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# LAW & COMPLIANCE DIVISION



## COMMENT



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July 2, 1998

Jean A. Webb
Secretary of the Commission
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Ms. Webb:

The Law and Compliance Division of the Futures Industry Association ("FIA") respectfully submits this comment letter in response to the Commodity Futures Trading Commission's Notice of Proposed Amendments to its Rules of Practice, published in the Federal Register, 63 Fed. Reg. 16453 (April 3, 1998).

FIA, a not-for-profit corporation, is a principal spokesman for the futures industry. Its members include approximately 70 of the largest futures commission merchants in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting on the scope and diversity of its membership, FIA estimates that its members effect more than 80 percent of all customer transactions executed on United States contract markets.

The FIA commends the Commodity Futures Trading Commission ("CFTC" or "Commission") for proposing rules intended to improve the overall fairness and efficiency of the administrative process, and supports this endeavor. The FIA does, however, believe that some provisions of the proposed rules may have unintended, adverse consequences, and so merit comment.

**10.42(a)**

The proposed amendment to 10.42(a) would expand the disclosure that could be ordered from all parties. Although the FIA generally supports the proposed amendment, the provision obligating parties to disclose (i) a complete statement of any expert's opinion and the basis or reasons therefor, and (ii) a list of and copies of any documents considered by the expert in forming the opinion could unfairly burden respondents if this disclosure is ordered in the early stages of the proceeding. Respondents are at a disadvantage in that they, unlike the Division of Enforcement ("Division"), have not had the opportunity to develop a theory and strategy of the case prior to commencement of the proceeding. A respondent may need additional time to determine whether to seek the assistance of an expert and whether or not the expert will be offered as a witness. As such, the FIA recommends a requirement in 10.42(a) that the Administrative Law Judge ("ALJ") take into consideration the amount of time the respondent has had to prepare when issuing such an order. In the alternative, the FIA recommends that the commentary to 10.42(d) acknowledge that this timing issue is one of the circumstances the ALJ should consider when determining whether to modify disclosure under 10.42(a).

**10.42(b)**

The FIA recommends that proposed rule 10.42(b), the regulation governing the Division's obligation to disclose investigatory materials, be expanded to require that the Division also disclose all: (i) subpoenas issued at the Division's request, (ii) written requests for information made by the Division, and (iii) all relevant final examination and inspection reports created by the Division of Trading and Markets and the Division of Economic Analysis. Also, this subsection should be amended to authorize ALJs to conduct *in camera* reviews of withheld documents. In addition, this regulation should mandate that the Division make this disclosure within 14 days after the respondent files an answer.

Finally, we recommend that the provision in 10.42(b), which precludes a rehearing or redecision for the Division's failure to comply with this section's discovery obligations unless the respondent can show prejudice, be amended to place the burden of showing a lack of prejudice upon the Division. As written, the regulation effectively creates a presumption that any such failure will be harmless. Instead, the regulation should be written from the perspective that a failure to disclose investigatory material is presumptively prejudicial, but that the Division will have the opportunity to establish a lack of prejudice. Placing the burden on the party at fault appears more equitable and creates an incentive to comply with the discovery obligations.

**10.42(c)**

The FIA opposes amending section 10.42(c), as proposed, to create an obligation on the part of respondents to produce witness statements. Currently, only the Division is obligated to make this disclosure, which parallels the SEC regulation, 17 C.F.R. § 201.231. Although the commentary notes that this proposed rule is generally in accord with Federal Rule of Criminal Procedure 26.2 (which places the substance of the Jencks Act, 18 U.S.C. 3500, in the Federal Rules), it is important to note that the Jencks Act does not mandate disclosure of witness statements until after the witness has testified. The proposed rule, though expanding this discovery obligation to respondents in accord with the Federal Rules, continues to mandate that this disclosure occur before the hearing. As such, respondents will be required to disclose statements of potential witnesses who may not ultimately testify and will have to submit witness statements based upon assumptions as to what any witness may testify to in the hearing.

