# ARBITRATION, EXPEDIENCY, AND THE DEMISE OF JUSTICE IN DISTRICT COURTS: ANOTHER SIDE OF THE HEDGE-TO-ARRIVE CONTROVERSY

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## I. INTRODUCTION

Over a decade has elapsed since the U.S. Supreme Court's decision in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[1] one of three cases aptly described as instituting a "sea change" in policy[2] that anointed the use of private arbitration as a preferred forum to adjudicate public rights. The subject of this Article is the extent to which this policy change has affected the administration of justice in federal district courts. The author shall provide some insight into that question by reviewing eight decisions issued by different district court judges in five states.[3] These cases involved claims asserted under the Commodity Exchange Act (CEA),[4] a comprehensive legislative scheme that regulates the trading of commodity futures contracts in much the same manner as the Securities Exchange Act of 1934 (Securities Act)[5] regulates security transactions. Following *Mitsubishi Motors*, the Supreme Court held that Securities Act claims were arbitrable in *Shearson/American Express, Inc. v. McMahon*,[6] giving approval to the use of mandatory arbitration agreements on an industry-wide basis as a condition for opening a securities brokerage account. Unlike the Securities Act, the CEA specifically addresses the use of arbitration and has, since its inception, placed strict limitations on its use in resolving commodity claims. The Commodity Futures Trading Commission (CFTC) has enacted specific rules[7] regulating both the use of the arbitration process and the content of arbitration agreements by commodity brokers.[8] Failure to comply

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1. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).

2. *See* Stephen L. Hayford, *Commercial Arbitration in the Supreme Court 1983-1995: A Sea Change*, 31 WAKE FOREST L. REV. 1, 7-10 (1996).

3. Chronologically, the cases are: Andersons, Inc. v. Horton Farms, Inc., No. 96-CV-171 (W.D. Mich. Aug. 26, 1996) (appeal pending); Hodge Bros. v. DeLong Co., 942 F. Supp. 412 (W.D. Wis. 1996); Harter v. Iowa Grain Co., No. 96 C 2936, 1996 WL 556734 (N.D. Ill. Sept. 26, 1996) (appeal pending); Herwig v. Hahnaman-Albrecht, Inc., No. 96 C 6107, 1997 WL 72079 (N.D. Ill. Feb. 13, 1997); Harris Farms v. Continental Grain Co., No. 96 C 4369, 1997 WL 381853 (N.D. Ill. Mar. 19, 1997); Heithoff v. Cargill Inc., No. 4:CV96-337 (D. Neb. Mar. 21, 1997); Hazlett Farms, Inc. v. Andersons, Inc., No. IP 97-346-C-D/F (S.D. Ind. Sept. 18, 1997); Nagel v. ADM Investor Servs., Inc., Nos. 96 CV 2675, 96 CV 2741, 96 CV 2879, 96 CV 2972, 96 CV 5215, 1998 WL 25208 (N.D. Ill. Jan. 12, 1998).

4. 7 U.S.C. §§ 1-25 (1994).

5. 15 U.S.C. §§ 78a-78ii (1994).

6. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987).

7. *See* 17 C.F.R. pt. 180 (1998).

8. *See id.* § 180.3. Section 180.3 reads as follows:

> (a) The use by customers of the dispute settlement procedures established by contract markets pursuant to the Act or this part or of the arbitration or other dispute settlement procedures specified in an agreement under paragraph (b)(3) of this section shall be voluntary. The procedures so established shall prohibit any agreement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for

settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

(b) No futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor, or associated person shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time the claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by the futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor or associated person.

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and provisions specified in this section. Such futures commission merchant or introducing broker may obtain such endorsement as provided in § 1.55(d) of this chapter for the following classes of customers only:

(i) An investment company registered under the Investment Company Act of 1940;

(ii) An insurance company subject to regulation by any State;

(iii) A bank, trust company or any other such financial depository institution subject to regulation by any State or the United States;

(iv) A pension plan subject to title I of the Employee Retirement Income Security Act of 1974, an employee welfare benefit plan subject to the fiduciary responsibility provisions of the Employee Retirement Income Security Act of 1974, and a plan defined as a government plan in section 3(32) of title I of the Employee Retirement Income Security Act of 1974;

(v) A foreign entity that is regulated in a manner comparable to the entities specified in paragraphs (b)(2)(i)-(iv) of this section; or

(vi) A person who is a "qualified eligible participant" as defined in § 4.7(a)(1)(ii) of this chapter.

(3) The agreement may not require the customer to waive the right to seek reparations under section 14 of the Act and part 12 of these regulations. Accordingly, the customer must be advised in writing that he or she may seek reparations under section 14 of the Act by an election made within 45 days after the futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor or associated person notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when such person notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (i.e. do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexisting arbitration agreement.

(4) The agreement must advise the customer that, at such time as he or she may notify the futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor or associated person that he or she intends to submit a claim to arbitration, or at such time as such person notifies the customer of its intent to submit a claim to arbitration, the customer will have the opportunity to elect a qualified forum for conducting the proceeding.

(i) In the case of a future commission merchant, introducing broker, commodity pool operator, commodity trading advisor or associated person, within ten business days after receipt of such notice from the customer, or at the time such a registrant so notifies the customer, the futures commission merchant, introducing broker, commodity pool operator, commodity trading advisor or associated person must provide the customer with a list of organizations whose

procedures qualify them to conduct arbitrations in accordance with the requirements of § 180.2 of this part, together with a copy of the rules of each forum listed. The list must include:
(A) The contract market, if available, upon which the transaction giving rise to the dispute was executed or could have been executed;
(B) A registered futures association; and
(C) At least one other organization which will provide the customer with the opportunity to select the location of the arbitration proceeding from among several major cities in diverse geographic regions and which will provide the customer with the choice of a panel or other decision-maker composed of at least one or more persons, of which at least a majority are not members or associated with a member of a contract market or employee thereof, and which are not otherwise associated with a contract market (mixed panel).
(ii) A floor broker, within ten business days after receipt of notice from the customer that he or she intends to submit a claim to arbitration, or at the time the floor broker notifies the customer of his or her intent to submit a claim to arbitration, must provide the customer with a list of organizations whose procedures qualify them to conduct arbitrations in accordance with the requirements of § 180.2 of this part, together with a copy of the rules of each forum listed. The list must include the organizations specified in paragraphs (b)(4)(i)(A) and (b)(4)(i)(C) of this section. The customer shall, within forty-five days after receipt of such list, notify the opposing party of the organization selected. A customer's failure to provide such notice shall give the opposing party the right to select an organization from the list.
(5) The agreement must acknowledge that the futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor or associated person will pay any incremental fees which may be assessed by a qualified forum for provision of a mixed panel, unless the arbitrators in a particular proceeding determine that the customer has acted in bad faith in initiating or conducting that proceeding.
(6) The agreement must include the following language printed in large boldface type:
**THREE FORUMS EXIST FOR THE RESOLUTION OF COMMODITY DISPUTES: CIVIL COURT LITIGATION, REPARATIONS AT THE COMMODITY FUTURES TRADING COMMISSION (CFTC) AND ARBITRATION CONDUCTED BY A SELF-REGULATORY OR OTHER PRIVATE ORGANIZATION.**
**THE CFTC RECOGNIZES THAT THE OPPORTUNITY TO SETTLE DISPUTES BY ARBITRATION MAY IN SOME CASES PROVIDE MANY BENEFITS TO CUSTOMERS, INCLUDING THE ABILITY TO OBTAIN AN EXPEDITIOUS AND FINAL RESOLUTION OF DISPUTES WITHOUT INCURRING SUBSTANTIAL COSTS. THE CFTC REQUIRES, HOWEVER, THAT EACH CUSTOMER INDIVIDUALLY EXAMINE THE RELATIVE MERITS OF ARBITRATION AND THAT YOUR CONSENT TO THIS ARBITRATION AGREEMENT BE VOLUNTARY.**
**BY SIGNING THIS AGREEMENT, YOU: (1) MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW; AND (2) ARE AGREEING TO BE BOUND BY ARBITRATION OF ANY CLAIMS OR COUNTERCLAIMS WHICH YOU OR [NAME] MAY SUBMIT TO ARBITRATION UNDER THIS AGREEMENT. YOU ARE NOT, HOWEVER, WAIVING YOUR RIGHT TO ELECT INSTEAD TO PETITION THE CFTC TO INSTITUTE REPARATIONS PROCEEDINGS UNDER SECTION 14 OF THE COMMODITY EXCHANGE ACT WITH RESPECT TO ANY DISPUTE WHICH MAY BE ARBITRATED PURSUANT TO THIS AGREEMENT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [NAME] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL HAVE 45 DAYS FROM THE DATE OF SUCH NOTICE IN WHICH TO MAKE THAT ELECTION.**

with the CFTC regulations renders an arbitration agreement void and unenforceable.[9]

The issue of arbitrability in a commodity case generally is simply a question of whether the broker complied with the applicable regulation. The eight decisions that are the subject of this article, however, involve anything but run-of-the-mill commodity controversies. On the contrary, these eight cases raise unique issues concerning the definition of what constitutes a commodity futures contract.

The district court cases arose from what is known as the hedge-to-arrive (HTA) controversy in which numerous farmers have *claimed* that what were held out by grain elevators to be cash forward grain contracts, were instead, nothing more than illegal, off-exchange futures contracts.[10] In each case the written contract contained

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**YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [NAME].**
**SEE 17 CFR 180.1-180.5.**

Customer

(7) If the agreement specifies a forum for arbitration other than a contract market or registered futures association, the procedures of such forum must be fair and equitable as defined by §180.2 of this part.

(c) The procedure established by a contract market pursuant to section 5a(a)(11) of the Act or this part may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (b) of this section or that agreement to submit the claim or grievance was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act of this part shall not establish any unreasonably short limitation period foreclosing submission of customers' claim or grievances or counterclaims (permitted by §180.4 or this part) by contract market members or employees thereof.

*Id.*

9. *See* 41 Fed. Reg. 27,526, 27,527-28 (1976); 41 Fed. Reg. 42,942, 42,944 (1976); Smokey Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 720 F.2d 1446, 1450-51 (5th Cir. 1983); Wotkyns v. D.E. Jones Commodities, Inc., 791 F.2d 749, 751 (9th Cir. 1986) (per curiam); Felkner v. Dean Witter Reynolds, Inc., 800 F.2d 1466, 1469 (9th Cir. 1986); *In re* ContiCommodities Servs., Inc. Sec. Litig., 1987 WL 10987, at *5 (N.D. Ill. May 8, 1987).

