established no such presumption. It is basic that no general presumption to violate a statute may be imputed.

Respondents have not admitted an intent to manipulate the price of cotton, and have vigorously denied such intent.

In the circumstances, as presented by the facts as found and the charge, what we have left to consider is whether or not respondent company officials' mental attitude embodied the alleged intent and whether or not this intent was so clearly exposed by the company's actions as to leave no reasonable doubt of the existence of such intent as the motive for its actions. In the circumstances of no actual manipulation we cannot come to grips with the charge by following the usual approach of considering that the results of the act corroborated an intent to do the act, because the very opposite result of the alleged intent took place, i.e., the price of cotton did not decline on first notice day.

Complainant attempts to construct intent on the part of respondents, first, by alleging a motive to save an alleged $ 270,000, or a substantial part thereof, by showing how they might have done so by trading in a different manner than was done. The facts as found herein show this $ 270,000 to be a hypothetical figure. An analysis of all of

the facts involved discloses that if respondent company had made the trades and conducted its business according to Dr. Olson's hypothesis there was no clear showing that it would have profited to a greater extent than it did. We conclude, therefore, that complainant has failed to establish even a real motive for formulating the alleged illegal intent. Without such a motive the charge is rank speculation.

Complainant attempts, second, to construct intent on the part of respondents by imputing to them the false knowledge of Dr. Olson's conclusion based upon historical data as a premise for their action.

The evidence discloses that the simple hypothesis of Dr. Olson, i.e., that a large volume of tenders on first notice day drives the market down, that respondents knew this, and that respondent company's tenders *ergo* were intended to drive the market down, is unsupported by the facts as found. Exhibit No. 26 discloses that there is no sound historical basis for the simple conclusion. It discloses that large tenders on first notice day, absent other material factors, such as a large number of passes, a smaller than ordinary amount of open interest, etc., do not reasonably assure the result of driving the market down. Respondents cannot be assumed to be unreasonable in the conduct of their business, or to be otherwise imprudent or unknowledgeable about trading and the risks involved. The fact alone of a large number of open contracts on first notice day constituted a present possibility that some holder would stop notices. This is basic. Mr. Hohenberg's conversation with Plains officials indicates that he thought Plains might stop notices if they were issued.

To make Dr. Olson's hypothesis hold together one would have to assume that respondents somehow had the capability of preventing notices being stopped. Respondents obviously did not have this capability, and the condition of the market was such that they could not reasonably have expected that they had this capability. Yet, this is what they would have had to know to intend to manipulate the market. To assume that respondents could have intended to do that which they patently could not do is either to attribute to them a great ignorance of trading, or an unbelievably speculative business attitude. This has not been demonstrated.

We could perhaps write at greater length to cover all of the nuances of Dr. Olson's hypothesis, but it would serve little useful purpose. We conclude, shortly, that absent a demonstrated profit motive for holding an intent to manipulate, and absent a demonstrated capability of realizing a manipulation, it cannot be concluded that respondents intended to manipulate the market from the actions taken by respondent company on first notice day and the facts presented in evidence. Any further speculation on the thought processes of respondent company officials and the individual respondent evade demonstration. We doubt, more-ever, that the Act was intended to reach this far as a necessary part of the regulatory program to be undertaken under the Act.

All of the evidence presented has been considered in arriving at the facts and conclusions stated herein. All requests, motions, proposed findings, and arguments presented, whether or not specifically referred to herein, have been considered, and to the extent they are inconsistent or contrary to the findings and conclusions herein are denied.

Order

The charge in this complaint not having been proved, the complaint is dismissed on the merits.

Pursuant to § 10.84 of the Rules of Practice (17 CFR Part 10; 41 F. R. 2508 *et seq.,* January 16, 1976), this order shall become effective 30 days after service thereof unless a timely appeal is filed.

LOAD-DATE: August 6, 2008