This provision should also be amended to explicitly authorize the ALJ to conduct an *in camera* review of documents withheld on claims of privilege. Finally, the provision in this section which limits the availability of rehearing or redecision as a remedy for a party's failure to comply with this section should be amended to place the burden of showing a lack of prejudice on the party who failed to comply. Again, this appears more equitable and creates an incentive to comply.

**10.68**

The FIA makes no objections to the proposed amendments to 10.68, the section governing subpoenas. Instead, the FIA offers the following recommendations for additional amendments to the section. The provision for motions to quash or modify a subpoena duces tecum should be amended to parallel the SEC regulation, 17 C.F.R. § 201.232(e). Persons entitled to make such a motion should be defined to include not only the recipient of the subpoena, but also the owner, creator, or subject of the subpoenaed document. Also, the time allowed for making a motion to quash or modify a subpoena should be increased from 7 days to 15 days from the date of service. Finally, the standards applicable to a motion to quash or modify a subpoena should be clarified, including the availability of protective orders to prevent disclosure of confidential information.

**10.84**

With this amendment, the Commission proposes to promulgate regulations governing the award of restitution. The FIA strongly believes that restitution should only be available for persons injured no more than two years before the initiation of the proceedings. Congress conferred upon all injured persons the ability to seek redress for their injuries through private causes of action and reparation proceedings. Congress chose to limit these remedies by imposing a two year statute of

limitations. 7 U.S.C. § 25(c) (private rights of action); 7 U.S.C. § 18(a) (reparations). Indeed, Section 22 (a)(2) of the Act provides:

> Except as provided in subsection (b) of this section, the rights of action authorized by this subsection and by sections 5a(11)[governing contract markets' settlement of customers' claims], 14 [governing reparations proceedings], and 17(b)(10) [governing futures associations' settlement of customers' claims] of this title shall be the exclusive remedies under this Act.

7 U.S.C. § 25(a)(2) (emphasis added). It would be contrary to these clear expressions of legislative intent for the Commission to permit restitution for claims that are otherwise unenforceable.

Moreover, the proposed rules governing restitution should be amended to clarify the interaction between private causes of action, reparation proceedings, and restitution orders. As proposed, it is unclear how the different categories of potential recipients (those fully compensated through private actions, those compensated through private actions for harms caused by statutory violations but not for harms caused by regulatory violations, *etc.* . .) will be administered. The FIA recommends a provision expressly eliminating any persons who have sought recovery under a private cause of action or a reparations proceeding from the pool of potential recipients to the extent that the restitution order is intended to provide a remedy for the same violations already addressed in the private action.

Furthermore, though the restitution process proposed is divided into two steps, it is not bifurcated in the traditional sense. The proposed restitution rules should be amended to create a truly bifurcated process, with the issue of violation being established in the first proceeding and the appropriateness and specifics of restitution being addressed in the second. Upon a finding of unlawful activity, the ALJ would be authorized to determine that the circumstances warrant a restitution proceeding. At the restitution proceeding, the requisite elements for restitution would be litigated, as would the issues of potential recipients and the appropriate amount of the restitution order.

This would be a more fitting arrangement than the proposed procedure, as certain findings, particularly "proximate cause," are not required for the imposition of certain remedial sanctions but must be made before restitution can be ordered. For example, reliance on a misrepresentation may not be necessary to establish a violation in an enforcement action, whereas the statutorily mandated finding of proximate cause would require such a determination be made in order to award restitution to customers. As proposed, the restitution process would necessarily require that the Division present evidence on proximate cause even though, ultimately, the respondent may not be found liable for any violations. The investigation and presentation of this evidence in the cases where liability

is not found is an inefficient use of the Division's resources and interferes with the Division's fundamental mission.