10. *See* Nicholas P. Iavarone, *Understanding The Hedge To Arrive Controversy*, 2 DRAKE J. AGRIC. L. 371, 393 (1997) (emphasis added). An explanation of HTA contracts is beyond the scope of this Article. The farmers allege that what they thought they were buying or selling was something that was virtually without risk and which was represented as being capable of eliminating both the risk of falling prices and of failed crops for a few cents a bushel a year. *See id*. For each HTA the grain merchandiser sold an underlying futures contract on the Chicago Board of Trade (CBOT) for the farmer's risk. *See id*. at 372. The allure of the HTA contract was that the farmer could deliver on the HTA contract or, if the cash market price was higher or his production proved less than had been anticipated, deliver on the cash market, and "roll" both the HTA contracts and the underlying futures contracts forward. *See id.* at 375. The grain merchandisers (for the most part, country elevators) executed the futures trades in their hedge accounts and paid the margins. *See id*. at 376. When the price of corn rose sharply in early 1996, the merchandisers could not or would not pay the increased margins and the futures positions were liquidated. *See id*. The farmers learned that they had been in a speculative short market position. *See id*. The HTA controversy swirls around who is responsible for

a clause requiring the farmer to arbitrate any controversy arising under the contract before the grain elevator's industry association, the National Grain and Feed Association (NGFA). Each of the district courts compelled arbitration. The manner in which the courts arrived at these decisions raises serious concerns over whether the Supreme Court's *Mitsubishi Motors* about-face and the method employed to achieve it have proven deleterious to the administration of justice in the district courts. The eight HTA cases provide an excellent opportunity to reflect on that concern since, unlike the Securities Act which permitted the Court in *McMahon* to "re-interpret" its prior decision in *Wilko v. Swan*,[11] arbitration under the CEA is a legislative creature and, theoretically, not dependent upon the winds of judicial fashion. The presence of a number of pre-*McMahon* circuit court decisions dealing with the issue of arbitrability under the CEA provides a basis to contrast the HTA decisions and determine the extent to which the decisions were occasioned by a shift in prevailing judicial attitudes rather than a change in the law.

The HTA cases are a good measuring rod for gauging any change in the administration of justice as a result of *Mitsubishi Motors* and its progeny. First, the issue was a simple one. The content and verbiage required by the CFTC in arbitration agreements is specified in 17 C.F.R. § 180.3(b). While voicing some reservations, none of the eight district courts suggested that the farmers failed to state a claim under the CEA.[12] Therefore, the only issue facing the courts was whether the reach of the CFTC's Arbitration Rules is congruent with the scope of the CEA that prohibits any commodity fraud practiced on anyone by anyone.[13] Alleging violations of each of the evils the CEA was intended to prevent—the sale of off-exchange commodity futures contracts by unregistered persons through the use of fraud—the farmers' claims travel to the very heart of the CEA.[14] What ultimately

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the loss—the farmers who allege that, through various misrepresentations, they were induced into unwittingly trading commodity futures or the grain merchandisers who allege that they were merely buying cash grain. *See id.* at 399-402. The CFTC, while not ruling, has essentially banned the future use of multi-year HTA contracts by prohibiting crossing crop years in selling the underlying futures contracts. *See* CFTC Interpretative Letter No. 96-41, [1994-96 Transfer Binder] Comm. Fut. Law. Rep. (CCH) ¶ 26,691, at 43,849-50 (May 15, 1996).

11. Wilko v. Swan, 346 U.S. 427 (1953).

12. Similar claims were later validated. *See, e.g.*, *In re* Competitive Strategies for Agric., Ltd., No. 98-4 (C.F.T.C. filed Aug. 24, 1998) (order making findings and imposing remedial sanctions) (finding at HTA contract that provided rolling between futures references months in different crop years and uniform buy-back provision constituted illegal, off-exchange futures contracts and failure to fully disclose risk constituted commodity fraud); *accord In re* Grain Land Coop., No. 97-1, 1998 WL 770595 (C.F.T.C. Initial Dec. Nov. 6, 1998).

13. *See* CFTC v. Schor, 478 U.S. 833, 845 (1986).

14. The validity of the farmers' theory of liability under the CEA, if not the quality of the underlying facts, was established prior to six of the eight HTA decisions when the CFTC filed three enforcement actions against commodity brokers and grain elevators for selling HTA contracts in violation of the CEA. *See In re* Grain Land Coop., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,164, at 45,551 (D. Minn. Sept. 25, 1997); *In re* Wright, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,164, at 45,551 (D. Minn. Sept. 25, 1997); *In re* Southern Thumb Coop, Inc., [Current Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 27,164, at 45,551 (D.Minn. Sept. 25, 1997). The CFTC subsequently filed a fourth enforcement action. *See In re* Competitive Strategies for Agric.,

proved to be the farmers' undoing and what makes these decisions so well-suited to their task, is that their claims simply appear suspicious. Unlike the usual victim of an off-exchange commodity fraud whom neither owns, nor desires to own, the commodity purchased through an "option" or "leveraged contract" or other similarly named instrument, the farmers do own their crops. What is more, they must sell their crop to grain merchandisers using a contract similar, if not identical, in appearance to the HTA contracts. Since valid cash forward contracts are excluded by definition from the operation of the CEA,[15] the farmers run the risk of being perceived as debtors desperately grasping at a statutory straw to forestall the inevitable by alleging that something which appears to be legal is, instead, illegal. The nature of the misrepresentations alleged, the incompleteness of the written contract, and the need to determine the intent of one, if not both parties, combine to render a HTA case particularly unsusceptible to summary disposition.[16] Furthermore, at least six of the eight HTA cases carried the legal baggage of being filed as punitive class actions.[17]

The eight district courts faced a quandary. On one hand, they were confronted with legally sufficient claims alleging a violation of a remedial statute and with a regulation promulgated to promote the purpose of the legislation that clearly trumped the general federal policy favoring arbitration. On the other hand, the district courts faced the prospect of a piece of protracted, and perhaps wide-ranging, litigation involving a unique and difficult claim burdening their already crowded dockets. The HTA controversy suddenly became a mirror reflecting the ethical soul of federal district courts. Would the district courts follow Polonius' directive: "[t]o

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Ltd., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,215, at 45,878-82 (C.F.T.C. Dec. 22, 1997). Prior to the decisions in the last four HTA courts, the CFTC recognized that HTA claims were the proper subject of a reparations claim filed pursuant to 7 U.S.C. § 18 (1994) from farmers making identical claims against one of the defendant grain merchants in one of the pending HTA cases. *See* Schaefer v. Cargill Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,962, at 44,662 (C.F.T.C. Feb. 27, 1997).

15. The term "future delivery" does not include the sale of any cash commodity for deferred shipment of delivery. *See* 7 U.S.C. § 1a(11) (1994). That is as close as the CEA comes to defining a futures contract.

16. *See, e.g.*, CFTC Interpretive Letter No. 96-23, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,646, at 43,697 (Mar. 14, 1996) (interpreting Commodities Exchange Act, 7 U.S.C. §§ 1a(11), 2a(i)(I) (1994)); Characteristics Distinguishing Cash and Forward Contracts and "Trade" Options, 50 Fed. Reg. 39,656, 39,657 (1985) (interpreting 17 C.F.R. ch. 1 and stating a commitment must exist on both sides to the contract—one to make delivery and the other to take it).

17. *See* Andersons, Inc. v. Horton Farms, Inc., No. 96-CV-171 (W.D. Mich. Aug. 26, 1996); Hodge Bros. v. DeLong Co., 942 F. Supp. 412 (W.D. Wis. 1996); Harter v. Iowa Grain Co., No. 96 C 2936, 1996 WL 556734, (N.D. Ill. Sept. 26, 1996); Herwig v. Hahnaman-Albrecht, Inc., No. 96 C 6107, 1997 WL 72079 (N.D. Ill. Feb. 13, 1997); Harris Farms v. Continental Grain Co., No. 96 C 4369, 1997 WL 381853 (N.D. Ill. Mar. 19, 1997); Heithoff v. Cargill Inc., No. 4:CV96-337 (D. Neb. Mar. 21, 1997); Hazlett Farms, Inc. v. Andersons, Inc., No. IP 97-346-C-D/F (S.D. Ind. Sept. 18, 1997); Nagel v. ADM Investor Servs., Inc., No. 96 CV 2675, 96 CV 2741, 96 CV 2879, 96 CV 2972, 96 CV 5215, 1998 WL 25208 (N.D. Ill. Jan. 12, 1998).

thine ownself be true"?[18] The answer, unfortunately was to be found in another literary metaphor. While Sir Thomas More may have been reluctant to cut down the laws to capture as worthy a prey as the devil, the district courts harbored no such hesitation in chopping down the CFTC's regulations and, if necessary, the CFTC itself, to pursue the grail of arbitrability.

## II. THE ENSHRINEMENT OF THE BARGAIN

The right to contract and the concept of due process have recently come into conflict within the federal judicial system as a consequence of the Supreme Court's decision to accord preferential status to arbitration as a proper venue for resolving claims that seek to vindicate rights conferred by remedial legislation. Initially suspicious of arbitration as a forum for the vindication of such rights,[19] in a decade the Supreme Court orchestrated a complete about-face and fully embraced arbitration.[20] Respect for "the bargain," regardless of whether one actually existed, became the penultimate consideration, displacing the concerns voiced only a few years earlier over whether public rights could properly be vindicated in private forums.[21] Having so ennobled "the bargain," the Supreme Court fashioned a series of

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18. WILLIAM SHAKESPEARE, HAMLET, act 1, sc. 3.

19. *See* Alexander v. Gardner-Denver Co., 415 U.S. 36, 53 (1974). *Alexander* cites the following reasons for not allowing the arbitration of a Title VII action: (1) the uniqueness of the statutory claim; (2) congressional intent to permit a person to pursue multiple remedies; (3) deficiencies in the arbitration process including limited discovery; (4) the voluntariness of the individual's waiver to proceed in court as reflected in a collective bargaining agreement; and (5) the following concerns relating to the deficiency of the arbitration:

> [T]he factfinding process in arbitration usually is not equivalent to judicial factfinding. The record of the arbitration proceedings is not as complete; the usual rules of evidence do not apply; and rights and procedures common to civil trials, such as discovery, compulsory process, cross-examination, and testimony under oath, are often severely limited or unavailable. See *Bernhardt v. Polygraphic Co*., 350 U.S. 198, 203 (1956); *Wilko v. Swan*, 346 U.S. at 435-37. And as this Court has recognized, '[a]rbitrators have no obligation to the court to give their reasons for an award.' *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. at 598.

*Id.* at 49-60.

20. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626-27 (1985) (stating "we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.").

21. *See id.* at 627-28. *See also* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987) (explaining "this duty to enforce arbitration agreements is not diminished when a party bound by an agreement raises a claim founded on statutory rights."). The enormity of the change in policy may be seen by comparing that statement, not merely to the Court's statements in *Alexander v. Gardner-Denver Co*., 415 U.S. 36 (1974), but to cases discussing the complete lack of due process requirements in arbitration forums. In refusing to impose constitutional requirements on commercial arbitration in *Stroh Container Co. v. Delphi Industries., Inc*., 783 F.2d 743 (8th Cir. 1986), the Eighth Circuit made the following observation: "the arbitration system is an inferior system of justice, structured without due process, rules of evidence, accountability of judgment and rules of law. . . . No

legal fictions and artifices[22] to create the minor deity of arbitration,[23] or as it is more euphemistically described, a "federal policy favoring arbitration,"[24] to sweep from federal dockets a myriad of statutory rights actions.