This process will cause unnecessary delay and expense to the respondent too, as the respondent will have to devote a significant amount of time defending against the element of proximate cause, regardless of whether or not the complaint is ultimately determined to be well-founded. The proposed process will also subject the respondent to more extensive and burdensome discovery than may ultimately have been justified, especially in light of the proposal to expand availability of subpoenas duces tecum to the prehearing phase of the proceeding.

**10.24**

The FIA understands that the amendments to this provision are intended to clarify that the Division is prohibited from making substantive amendments to a complaint and notice of hearing, and that only the Commission has such authority. In order to make clear that the ALJ is expected to accommodate the needs of parties when such an amendment is made, the FIA recommends that 10.42(a) provide that the ALJ "shall adjust the scheduling of the proceeding so as to avoid any prejudice to any of the parties to the proceeding."

**10.102**

The FIA recommends that the Commission take this opportunity to amend the provision governing the review of initial decisions by obligating the Commission to provide notice and the opportunity to be heard if any issue is to be considered and decided by the Commission that has not been advanced as a basis for appeal by one of the parties. We do not dispute the Commission's authority to address such matters, but, for example, the Commission's *sua sponte* imposition of sometimes significantly larger sanctions without notice to the respondent and an opportunity to be heard appears to undermine the fairness of the proceeding.

**10.106**

The FIA has no objection to the amendment of this provision providing for the posting of a surety bond upon the issuance of a stay. The FIA does, however, recommend that this provision be clarified so that it is evident that such a surety bond would not be required upon application for a stay but, rather, only as a condition of granting a stay.

**Appendix A**

The FIA is aware that it is currently the practice of the Commission to only accept settlements upon the basis of "neither admitting nor denying" the allegations. Despite this practice, the FIA questions the wisdom of foreclosing other options in an extraordinary case by the codification of this policy. If the Commission is committed to issuing such a statement, the FIA recommends that the Commission model its statement upon that of the SEC, which is found at 17 C.F.R. § 202.5(e). The language of the Commission's statement, too, should reflect that the Commission's position is grounded in public policy.

**OTHER PROVISIONS**

**10.9**

Although the separation-of-functions provision of 10.9(b) is not addressed in the Proposed Rules, the FIA recommends that it be amended to conform to the requirements of the Administrative Procedure Act provision upon which it is based. That provision provides, in pertinent part:

> An employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review . . . except as witness or counsel in public proceedings.

5 U.S.C. § 554(d). In its present form, Rule 10.9 applies this prohibition of section 554(d) only with regard to the decision of an ALJ, which may lead members of the Commission or affected members of the Commission's staff to misunderstand the true breadth of the statutory separation-of-functions standard to which they are subject. Accordingly, we recommend that the rule be amended to encompass advice regarding "the decision, recommended decision, or agency review" in a proceeding, rather than merely "the decision of the Administrative Law Judge."

**10.10**

Regulation 10.10, governing *ex parte* communications, is not addressed in the Proposed Rules either, but the FIA strongly recommends its amendment. As written, this regulation only prohibits *ex parte* communications between any Commissioner or Administrative Law Judge or Commission decisional employee and interested persons outside the Commission. This provision has been held not to apply to the Division of Enforcement, because they are not "outside the Commission." In the Matter of Grain Land Cooperative, 1997 WL 572821 at *4 (CFTC 1997). Given this interpretation, the plain language of this regulation does not prohibit the Division of Enforcement from engaging in *ex parte* communications with Commissioners, Administrative Law

Judges, and Commission decisional employees throughout the proceedings, regardless of when a proceeding is deemed to have been commenced.

This regulation should be amended by striking the phrase "outside the Commission," thereby prohibiting any interested person, who knows that a proceeding has been or will be commenced, from engaging in *ex parte* communications with decisional employees. In addition, 10.10(a)(4) should be amended to explicitly include the Division in its definition of parties. This amendment is necessary, as the definition of "interested person" depends upon the definition of "parties" and only an "interested person" is prohibited from engaging in *ex parte* communications.

The FIA recognizes that the current provisions of Rule 10.10 were adopted by the Commission in 1977 "to implement the specific prohibitions and sanctions against ex parte communications" that are set forth at 5 U.S.C. §557(d)(1) as part of the Government in the Sunshine Act. See Open Commission Meetings, Ex Parte Communications: Implementation of the Requirements of the Government in the Sunshine Act, 42 Fed. Reg. 13700, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. ¶ 20,277 at p. 21,508 (March 11, 1977). Section 557(d)(1) applies to certain rulemaking proceedings as well as to non-enforcement adjudications conducted by all of the diverse agencies of the Federal government. To implement the "sunshine" objective of the legislation of which it is a part, it prohibits communications from "interested persons" "outside the agency" who might wish in secret to influence agency action. Nevertheless, Congress made clear that this enactment was not intended to deter agencies from adopting broader protections against ex parte communications "in a way best designed to meet [their] special needs and circumstances." See H.R. Rep. No. 94-880 (Part II), 94th Cong., 2nd Sess. 18 (1976).

By adopting our recommended amendments to 10.10, the Commission would be conforming its practice to the practice of numerous other agencies with similar enforcement responsibilities that have implemented 5 U.S.C. § 557(d) with rules applying the prohibition against ex parte communications to it own investigative and prosecutorial personnel as well as to outside parties. Some, like the Federal Trade Commission, expressly apply the prohibition to all employees or agents of the Commission "who perform[] investigative or prosecuting functions in adjudicative proceedings" as well as to all persons "not employed by the Commission." 16 C.F.R. § 4.7(b)(1). Others, like the National Labor Relations Board, simply define certain of their employees as "outside the agency." See 29 C.F.R. § 102.127, pursuant to which the "general counsel [of the NLRB] or his representative when prosecuting an unfair labor practice proceeding before the Board," is a "person outside this agency" subject to the prohibition against ex parte communications. See also 5 C.F.R. § 2414.3(a) (Federal Labor Relations Authority); 7 C.F.R. § 15.68(a) (Department of Agriculture); 10 C.F.R. § 820.35 (Department of Energy); 14 C.F.R. § 16.303(b)(1) (Federal Aviation Administration); 21 C.F.R. § 13.15(a) (Food and Drug Administration); 15 C.F.R. § 904.254(a)(1) (National Oceanic and Atmospheric Administration); 39 C.F.R. § 3001.7(b)(1) (Postal

Service); 33 C.F.R. § 328.6(a)(vi) (Army Corps of Engineers); 34 C.F.R. § 101.113 (Department of Education); 39 C.F.R. § 18b.92 (Department of Veterans Affairs).

**10.42(g)**

The FIA recommends the creation of a new discovery provision which clarifies that, notwithstanding any provisions in this section allowing the Division to withhold materials on claims of privilege or work product, the Division is obligated to produce all exculpatory materials as would be required pursuant to Brady v. Maryland, 373 U.S. 83, 87 (1963). As written, the only reference to this obligation in the proposed rules is a commentary footnote stating that compliance with 10.42(b) "will not necessary satisfy the Division's obligation to produce exculpatory material." Commentary to Proposed Rules of Commodity Futures Trading Commission, 63 Fed. Reg. 16453, 16455 n.3 (April 3, 1998) (citing In re First National Monetary Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) 21,853, 27,851 (CFTC Nov. 13, 1981)). The FIA is aware that First National refers to Brady as the standard for disclosure. By these proposals, however, the Commission, for the first time, will be codifying the availability of privileges. Fairness requires that this codification be balanced by a rule that the privilege provisions in this section do not authorize the Division to withhold material subject to disclosure under Brady.

Very truly yours,

Ronald H. Filler

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cc: Geoffrey Aronow, Director, Division of Enforcement
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