Arbitration as originally conceived was both a fair and efficient method for businessmen and merchants to settle disputes arising from a specific transaction without engaging the formal legal process and of avoiding placing the decision in the hands of juries unacquainted with their trade or business.[25] Whether widgets or

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one ever deemed arbitration successful in labor conflicts because of its superior brand of justice." *Id*. at 751 n.12. *See* Moseley, Hallgarten, Estabrook & Weeden, Inc. v. Ellis, 849 F.2d 264, 268 (7th Cir. 1988). The CFTC, however, seems to have contemplated just such an accountability in CEA arbitrations. In explaining its decision not to publish standards for arbitration awards, the CFTC stated: "[t]his is not to imply, however, that the Commission is in any manner limiting recognized grounds to challenge an arbitration award, such as when the award is in manifest disregard of the commodities laws or fundamentally irrational." 48 Fed. Reg. 22,136, 22,141 (1983) (to be codified at 17 C.F.R. pts. 170, 180) (citing Wilko v. Swan, 346 U.S. 427, 436-37 (1953)); Shearson Hayden Stone, Inc. v. Liang, 493 F. Supp. 104, 108 (N.D. Ill. 1980), *aff'd*, 653 F.2d 310 (7th Cir. 1981). The passage the CFTC referenced in *Liang* reads as follows:

> Again, while the phrases 'fundamentally irrational' and 'in manifest disregard of the law' do not appear in section 10 as grounds for vacating an arbitration award, the courts have used these phrases in the context of section 10(d) as instances where the arbitrators have exceeded their powers. *See I/S Stavborg v. National Metal Converters, Inc.*, 500 F.2d 424, 430-31 (2d Cir. 1974); *Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp*., 274 F.2d 805, 808 (2d Cir.), *cert. denied*, 363 U.S. 843, 80 S.Ct. 1612, 4 L.Ed.2d 1727 (1960). 'Manifest disregard of the law' and 'fundamentally irrational' mean the failure to decide in accordance with the relevant provisions of the law and *not* an error in the interpretation of the law. *Wilko v. Swan*, 346 U.S. 427, 436-37, 74 S.Ct. 182, 187, 98 L.Ed. 168 (1953); *I/S Stavborg v. National Metal Converters, Inc*., 500 F.2d 424, 430-31 (2d Cir. 1974); *San Martine Compania de Navegacion v. Saguenay Terminals, Ltd*., 293 F.2d 796, 801 n.4 (9th Cir. 1961). There must be something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand and apply the law. *Drayer v. Krasner*, 572 F.2d 348, 352 (2d Cir.), *cert. denied*, 436 U.S. 948, 98 S.Ct. 2855, 56 L.Ed.2d 791 (1978); *Saxis S.S. Co. v. Multifacs International Traders, Inc*., 375 F.2d 577, 581-82 (2d Cir. 1967); *San Martine Compania de Navegacion v. Saguenay Terminals, Ltd*., 293 F.2d 796, 801 (9th Cir. 1961); *see also Sobel v. Hertz, Warner & Co*., 469 F.2d 1211, 1214 (2d Cir. 1972*); Swift Industries, Inc. v. Botany Indus., Inc.*, 466 F.2d 1125, 1131-32 (3d Cir. 1972).

Shearson Hayden Store, Inc. v. Liang, 493 F. Supp. 104, 108 (N.D. Ill. 1980).

22. *See* Jean Braucher, *The Afterlife of Contract*, 90 NW. U. L. REV. 49, 61-69 (1995).

23. *See* Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?*, 62 BROOK. L. REV. 1335, 1390 (1996) [hereinafter Speidel, *Contract Theory*] (stating the Supreme Court has "fostered the view that arbitration is suitable for every dispute regardless of the . . . issues" which, due in part to the pressure of federal case loads, has placed the FAA in an exalted position). Professor Speidel is co-author of *Federal Arbitration Law: Agreements, Awards and Remedies Under the Federal Arbitration Act* along with Ian R. MacNeil and Richard E. Speidel. *See* G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 433, 517 (1993).

24. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

25. *See, e.g.*, Thomas J. Stipanowich, *Punitive Damages and the Consumerization of Arbitration*, 92 NW. U. L. REV. 1, 2 (1997). Professor Stipanowich is also co-author of *Federal*

skyscrapers, measuring what is delivered against what had been ordered can usually be achieved through objective comparison of the end product with the contract's terms.[26] Similarly, when the issue is either the existence of a contract or defining its terms, that, too, can generally be measured in arbitration by assessing words and actions of the parties within the standard framework of a given industry or trade.[27] The Supreme Court appropriated this device which served the purpose of businessmen and merchants in a commercial setting and applied it to controversies between individuals and large corporations or, as in the case of *McMahon*, to an entire industry.[28] What had been a voluntary decision between two roughly equal businessmen to privately adjudicate the question of performance of a specific contract became the preferred method to resolve any claim that might possibly arise from a budding broker/customer[29] or an embryonic employment relationship:[30]

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*Arbitration Law: Agreements, Awards and Remedies Under the Federal Arbitration Act* published in 1994.

26. *See* Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81, 116-17 (1992).

27. In *Punitive Damages and the Consumerization of Arbitration*, Stipanowich describes the situation as follows:

> Although arbitration has always comprehended a wide spectrum of processes, its appeal for commercial parties may be understood by envisioning arbitration in its purest and simplest traditional form: a merchant huddled over shipping crates at dockside, pronouncing on the quality of goods to resolve a dispute between brethren in trade.

Stipanowich, *supra* note 25, at 2. The birth of this process is the antithesis of the considered deliberations of Madison, Monroe, and their brethren in creating a judicial system designed to safeguard constitutional and civil rights. One can only ponder what their reaction would be to the Supreme Court's decision to relegate their descendants to forums that might possess little more respect for "due process" than they perceived their former English sovereign had.

28. The conception that arbitration agreements in such situations embody the right to freely contract from an individual's viewpoint is, of course, a fiction. Reality presents quite a different picture. As the Ninth Circuit commented relative to the CFTC regulations at issue in the HTA arbitration cases: the central purpose of section 180.3 is "to assure the efficacy of arbitration . . . as well as to meet the requirement of [7 U.S.C. § 7a(11)], which requires that such procedures be available and voluntary." Arbitration and Other Dispute Settlement Procedures, 41 Fed. Reg. 27,526-27 (1976). The CFTC wanted to encourage arbitration, but its regulations reflect its concern over the adhesive and overreaching nature of arbitration clauses that had been used by brokers and dealers trading in the contract markets. *See id*. at 27,526. *See also* 41 Fed. Reg. 42,942, 42,945 (1976) (discussing final rules); Felkner v. Dean Witter Reynolds, Inc., 800 F.2d 1466, 1469 (9th Cir. 1986) (citing 41 Fed. Reg. 42,944-45 (Sept. 29, 1976)). As Professor Stipanowich has observed:

> Rarely is conflict resolution a subject for "dickering" in negotiations; a consumer's first awareness of her election to arbitrate usually comes when a lawyer is consulted in the wake of a conflict. Then the realities – good or bad – come home. In place of the public process of which they may claim some basic understanding, there is a more abbreviated system with different decision makers, less discovery and prehearing process, and less assurance that the law will be strictly followed.

Stipanowich, *supra* note 25, at 3. Nevertheless, a "contract of adhesion" defense is foredoomed to failure. *See* Speidel, *Contract Theory*, *supra* note 23, at 1351 n.58. "[O]bjective assent coupled with a preferred outcome (here arbitration) is a dominant theme in Supreme Court adjudication." *Id*.

29. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 230 (1987). *McMahon* presents the following incongruous situation should a person decide to dabble in both

> In the new era, arbitration is suddenly everywhere. A veritable surrogate for the public justice system, it touches the lives of many persons who, because of their status as investors, employees, franchisees, consumers of medical care, homeowners and signatories to standard contracts, are bound to private processes traditionally employed by commercial parties.[31]

The use of the transparent fiction of "the bargain" by the Supreme Court to advance the Arbitration Act as the controlling law applicable to private litigation, has as one commentator has stated, a "darker side . . . that avoids validity and public policy questions."[32] The true "dark side" of the arbitration coin, however, is that the adoption of this policy has turned the legal system on its head. While the law requires that plaintiffs be accorded the benefit of every possible fact and inference in determining whether they can prove any set of facts entitling them to relief in order to keep them in court when confronted with a motion to dismiss,[33] in the context of arbitrability's case within a case, every doubt is resolved in favor of sending them away.[34] This shift in Supreme Court policy, if the HTA cases are any indication, has worked a profound change in the administration of justice in district courts. Prior to *Mitsubishi Motors*, the circuit courts deciding issues relating to either the reach of the

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securities and commodities: (1) they will be deemed to have "voluntarily" agreed to arbitrate their securities law claims by signing a non-negotiable, industry-wide arbitration clause, and (2) if the commodity agreement fails to comport completely with the CFTC's regulations, the same persons will be deemed not to have voluntarily agreed to arbitrate commodity claims with that same broker. *See id*. at 220, 238.

30. *See* Richard E. Speidel, *Afterword: The Shifting Domain of Contract*, 90 NW. U. L. REV. 254, 258-61 (1995) [hereinafter Speidel, *Shifting Domain*] (discussing the concept of contractual freedom after *McMahon)*. In a case decided when *Alexander v. Gardner-Denver Co.* still controlled, the court in *Arkoosh v. Dean Witter & Co.*, 415 F. Supp. 535 (D. Neb. 1976), *aff'd on other grounds*, 571 F.2d 437 (8th Cir. 1978), stated in discussing why the CFTC arbitration regulations:

> Proposed Regulation § 180.3 also tends to insure the Commission's adjudicatory jurisdiction under 7 U.S.C.A. § 18. It is extremely difficult for parties to foresee the dimensions which a subsequent dispute may take. If that dispute should involve a construction of the parties' rights under the Act it is obviously advantageous for customers to have access to the CFTC which is now the repository of expertise on traders' rights under the Act of 1974. Agreeing to private arbitration before the dimensions of the dispute are known may place a hardship upon the customer because arbitration usually means that the parties will be less certain of the correctness of the legal result.

*Id*. at 542 n.7.

31. Stipanowich, *supra* note 25, at 3.

32. Speidel, *Contract Theory*, *supra* note 23, at 1337.

33. *See* Conley v. Gibson, 355 U.S. 41, 45-46 (1957).

34. *See, e.g.*, Dickinson v. Heinold Sec., Inc., 661 F.2d 638, 643 (7th Cir. 1981). The *Dickinson* court noted that "when construing arbitration agreements, every doubt is to be resolved in favor of arbitration." *Id.* The court also stated that the "parties are bound to arbitrate all matters, not explicitly excluded, that reasonably fit within the language used." *Id.* (citing United Textile Workers of America v. Newberry Mills, Inc., 315 F.2d 217, 219 (4th Cir. 1963)).

CEA or the applicability of the CFTC's regulations were consumed with preserving the legislative purpose and advancing the regulatory scheme. The HTA decisions, by contrast, never once mention the purpose of the legislation nor ponder the effect that their decisions might have on the overall regulatory scheme. Instead, the HTA decisions steadfastly refuse to venture beyond the "four corners" of the regulations being "interpreted."

## III. A BRIEF HISTORY OF THE CEA—REGISTRATION, REPARATIONS, AND OFF-EXCHANGE CONTRACTS

The 1974 amendments to the CEA altered the regulatory landscape by turning what had been essentially a self-regulated industry with marginal governmental oversight into one in which the newly created CFTC would administer and enforce a comprehensive regulatory scheme.[35] The purpose of the CEA is to insure that commodity futures transactions are conducted on designated contracted markets[36] by properly registered persons[37] in a fraud-free environment.[38] To accomplish the goal of casting fraud out of commodity futures trading, Congress provided the CEA with a sweeping antifraud provision[39] that the Supreme Court described as one which "by its terms makes it unlawful for any person to deceive or defraud any other person in connection with any futures contract."[40] The CFTC immediately snared various entities who attempted to escape the nascent agency's regulatory net by trying to narrow the CEA's reach.

The first such attempt focused on the CEA's use of the term "registered" to define those required to respond to complaints filed in the newly created administrative remedy of reparations, a procedure through which aggrieved members of the public could seek to recover damages arising from a violation of the CEA.[41] Stating that registration is the "kingpin" of the CEA, the CFTC spurned this attempt to use the lack of registration "as a shield" against reparations claims.[42] Rejecting a

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35. *See* Arkoosh v. Dean Witter & Co., Inc., 415 F. Supp. 535, 539-40 (D. Neb. 1976).

36. *See* 7 U.S.C. §§ 2a, 6(a), 6c(b), 7, 8 (1994); *In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,779-81 (C.F.T.C. Dec. 6, 1979).

37. *See* Stucki v. American Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,559, at 22,284-85 (C.F.T.C. Feb. 13, 1978). The CEA, for example, prevents unregistered persons from acting in the capacity of a futures commission merchant (FCM), an introducing broker (IB), a floor broker on a contract market, an associated person (broker), a commodity trading advisor (CTA), or a commodity pool operator (CPO). *See* 7 U.S.C. §§ 6d, 6e, 6k, 6m (1994).

38. *See* 7 U.S.C. §§ 6b, 6c, 6f, 6o (1994); Silverman v. CFTC, 562 F.2d 432, 435 (7th Cir. 1977); CFTC v. Savage, 611 F.2d 270, 280 (9th Cir. 1979).

39. *See* 7 U.S.C. § 6b (1994).

40. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 389 (1982).

41. *See* 7 U.S.C. § 18 (1994).

42. *See* Stucki v. American Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,559, at 22,285 (C.F.T.C. Feb. 13, 1978); Commodity Futures Trading Comm'n v. British Am. Commodity Options Corp., 560 F.2d 135, 139 (2d Cir. 1977) (stating "[t]he intent of the congressional design is clear; persons engaged in the defined regulated activities within the commodities business are not to operate as such unless registered . . . .").

literal reading of the CEA that would stand at variance to the remedial purpose of the statute, the CFTC observed that legislation intended to regulate through registration or licensing could never be effective if the mere refusal to register enabled a person to evade the law's grasp.[43] Conduct, the CFTC said, not registration status, is determinative;[44] or more simply stated, two "wrongs" do not equal a "right" in regulatory terms: "[i]t is difficult to rationalize a result which permits a person to escape from pecuniary liability for violations of the Act in the reparations forum when that person violates the Act by engaging in activities without registration and also violates the Act in dealing with customers."[45] Congress immediately conformed the CEA to the CFTC's interpretation by inserting "required to be registered" into 7 U.S.C. § 18.[46]

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43. *See* Stucki v. American Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,559 at 22,285 (C.F.T.C. Feb. 13, 1978).

44. As stated in *Stucki*, "[i]t is not the willingness to register which makes one subject to the reparation process; it is a person's choice to engage in certain activities." *Id*. at 22,286.

45. *Id.* at 22,285.

46. *See* Futures Trading Act of 1978, Pub. L. No. 95-405, § 21, 92 Stat. 865, 876. The subsequent press of claims filed against defaulting non-registrants who could not be located caused the CFTC to request that Congress limit reparations jurisdiction to claims against actual CFTC registrants. *See, e.g.*, H.R. Rep. No. 97-565, pt. 1, at 56 (1982), *reprinted in* 1982 U.S.C.C.A.N. 3871, 3905; 48 Fed. Reg. 22,136, 22,138 (1983); Nelson v. Chilcott Commodities Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,934, at 28,032 (C.F.T.C. Dec. 12, 1983). As the CFTC stated subsequent to this amendment:

> Further, the amendments to section 14 of the Act by the Futures Trading Act of 1982 now limit reparations proceedings to those actions involving a violation of the Act, Commission rule or order which is brought only against *actual* Commission registrants, as compared to the previous statutory right to seek reparations against individuals *required* to be registered with the Commission.

Regulations Pertaining to Arbitration and Registered Futures Associations, 48 Fed. Reg. 22,136, 22,138 (1983). The CFTC imposed mandatory NFA membership on both actual and required registrants. *See* 17 C.F.R. § 170.15 (1998). The NFA, tracking the language of the regulation, adopted arbitration rules which applied to both actual and required registrants: "(i*) "Futures Commission Merchant" or "FCM"*—means a futures commission merchant as that term is used in the Commodity Exchange Act, and *that is required to be registered* as such under the Commodity Exchange Act and Commission Rules." NATIONAL FUTURES ASS'N, CODE OF ARBITRATION § 1(i) (1997). The NFA adopted identical definitions for a commodity pool operator, a commodity trading advisor, and for an introducing broker. *See id.* §§ 1(e), (f), (*l*). The NFA defines a leveraged transaction merchant (LTM) in the same manner. *See id.* § 1(m). The NFA compels these actual and required entities to submit to mandatory arbitration which provides an injured party with an alternative forum to federal court. *See id.* § 2. Furthermore, just as the CFTC compliance regulations apply to actual and required registrants, the NFA adopted the same definitions in its Compliance Rules as in the Arbitration Rules. *See* NATIONAL FUTURES ASS'N, COMPLIANCE RULE 1-1 (1996). The CFTC further effectuated the congressional mandate that the use arbitration be made voluntary on the part of the public by adopting a regulation requiring the NFA's compliance with the CFTC's own arbitration regulations. *See* 17 C.F.R. § 170.8 (1997). To ensure that the customer voluntarily entered into any pre-dispute arbitration agreements, mandatory arbitration against a customer is permitted only if the arbitration agreement that is in full compliance with § 180.3. *See* NATIONAL FUTURES ASS'N, CODE OF ARBITRATION § 2(a)(1)(ii) (1997). Removing any doubt as the universal application of § 180.3, the NFA declared in another section of its arbitration rules: "[*a*]*ny* pre-dispute arbitration agreement between a customer and an FCM, IB, CPO, CTA or LTM Member or

In the same amendments Congress also struck the phrase "registered under this chapter" from the CEA provision prohibiting fraudulent conduct perpetrated by commodity trading advisors and commodity pool operators.[47] An unregistered trading advisor subsequently charged with violating the original version of that section contended the amendment proved that Congress initially had intended the prohibition to extend only to registered entities.[48] After discussing the CFTC's previous interpretation of "registered" relative to reparations claims to include unregistered persons engaging in conduct that required registration (i.e., required registrants) as well as actual registrants,[49] the Ninth Circuit viewed the amendment as merely clarifying Congress' original intent to reach all persons engaging in such frauds. The *Savage* court concluded that "[i]t would be anomalous indeed if an advisor could escape the fiduciary duties of section 4*o* by avoiding required registration" since "[t]his would frustrate a principal purpose of the Act."[50]

The CFTC then codified its interpretations of the CEA in its Customer Protection Rules,[51] expanding their scope whenever necessary to keep pace with congressional amendments. The Customer Protection Rules, like the statute they were promulgated to enforce, reach actual and required registrants as well as both members and non-members of contract markets: "[t]he term [*c*]*ommission registrant* as used in this part means *any person* who is registered or *required to be registered* with the Commission pursuant to the Act or any rule, regulation, or order thereunder."[52] The scope of the CFTC's Customer Protection Rules are, and always have been, co-extensive with the reach of the CEA.

Next, a defendant charged with selling off-exchange futures contracts attempted to read the language "on or subject to the rules of any board of trade in the United States" in section 4 of the CEA's 1922 version of the general antifraud provision as only encompassing fraud occurring in the sale of exchange-traded

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Associate thereof that does not comply with Commission Rule § 180.3 shall be unenforceable under this Code." *Id.* § 3 (emphasis added).

47. 7 U.S.C. § 6o (1994), *amended by* Futures Trading Act of 1978, Pub. L. No. 95-405, § 10, 92 Stat. 865, 870.

48. *See* CFTC v. Savage, 611 F.2d 270, 281 (9th Cir. 1979).

49. *See id.* at 282.

50. *Id.*

51. 7 C.F.R. §§ 166.1-.4 (1998).

52. Consumer Protection Rule, 17 C.F.R. § 166.1(a) (1998) (emphasis added). Section 6c of Title 7 of the United States Code prohibits "wash sale[s]," "cross trade[s]," "accommodation trade[s]," and fictitious sales, while 7 U.S.C. § 23(a) pertains to leveraged transactions. *See* 7 U.S.C. § 6c (1994); 7 U.S.C. § 23(a) (1994). The CFTC's Bankruptcy Rules, which the CFTC likewise deems a customer protection measure, define a "[c]ommodity broker" as follows:

> [*C*]*ommodity broker* means any person who is registered or *required to register* as a futures commission merchant under the Act including a person registered or *required to be registered* as such under parts 32 and 33 of this chapter, and a "commodity options dealer," "foreign futures commission merchant," "clearing organization," and "leverage transaction merchant" with respect to which there is a "customer" as those terms are defined in this section.

17 C.F.R. § 190.01(f) (1998) (emphasis added). *See generally* 48 Fed. Reg. 28,977 (1983) (to be codified at 17 C.F.R. pt. 190) (discussing customer protection measures and commodity brokers).

futures contracts.[53] The CFTC also rejected this attempt to literally interpret the CEA in a manner that would undercut its "central purpose" of requiring futures transactions to be conducted on designated contract markets.[54] The CFTC ruled that the provision was intended to encompass both exchange-traded futures contracts and those that should have been traded on a futures exchange.[55] Congress reacted and again conformed the language of CEA to the CFTC's interpretation[56] to prevent a restrictive judicial reading of the section:[57]

> Since Congress has historically confirmed that all futures trading must take place on designated exchanges, it would be anomalous if section [4b] were read narrowly, so as not to apply to the sale of unlawful futures contracts. The amendment, however, removes all doubt as to the applicability of section [4b].
>
> The amendment will also avoid a possible misinterpretation of the Act under which a purveyor of illegal futures contracts could escape prosecution under section 9(c), which attaches felony penalties for knowing violations of section 4b. In two recent court decisions involving *private litigation*, federal district courts have held section 4b inapplicable to foreign futures contracts because these contracts are not traded on or subject to the rules of a contract market in the United States.[58]

In a replay of *Savage*, a defendant charged with the fraudulent sale of off-exchange futures contracts prior to the effective date of the amendment argued that the amendment which established the sale of off-exchange contracts had previously fallen outside the CEA's purview. The Ninth Circuit rejected the defendant's argument, as it had previously relative to the registration issue, and ruled that Congress had once again merely acted to clarify its original legislative intent.[59]

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53. *See In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 23,781 (C.F.T.C. Dec. 6, 1979).

54. *See id.*

55. *See id.* at 23,779. The CFTC also rejected the contention that the CEA merely required futures contracts to be executed through a member of an exchange rather than on an exchange. *See id.* at 23,782 n.28.

56. *See* Futures Trading Act of 1986, Pub. L. No. 99-641, §§ 101-111, 100 Stat. 3556, 3557-62.

57. *See* S. REP. NO. 99-291, at 4-5 (1986) (emphasis added).

58. *Id*. at 5.

59. *See* CFTC v. P.I.E., Inc., 853 F.2d 721, 725-26 (9th Cir. 1986). The Ninth Circuit reasoned:

> We recognize that as a general rule a court should not look beyond a statute if its meaning is plain. An exception to that rule of construction arises when a literal reading of the statute would thwart the underlying purposes of the statutory scheme or lead to an absurd result. *See, e.g., Bob Jones University v. United States*, 461 U.S. 574, 586, 103 S.Ct. 2017, 2025, 76 L.Ed.2d 157 (1983); *Brothers v. First Leasing*, 724 F.2d 789, 793 (9th Cir. 1984); *Brooks v. Donovan*, 699 F.2d 1010,

While Congress did not provide an explicit private right of action, in the 1974 amendments, one had been previously implied that federal courts generally continued to recognize[60] and that the Supreme Court ultimately confirmed.[61] The CFTC's determination to preserve both the right to pursue a claim in reparations or to file a private action in a judicial forum shaped the CFTC's use of another remedy provided by the 1974 amendments: the limited right to contract market arbitration.

## IV. ARBITRATION AS A LEGISLATIVE REMEDY UNDER THE CEA 7 U.S.C. § 7a(11).

Arbitration under the 1974 amendments to the CEA was addressed by 7 U.S.C. § 7a(11), which provided that contract markets provide a "fair and equitable" dispute resolution procedure:[62] "(i) the use of such procedure by customers shall be

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> 1011 (9th Cir. 1983). That exception applies here. The Act requires futures contracts to be sold on a designated market. Sales on these markets enable the Commission to regulate the transactions to protect investors. Paragon violated the Act by selling futures contracts directly to the public. By doing so, Paragon avoided direct supervision by the Commission, thus facilitating a scheme to defraud investors. Because Paragon proceeded in this manner, Brandon argues that Paragon and Brandon should not have to answer for the fraud perpetrated on investors because the original version of section 6b applied only to sales made on designated markets. We understand but reject the argument. It is obviously at odds with the underlying purposes of the Act. The Act requires futures sales to be made on a designated market in order to protect investors. Paragon and Brandon cannot illegally avoid sales on these markets and then argue that because they did so they need not answer for a fraud perpetrated on investors. We hold that the unamended version of section 6b applied to Paragon's off-exchange sales.

*Id.*

60. *See, e.g.*, Goodman v. H. Hentz & Co., 265 F. Supp. 440, 447 (N.D. Ill. 1967) (holding that plaintiffs had stated a cause of action under the CEA); Booth v. Peavey Co. Commodity Servs., 430 F.2d 132, 133 (8th Cir. 1970) (recognizing that a remedy is provided for in the CEA); Deaktor v. L. D. Schreiber & Co., 479 F.2d 529, 534 (7th Cir. 1973) (holding that a private cause of action exists under the CEA), *rev'd on other grounds sub nom*., Chicago Mercantile Exch. v. Deaktor, 414 U.S. 113 (1973); Seligson v. New York Produce Exch., 378 F. Supp. 1076, 1084 (S.D.N.Y. 1974) (recognizing cause of action under CEA); Case & Co. v. Board of Trade, 523 F.2d 355, 360 (7th Cir. 1975) (stating a private cause of action may be maintained); Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 103-04 (7th Cir. 1977) (recognizing cause of action); Hofmayer v. Dean Witter & Co., Inc., 459 F. Supp. 733, 738 (N.D. Cal. 1978) (stating a private cause of action may be maintained); Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 235 (6th Cir. 1980) (stating a private cause of action may be maintained).

61. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 394-95 (1982). Congress amended the CEA to explicitly provide that "any person" aggrieved by a violation of the Act committed by "any person" has a private remedy actionable in federal court. *See* 7 U.S.C. § 25 (1994).

62. The CFTC fulfilled this mandate to provide a fair and equitable procedure by promulgating 17 C.F.R. § 180.2 (1997) that requires, inter alia: (1) that arbitration panels be comprised of a majority of arbitrators not connected with either the contract market or the brokerage industry; (2) an evidentiary hearing that meets due process standards; (3) the right to cross-examine witnesses; (4) a verbatim record of the proceeding; (5) reasonable arbitration fees with incremental costs incurred in

voluntary, (ii) the procedure shall not be applicable to any claim in excess of $15,000, and (iii) the procedure shall not result in compulsory payment except as agreed upon between the parties."[63] Congress and the CFTC both viewed this limited contract market arbitration as a *customer protection measure*,[64] the equivalent of "a small claims court"[65] that: (1) provided customers, who might otherwise be deterred by the expense of a court proceeding, with an inexpensive forum to air their grievances;[66] and (2) also provided a remedy for claims not cognizable in either courts or in the CFTC's reparations procedure, such as claims arising from a violation of exchange rules.[67] Therefore, unlike claims arising under the Securities Act and other federal statutes under which arbitration is a private, contractual remedy that has received judicial approval, arbitration under the CEA is a limited *legislative remedy.* As the CFTC explained when rumblings of discontent were voiced over its proposed strict limitations on the use of arbitration under the CEA:

> The Commission received several comments strongly criticizing this provision. The principal criticisms expressed in those comments were that the Commission had incorrectly relied on an unrelated Supreme Court case, *Wilko v. Swan*, 346 U.S. 427 (1953), an action under the federal securities laws; that the Commission is not empowered to adopt such a requirement under section 5a(11); that the Federal Arbitration Act, 9 U.S.C. Sections 1-14 (1970), precludes such a requirement; and that such a provision would interfere with existing contractual rights. *The Commission's action*[*s*] *in the first instance* [*were*] *not premised on Wilko v. Swan*. The second of these objections overlooks the fact that the Commission's prior proposed rules were not adopted solely pursuant to section 5a(11). The Commission's announcement stated that those prior rules were being proposed pursuant to section 8a of the Commodity Exchange Act, as amended, 7 U.S.C. 12a, as

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obtaining non-industry arbitrators to be a shoulder by the contract market member; and (6) there must be no appeal procedure within the contact market that can overturn an award. *See* 17 C.F.R. § 180.2(d), (e), (f) (1998). When the CFTC later permitted the use of non-contract market arbitration venues, it imposed these requirements by reference on those venues. *See id.* § 180.3(b).

63. 46 Fed. Reg. 57,457, 57,459 (1981). The House originally proposed to restrict arbitration to claims not exceeding $5000. *See* S. CONF. REP. NO. 93-1194, at 23 (1974). The $15,000 limitation was eventually removed in 1983. *See* Futures Trading Act of 1982, Pub. L. No. 97-444, § 217, 96 Stat. 2294, 2307 (1983).

64. *See Curran*, 456 U.S. at 385-86 (emphasis added) (citing various portions of the congressional record, including the statement by the chairman of the Senate committee stewarding the legislation, that both reparations and limited contract market arbitration were "new customer protection features").

65. 46 Fed. Reg. at 57,461 (to be codified at 17 C.F.R. pt. 7).

66. *See id.* at 57,459.

67. *See* 41 Fed. Reg. 27,526, 27,527 n.5 (1976) (to be codified at 17 C.F.R. pt. 180); Felkner v. Dean Witter Reynolds, Inc., 800 F.2d. 1466, 1469 (9th Cir. 1986); *see also* 46 Fed. Reg. 57,457, 57,462 (discussing arbitration rules and regulations). This limited arbitration might provide the only venue for customer claims against floor brokers who were not required to join a national futures association. *See* 46 Fed. Reg. at 57,461-62.

well as under section 5a(11).[68]

The concept of arbitration as a supplemental legislative remedy limited to a range of claims falling far short of all the claims allowed under a statute is the antithesis of the Supreme Court's arbitration policy as advocated in *Mitsubishi Motors*,[69] *McMahon*,[70] and *Gilmer v. Interstate/Johnson Lane Corp.*[71]

Just how narrow a remedy the CFTC considered arbitration became apparent when it initially decided that the only sure method to insure that arbitration was truly voluntary would be to permit only post-dispute arbitration agreements.[72] The CFTC eventually relented and, as discussed below, permitted the use of pre-dispute arbitration clauses for claims not exceeding the $15,000 limit imposed by 7 U.S.C. § 5a(11).[73] Viewing the entire reach of the CEA as a large regulatory pond, the legislative stone of arbitration initially caused hardly a ripple. As the CFTC later commented in discussing the "small claim" nature of CEA arbitration: "Congress also recognized, however, that arbitration was an incomplete remedy—*it provided no forum for disputes against non-members or for disputes arising outside the contract markets' jurisdiction*."[74] Indeed, the members of contract markets initially believed that the remedy was so limited that it did not even bind the customer to an adverse award.[75]

Since the CFTC published its consistent interpretations of 7 U.S.C. § 7a(11) as imposing strict limits on the remedy of arbitration, Congress revisited the CEA on

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68. 40 Fed. Reg. 54,430, 54,432 (1975) (to be codified at 17 C.F.R. pt. 180) (emphasis added). The CFTC specifically concluded that it was not restricted by the FAA in promulgating these regulations. *See id*. at 54,433.

69. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 624-28 (1985).

70. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 225-27 (1987).

71. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24-26 (1991).

72. *See* 40 Fed. Reg. 29,121, 29,122 (1975); 40 Fed. Reg. 34,152, 34,153-54 (1974); 40 Fed. Reg. 54,430, 54,430 (1975); *see also* Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 567 F.2d 1174, 1177 (2d Cir. 1977); Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 228 (6th Cir. 1980), *aff'd on other grounds,* 456 U.S. 353 (1982).

73. *See, e.g.*, 17 C.F.R. § 180.4 (1978). The CFTC did permit post-dispute arbitration of counterclaims in excess of $15,000, but in a preview of what would eventually be expanded in § 180.3(b) required that the customer sign a form stating that: "All formal legal safeguards provided in a court of law may not be available in this procedure. This procedure is voluntary and you need not submit to the procedure." 17 C.F.R. § 180.5 (1998); *see also* 40 Fed. Reg. 54,430, 54,435 (1975). The contract markets adopted rules consistent with the $15,000 limitation imposed by Congress. *See* 46 Fed. Reg. 57,457, 57,459 (1981) (to be codified at 17 C.F.R. pt. 7). When the CBOT refused to require its membership to stand answerable for such claims filed by customers, the CFTC exercised its oversight authority and promulgated CBOT Arbitration Rule 620.01(b). *See* 46 Fed. Reg. 57,457, 57,463 (1981). Since 7 U.S.C. § 5a (later renumbered § 7a(11)) would not allow a customer to be forced to submit to claims in excess of $15,000 and the exchanges did not require their membership to stand answerable for permissive claims filed by customers in excess of that amount, arbitration under the CEA was limited to claims under $15,000 until Congress removed that restriction in 1983. *See* 41 Fed. Reg. 42,942, 42,943 (1976).

74. 46 Fed. Reg. 57,457, 57,461 (1981) (emphasis added).

75. *See id*.

numerous occasions and even amended the very provisions the CFTC cited to support its interpretation.[76] Congress never took issue with the CFTC's interpretation nor with the regulatory scheme the CFTC promulgated as a result. While such silence, alone, would be sufficient under *Schor* to infer Congressional approval of the CFTC's interpretation of the limits on arbitration imposed by 7 U.S.C. § 7a(11),[77] Congress spoke directly to the issue in discussing its decision to remove the $15,000 limitation on arbitrations:

> As sections 5a(11) and 17(b)(10) currently read, exchanges and registered futures associations may refuse to arbitrate a customer's claim against one of their members or employees if the amount in question exceeds $15,000. The committee is of the view that arbitration is an equally viable forum for resolving customer claims in excess of $15,000 and there is no logical reason why reparations should be the *only* out-of-court forum for resolution of these disputes.[78]

## V. THE PURPOSE OF 17 C.F.R. § 180.1

Prepared to limit arbitration to the strict confines of 7 U.S.C. § 7a(11), the CFTC initially drafted § 180.1 to restrict the use of pre-arbitration for claims under $15,000 solely to contract market members and their employees.[79] All other claims were to be excluded from arbitration including transactions made against non-exchange members even though the claim arose from "a transaction that was proposed or attempted to be effected as well as completed transactions" on a contract market.[80] The term "claim or grievance," as defined in § 180.1(a), therefore excludes from arbitration claims the requirement of the presence of witnesses or parties over whom the contract market lacks jurisdiction.[81] Since contract markets limit access to

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76. Congress amended 7 U.S.C. § 7a(11) three times. *See* Futures Trading Act of 1978, Pub. L. No. 95-405, § 11, 92 Stat. 865, 870; Futures Trading Act of 1982, Pub. L. No. 97-444, § 217(a), 96 Stat. 2294, 2307 (1983); Futures Trading Practices Act of 1992, Pub. L. No. 102-546, § 222(a), 106 Stat. 3590, 3615. Section 21(b)(10), which requires national futures associations to provide arbitration forums, was amended in 1992. *See* Futures Trading Practices Act of 1992, Pub. L. No. 102-546 § 206(b)(1)(c), 106 Stat. 3590, 3603.

77. *See* CFTC v. Schor, 478 U.S. 833, 845-46 (1986).

78. H.R. REP. NO. 97-565, pt. 1, at 56 (1982) (emphasis added). Section 17(b)(10) originally imposed the same limitations on futures industry associations that 7 U.S.C. § 7a(11) had imposed on contract markets in 1974. *See* 7 U.S.C. § 7a(11) (1994).

79. *See* 40 Fed. Reg. 54,430, 54,430-32 (1975) (to be codified at 17 C.F.R. pt. 180).

80. *Id.* at 54,430. The CFTC had made clear in proposing § 200.1, the predecessor to § 180.1, that the term "customer" was defined "as a person engaging in a transaction through the facilities of a contract market . . . ." 40 Fed. Reg. 34,152, 34,153 (1975). As the CFTC explained in discussing the proposed rule that eventually was adopted: "[t]he Commission's rules relating to [contract market] arbitration and other dispute settlement procedures were intended to be and are applicable only to claims or grievances arising out of transactions effected on contract markets – that is boards of trade designated as contract markets by the Commission under the Act." 41 Fed. Reg. 42,942, 42,946 (1976).

81. *See* 17 C.F.R. § 180.1(a) (1998). Section 180.1(a) reads as follows:

their arbitration process to their membership,[82] excluding arbitrations involving non-members and their employees from the definition of "claim or grievance" served the CFTC's purpose of limiting commodity arbitration to the express dictates of 7 U.S.C. § 7a(11) as opposed to the universe of possible claims that could arise under the various anti-fraud provisions of the CEA.[83] Consistent with this purpose, the CFTC originally defined the term "customer" as "any person with a claim or grievance against a member of the particular contract market which is the forum for the settlement procedure."[84]

## VI. THE CFTC'S EXPANSION OF THE ARBITRATION REMEDY UNDER 7 U.S.C. § 12a(5) (1994)

Once having decided to permit the use of pre-dispute arbitration agreements, the CFTC then exercised its authority under 7 U.S.C. § 12(a)(5) (1994)[85] to expand

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> The term *claim or grievance* as used in this part shall mean any dispute which arises out of any transaction on or subject to the rules of a contract market, executed by or effected through a member of that contract market or employee thereof which dispute does not require for adjudication the presence of essential witnesses or third parties over whom the contract market does not have jurisdiction and who are not otherwise available. The term claim or grievance does not include disputes arising from cash market transactions which are not a part of or directly connected with any transaction for the purchase or sale of any commodity for future delivery or commodity option.

*Id.* The CFTC added the second sentence to exclude "cash market transactions which are not a part of or directly connected with" a futures transaction. *Id.*; *see* 41 Fed. Reg. 27,520, 27,521 (1976) (noting that the Commission has excluded cash market transactions quoted in the rule). As the CFTC explained, this exception applies to "exempt from the scope of this rule transactions which relate *entirely* to cash market activities." 41 Fed. Reg. at 27,520 (emphasis added).

82. *See* RULES AND REGULATIONS OF THE BOARD OF TRADE OF THE CITY OF CHICAGO, RULE 620.01B (1998); RULES OF THE CHICAGO MERCANTILE EXCH., RULE 601.A.1 (1998); MID-AMERICA COMMODITY EXCH. RULES & REGULATIONS, RULE 800 (1996); BOARD OF TRADE OF KANSAS CITY BY-LAWS, RULES, & REGULATIONS, RULE 1500.02 (1991); MINNEAPOLIS GRAIN EXCH. RULES & REGULATIONS, RULE 500.00.B (1998); BY-LAWS & RULES OF THE NEW YORK COTTON EXCH. & COFFEE, SUGAR & COCOA EXCH., RULES 6.01.(b), 8.01(e); NEW YORK MERCANTILE EXCH., RULE 5.04(B) (1996). The COMEX is a division of the New York Mercantile Exchange and FINEX is a division of the New York Cotton Exchange and apply the respective arbitration rules of those exchanges.

83. *See, e.g.*, 7 U.S.C. § 6(b) (1994) (stating "[i]t shall be unlawful for . . . any person . . . ."); 7 U.S.C. §§ 6(c), 6(e), 6(h), 6(k) (1994) (stating "[i]t shall be unlawful for any person . . . ."); 7 U.S.C. § 6(o) (1994) (excluding any commodity trading advisor or pool operator). A private right of action may be filed against "any person" pursuant to 7 U.S.C. § 25 (1994) and a reparations claim may be filed against "any registrant" (which effectively meant any person until the 1982 amendments as discussed previously) pursuant to 7 U.S.C. § 18 (1994). *See id.* § 18 (providing structure for filing a claim).

84. 40 Fed. Reg. at 54,434. The rule no longer restricts the definition to a particular contract market and now reads: "[t]he term *customer* as used in this part includes an option customer (as defined in §1.3(jj) of this chapter) and any person for or on behalf of whom a member of a contract market effects a transaction on such contract market, except another member of that contract market." 17 C.F.R. § 180.1(b) (1998).

85. *See* 40 Fed. Reg. at 54,432-33; Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 567 F.2d 1174, 1176-78 (2d Cir. 1977). Section 12a(5) states in pertinent part that the CFTC has authority

the use of arbitration beyond the literal bounds of 7 U.S.C. § 7a(11) and permit FCMs who were not exchange members access to the arbitration remedy.[86] As the CFTC later explained, this expansion:

> [W]as proposed under the general rulemaking authority of the Commission under section 8a(5) of the Act in order to effectuate the legislative intent, evidenced by section 5a(11), to make arbitration voluntary on the part of the customers, *without regard to whether the futures commission merchant or other registered person executing transactions for the customer was a member of a contract market*, or was submitting a dispute for settlement pursuant to a contract market settlement procedure established under the Commission's rules *or* to another type of arbitration or dispute settlement procedure.[87]

Rather than drafting a separate regulation to expand the availability of arbitration beyond the literal boundaries of 7 U.S.C. § 7a(11) (1994), the CFTC decided to amend 17 C.F.R. § 180.1(b) to broaden the definition of "customer" to include persons dealing with FCMs who were not members of a contract market.[88] The CFTC also enlisted § 180.3 for double duty; that regulation would define the contents of pre-arbitration agreements and would enfranchise the classes of commission registrants permitted to utilize arbitration agreements.[89]

While FCMs who were not contract market members were permitted to offer pre-dispute arbitration agreements, this privilege was denied to commodity trading advisors and pool operators.[90] After the 1982 amendments to the CEA, the CFTC

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"to make and promulgate such rules and regulations as . . . are reasonably necessary to effectuate any of the provision or to accomplish any of the purposes of" the CEA. 7 U.S.C. § 12a(5) (1994).

86. *See* 41 Fed. Reg. 42,942, 42,942 (1976).

87. *Voluntary Arbitration Procedure and Compulsory* Payments, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,216, at 21,165 n.5 (Sept. 29, 1976) (emphasis added). Section 12a(5) grants the CFTC the authority to adopt any regulation reasonably necessary to effectuate the CEA. *See* 7 U.S.C. § 12a(5) (1994).

88. *See* 41 Fed. Reg. at 42,942; 17 C.F.R. § 180.1(b) (1998).

89. The CFTC stated in reference to proposed § 200.3 (§ 180.3 predecessor) that: "proposed § 200.3(c) barred futures commission merchants, floor brokers and other persons registered with the Commission from entering into pre-dispute arbitration agreements or understandings with customers." 41 Fed. Reg. at 42,943. Proposed rule 200.3(c) was promulgated pursuant to the CFTC's general rule making authority pursuant to 7 U.S.C. § 12a(5) and was applicable to all registrants whether or not they were exchange members. *See id.* at 42,943 n.5.

90. In explaining why the phrase "or any person registered with the Commission under the Act" was deleted from the final draft of § 180.3(b), the CFTC stated:

> The commission did not intend that § 180.3 apply to commodity trading advisors or commodity pool operators: the phrase "or any other person registered with the Commission * * *" was inadvertently carried over from an earlier draft of the proposed rule, and thus has been deleted. However, *the Commission intends to consider adopting rules governing the settlement of disputes between customers and commodity trading advisors and pool operators at a later date*.

41 Fed. Reg. at 42,946 (emphasis added).

revised § 180.3(b) to extend the right to use arbitration agreements to commodity trading advisors and pool operators[91] and eventually to introducing brokers, who place or "clear" their transactions through an FCM.[92] As a result of two sudden and separate actions, one by the CFTC and the other by Congress, the use of arbitration agreements was extended to all actual CEA registrants. However, the remedy was never extended to persons or entities who avoided the "kingpin" of registration. Both the sudden expansion of the arbitration remedy and the CFTC's jerrybuilding of § 180.3(b) obscured: (1) the rule's original role as a parsimonious dispenser of the right to arbitrate; and (2) the fact that, unlike the Securities Act and other legislation where arbitration emerged fully formed, the evolution of arbitration under the CEA was an incremental process that never expanded to the full extent of possible claims that might be advanced under the statute.

## VII. THE ROLE OF § 180.3 IN ENSURING THE VOLUNTARINESS OF ARBITRATION AS MANDATED BY 7 U.S.C. § 7a(11) (1994)

The CFTC was also concerned that once pre-dispute arbitration agreements were permitted, the possible industry-wide use of such agreements as a pre-condition for opening an account could effectively undermine the congressional edict in 7 U.S.C. § 7a(11) (1994) that commodity arbitration be voluntary. The CFTC held public hearings on the issue and concluded that the use of arbitration clauses which could not be negotiated out of standard account agreements would effectively render such clauses contracts of adhesion.[93] As the Second Circuit subsequently observed, the CFTC determined that the practice was "so prevalent that a customer might effectively be frozen out of the futures market if he refused to execute a pre-dispute arbitration agreement."[94] The CFTC believed that such agreements would be statutorily unenforceable given the expressed voluntariness mandate of 7 U.S.C. § 7a(11) (1994). In an observation that further distanced arbitration under the CEA from *Wilko v. Swan* (and therefore *McMahon*), the CFTC stated:

> [T]he Commission believes that a court would not uphold currently extant pre-dispute arbitration agreements (if all the issues were before the court), notwithstanding the policy in favor of arbitration enunciated the Federal Arbitration Act and the lack of an express statutory provision in the Act comparable to the Securities Act of 1933, the basis upon which Wilko v. Swan. 346 U.S. 427 (1953), was decided. This belief is based upon the following: (1) Since pre-dispute arbitration agreements are used by the entire industry such agreements would effectively preclude a customer from seeking reparations as provided in section 14 of the Act; would negate the

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91. *See* 48 Fed. Reg. 22,136, 22,138 (1983).

92. *See* 48 Fed. Reg. 41,152, 41,152 (1983).

93. *See* 41 Fed. Reg. at 42,945; Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 567 F.2d 1174, 1178 (2d Cir. 1977).

94. *Ames*, 567 F.2d at 1178. *See also* 41 Fed. Reg. 27,526, 27,527 (1976); 41 Fed. Reg. at 42,945.

> meaning of "voluntary" in section 5a(11) of the Act and would deprive commodity customers of private rights of action in courts of law under the Act; thus depriving customers of the remedial effects of the 1974 amendment to the Act; (2) Since the Commission has been advised that futures commission merchants will not deal with customers who do not sign pre-dispute agreements, there exists a pattern of systematic refusals to deal except in circumstances which eliminate certain basic rights of customers; and (3) Certain commodity customers who are unsophisticated are compelled to sign such agreements under conditions which suggest a lack of informed consent and the imposition of a contract of adhesion on them to their detriment.[95]

Congress envisioned the right to pursue a private right of action as an integral component of its legislative scheme.[96] How to promote arbitration while not permitting it to swallow a person's right to proceed in court was the problem facing the CFTC, which it ultimately resolved through informed consent.[97] The CFTC also realized that nothing in the CEA expressly prevented brokerage firms from requiring persons to contractually waive their rights to the newly created reparations forum provided by Congress.[98] The CFTC effectively addressed each of these concerns in promulgating 17 C.F.R. § 180.3 (1997) by preserving the right to proceed in reparations even in the face of a valid arbitration agreement[99] and by adopting

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95. 41 Fed. Reg. at 42,944-45 (footnotes omitted).

96. Congress considered the private attorneys general concept embodied in the private right of action fundamental to enforcement of the CEA that when the private right of action was made explicit, Congress cautioned the CFTC not to slacken its enforcement efforts:

> The availability of these remedies - reparations, arbitration and private rights of action - supplements, but does not substitute, for the regulatory and enforcement program of the CFTC and the self-regulatory agencies. The Committee fully expects that these agencies will vigorously use the tools at their command to protect the investment public so that it does not become necessary to rely on private litigants as a policeman under the Commodity Exchange Act.

H.R. REP. NO. 97-565, pt. 1, at 56 (1982).

97. *See* 17 C.F.R. § 180.3(b)(1) (1998). As the CFTC realized, "unless there is an informed consent, customers may be unwittingly deprived of a private right of action in the federal courts for violation of the Commodity Exchange Act or rules thereunder." 41 Fed. Reg. at 27,526.

98. The CFTC subsequently observed that:

> The Commission notes that, contrary to the view of two commentators (Gary J. Lekas and M. Van Smith), it does not believe that any provision of the Commodity Exchange Act nor any court holdings would preclude the Commission from amending its rules to permit the use of pre-dispute arbitration agreements by which the parties thereto waive their right to reparations. Indeed, the Commission believes that, but for existing provisions in Part 180 of its regulations, such contractual waivers would be permissible.

48 Fed. Reg. 22,136, 22,138 n.21 (1983).

99. The CFTC stated: "[p]roposed § 180.3(b) has also been amended to make clear that predispute arbitration agreements are invalid to the extent that they require a waiver of the right to seek reparations: the reparations remedy can only be waived after a dispute arises." 41 Fed. Reg. at 42,946. As previously discussed, at this time the CFTC permitted claims to be filed against both actual and

minimum standards[100] to insure that the private right of action would only be "knowingly and voluntarily waived."[101] To put teeth into the rule, the CFTC declared that "all pre-dispute arbitration agreements that do not satisfy the conditions in the proposed rule will be null and void, including those heretofore signed by customers."[102]

## VIII. THE "CONFUSION" OVER § 180.3(b)

The CFTC's decision to enlist § 180.3 to perform a dual purpose has completely obfuscated the role of arbitration under the CEA. Section 180.1 was initially promulgated to effectuate the congressional mandate in 7 U.S.C. § 7a(11) regarding the establishment of contract markets arbitration, and was crafted to limit its purview to contract market members and their employees under post-dispute arbitration agreements. Similarly, § 180.2 was adopted to assure that such contract market arbitrations would be fair and equitable. Section 180.3(b), however, was promulgated under the CFTC's general grant of authority under 7 U.S.C. § 12a(5) to expand the availability of arbitration beyond the contract markets. Whatever confusion exists as a result of the CFTC's use of § 180.3(b) to expand the permissible scope of commodity arbitration, rather than drafting a separate regulation for that purpose, is disputed by the shining beacon of a clear regulatory purpose.

The intent of § 180.3 is to vouch-safe that neither the private right of action, nor the then coextensive, right to proceed in reparations, were unwittingly waived. Since both the private right of action and the right to reparations were congruent with the farthest reaches of the CEA during the promulgation of this regulation, any proffered interpretation of the Arbitration Rules that would disenfranchise persons alleging any violation of the CEA should send up red warning flags. The manner in which the HTA courts dealt with anomalous arguments demonstrates how completely the Supreme Court's directive to arbitrate whenever possible has supplanted the obligation of district courts to evaluate such arguments with reference to legislative and regulatory history.

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required registrants, CFTC's regulations conformed to the agency's interpretation of the term "registered" as used in 7 U.S.C. § 18 (1994). *See, e.g.*, 17 C.F.R. § 12.21 (1978).

100. Compliance with the regulation, however, is not conclusive but merely raises a rebuttable presumption of voluntariness:

> Proposed § 180.3(b) did not, and was not intended to eliminate the role of courts in assuring that the execution of an arbitration agreements is voluntary. Rather, proposed § 180.3(b) sets certain minimum requirements for pre-dispute arbitration agreements (*e.g.*, a prohibition on refusals to deal, cautionary language, etc.) to help assure an informed consent by customers. The courts still must decide whether the agreement was otherwise voluntary. The Commission recognizes the possibility that in some cases, the execution of pre-dispute arbitration agreements may be involuntary under applicable state or federal law, notwithstanding that the requirements of proposed § 180.3(b) are satisfied.

41 Fed. Reg. at 42,945.

101. *See id.* at 42,946-47.

102. *Id.* at 42,944.

## IX. FOUR CIRCUIT COURT DECISIONS BEARING ON THE SCOPE OF § 180.3

The initial issue concerning § 180.3 was whether the rule, while retrospectively applicable to existing arbitration agreements, governed agreements for disputes that had arisen prior to the effective date of the regulation. The CFTC sided with the brokerage firm in *Ames* and urged that the rule not be applied to such disputes.[103] The Second Circuit traced the history of the regulation and concluded that its remedial purpose was no less needed by those with existing claims than by those who would have claims in the future.[104] The same retroactivity issue faced the Sixth Circuit in *Curran*, where an arbitration agreement contained a one-year statute limitations period for the filing of claims.[105] The Sixth Circuit agreed with *Ames* that the reasons for adopting the regulation were no less valid when applied to persons whose disputes arose prior to the effective date of the arbitration clause.[106]

The Ninth Circuit subsequently addressed an analogous issue in *Wotkyns v. D.E. Jones Commodities, Inc.*,[107] where the agreement sought to be enforced, while conforming to the initial wording required by section 180.3(b)(6), failed to include language required by a 1983 amendment to the rule intended "to more clearly and simply convey the significance of the arbitration agreement to the customer."[108] While the arbitration agreement did not contain the changes required by the revised rule, the customer had executed a boldface agreement identical to that signed in *Ames* and *Curran*.[109] The Ninth Circuit applied the amendment retroactively and

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103. *See* Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 567 F.2d 1174, 1177 n.3 (2d Cir. 1997).

104. *See id.* at 1179.

105. *See* Curran v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 622 F.2d 216, 225 (6th Cir. 1980).

106. *See id.* at 229. The Sixth Circuit noted that the Eighth Circuit also had voiced its agreement with *Ames* in *Arkoosh v. Dean Witter & Co.*, 571 F.2d 437, 438 (8th Cir. 1978). *See id.*

107. Wotkyns v. D.E. Jones Commodities, Inc., 791 F.2d 749 (9th Cir. 1986) (per curiam).

108. *Id.* at 750 (quoting 48 Fed. Reg. 22,140 (1983)).

109. In *Marchese v. Shearson Hayden Stone, Inc*., 734 F.2d 414 (9th Cir. 1984), which is discussed in the next section, the Ninth Circuit had occasion to rule on the fairness of the very arbitration agreement the customer in *Wotkyns* had signed and that had met the requirement of the original version of § 180.3(b):

> We find that Shearson did not breach this duty or engage in any constructive fraud. First, the 1977 Agreement cited the relevant federal protective regulations, including 17 C.F.R. § 180.3. There was no concealment of the existence of these regulations or the fact that these regulations invalidated the previous agreements. *Cf. Smoky Greenhaw Cotton Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc*., 720 F.2d 1446, 1450-51 (5th Cir. 1983) (holding no fraud in arbitration agreement). Second, the 1977 Agreement contained the necessary cautionary language, including the provision that Marchese 'need not sign this arbitration agreement to open an account with Shearson Hayden Stone.' This emphasized the voluntariness of the decision to agree to arbitration. The agreement expressly stated that signing this new 'Commodity Customer Agreement' revoked all other agreements. Marchese could

invalidated the agreement.[110] Citing a few portions of the Federal Register that appeared to indicate the CFTC intended retroactive application of the amended regulation, *Wotkyns* focused primarily on the CFTC's decision to retroactively apply the original regulation to existing agreements. Agreeing with *Ames* that the purpose of the regulation was to make arbitration "truly voluntary,"[111] *Wotkyns* concluded that the 1976 and 1983 regulations should not be compartmentalized from their common purpose.[112]

*Felkner v. Dean Witter*,[113] decided on the heels of *Wotkyns*, confronted the issue of whether statutory claims based on commodity fraud but arising outside the CEA, fell within the penumbra of § 180.3 when the defendant moved to compel arbitration of a commodity fraud claim cast in terms of the Racketeer Influenced and Corrupt Organizations Act.[114] After reviewing the regulatory history of § 180.3, the *Felkner* court concluded that § 180.3(b) was intended to reach all claims arising out of commodity trading[115] and that the CFTC "intended non-CEA claims as well as

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> have entered into the basic Commodity Customer Agreement without agreeing to the separate arbitration provision. Had he not desired arbitration, he could have effectively repudiated his prior arbitration agreements by signing the basic agreement but not endorsing the arbitration provision.

Marchese v. Shearson Hayden Stone, Inc., 734 F.2d 414, 418 (9th Cir. 1984).

110. *See Wotkyns*, 791 F.2d at 751.

111. Ames v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 567 F.2d 1174, 1178 (2d Cir. 1977), *quoted in Wotkyns*, 791 F.2d at 750. The court in *Wotkyns* clearly interprets the concept of "voluntariness" under the CEA, and therefore the CFTC's regulations, as far more expansive than is normally envisaged. *See Wotkyns*, 791 F.2d at 750. The district court in *Arkoosh*, had previously addressed this possibility:

> [T]he term *voluntary* cannot be given an unyielding definition appropriate in all circumstances and applicable regardless of the context in which it is used. In the present case, that word is used in the context of a statute which is part of a sophisticated regulatory scheme. Therefore, it is possible that it has been used as a term of art and that it has a content which it would not otherwise be given in the context of a dispute arising at common law. *See* N.L.R.B. v. Hearst Publications, Inc., 322 U.S. 111, 120-22, 64 S.Ct. 851, 88 L.Ed. 1170 (1944).

Arkoosh v. Dean Witter, 415 F. Supp. 535, 539 (D. Neb. 1976).

112. *See Wotkyns*, 791 F.2d at 751-52.

113. Felkner v. Dean Witter Reynolds, Inc., 800 F.2d 1466 (9th Cir. 1986).

114. 18 U.S.C. §§ 1961-1968 (1994).

115. Any other interpretation, the *Felkner* court concluded, would undercut the fundamental purpose of the CEA:

> The contention by defendants that Congress intended to ensure only the voluntariness of agreements to arbitrate claims brought under the CEA is inconsistent with the 'fundamental purpose' of the CEA to 'insure fair practice and honest dealing on the commodities exchanges....' S. Rep. No. 93-1131, 93d Cong., 2d Sess. 1, *reprinted in* 1974 U.S. Code Cong. & Admin. News 5843, 5856. To enforce an adhesive arbitration agreement against non-CEA claims offends fairness and honesty as much as enforcing such an agreement against claims brought under the CEA itself. Furthermore, the fact that the CFTC intended section 180.3 to reach agreements to arbitrate non-CEA claims, creates a strong presumption that the CFTC did not exceed its authority in promulgating section 180.3. '[A]s the CFTC's contemporaneous interpretation of the statute it is entrusted to administer,

CEA claims to be subject to the requirements of § 180.3."[116] *Felkner* also specifically addressed the Supreme Court's decision in *Mitsubishi Motors* and determined that the restrictions in 7 U.S.C. § 7a(11) expressed a legislative policy that took precedence over the strong federal policy favoring arbitration as expressed in the Arbitration Act.[117]

## X. ARE CERTAIN COMMODITY DISPUTES A FIT SUBJECT MATTER FOR ARBITRATION?

In *Marchese v. Shearson Hayden Stone, Inc.*,[118] the Ninth Circuit faced the question of whether certain types of claims were unsuited for the arbitration process. At issue was whether brokerage firms were entitled to retain the incremental interest earned on margin funds or were required to credit such interest to the customer.[119] The *Marchese* court proceeded to review previously reported decisions relating to the arbitrability of CEA claims and concluded that each involved "factual inquiry that arbitrators traditionally have handled."[120] The claim for regarding interest on margin deposits raised an issue of first impression that *Marchese* viewed solely as a question of law which did not involve any allegation of wrongdoing.[121] *Marchese* concluded that the issue of statutory interpretation was one best suited to a judicial determination and that a reported decision would provide brokerage firms with a

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> considerable weight must be accorded the CFTC's position.' *Schor*, — U.S. at —, 106 S.Ct. at 3254; *accord State of Hawaii v. Heckler*, 760 F.2d 1031, 1033 (9th Cir.1985) (courts give 'substantial deference' to agency interpretations of statutes that they are charged with administering and enforcing).

*Felkner*, 800 F.2d at 1469-70.

116. *Id.* at 1469.

117. *See id.* at 1470. The court stated:

> Defendants argue that their narrow interpretation of CFTC power is mandated by the strong federal policy favoring arbitration under the Arbitration Act, 9 U.S.C. §§ 1-14 (1982). But nothing in the Arbitration Act requires a person to submit a claim to arbitration unless he has so agreed . . . . Moreover, any presumption favoring arbitration may be rebutted by the express or implicit command of a federal statute. In this case, 7 U.S.C. § 7a(11) clearly expresses Congress's intent to insure the voluntariness of arbitration agreements in contracts governing commodity-brokerage accounts.

*Id.* (citations omitted).

118. Marchese v. Shearson Hayden Stone, Inc., 734 F.2d 414 (9th Cir. 1984). The plaintiff Marchese was particularly litigious, having filed two actions against the defendant. *See id.* at 417. In the first action, the district court held that a previous agreement between the parties was valid, so that plaintiff must submit his claim to arbitration. *See id.* The Supreme Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), revived the case and the issue became one of whether the now cognizable claim was arbitrable. *See id.* at 421-22. The district court granted the defendant summary judgment in the second suit. *See id.*

119. *See id.* at 419.

120. *Id.* at 421.

121. *See id.*

basis on which they could conform their conduct.[122] Finally, *Marchese*, decided prior to *Mitsubishi Motors*, may have lost much of its luster in distinguishing between statutory right and commercial claims, although the Ninth Circuit did concede that statutory claims could be subject to a valid arbitration clause in instances where the waiver was clear and voluntary.[123] Still, the concern over the inappropriateness of arbitrators deciding an issue that might adversely affect their industry and the need for a reported decision in certain situations, remain valid.

The determination of whether HTA contracts violate the CEA's provision barring off-exchange trading of commodity futures contracts, like the issue in *Marchese*, does not require a finding of fault, bad faith, or fraud. While the inquiry may be more factually intensive than that faced by the Ninth Circuit, it is an issue that goes to the central purpose of the CEA rather than merely residing on its far periphery, as the issue in *Marchese* did. In addition, if the possible presence of one or more brokers on a panel determining an issue that could financially impact their firm was sufficient to raise a serious concern in *Marchese*,[124] referring a farmer to a panel comprised of nothing but arbitrators who may have such a financial interest in the outcome of the HTA's legality, should raise even deeper concerns. The real issue is private litigation's role in interpreting a regulatory statute on a matter of first impression that will have broad consequences for the industry as a whole. As *Marchese* realized, somewhere in the process a court must provide arbitrators a legal standard against which to apply the facts.[125] The continued development of the law cannot help but be arrested once an entire industry's disputes are relegated to a private forum for resolution. Security litigation in the wake of *McMahon* is an example where a complete body of law existed for determining a securities fraud or a valid defense.[126] While the same may generally be true of commodity fraud claims, the HTA controversy raises a unique issue of at what point a contract between

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122. *See id.* In *Amaro v. Continental Can Co*., 724 F.2d 747 (9th Cir. 1984), the Ninth Circuit stated:

> Arbitrators, many of whom are not lawyers, *see* F. Elkouri and E.A. Elkouri, How Arbitration Works, 3d Ed. (1981) at 90-91, 94, lack the competence of courts to interpret and apply statutes as Congress intended. As the Supreme Court has said, '[t]he specialized competence of arbitrators pertains primarily to the law of the shop, not the law of the land.' Alexander v. Gardner-Denver Co., 415 U.S. 36, 57, 94 S.Ct. 1011, 1024, 39 L.Ed.2d 147 (1974).

*Id.* at 750 (footnote omitted).

123. *See Marchese*, 734 F.2d at 419.

124. *See id.* at 421.

125. *See id*.

126. One need only review the federal reporter system after *McMahon* and compare the volume of securities cases deciding, for example, what conduct violates the Securities Act's anti-fraud provision, 15 U.S.C. § 78j(b) (1994), to verify this type of atrophy. When persons are compelled to arbitrate contract disputes, little is lost from law's public reservoir. Contract cases abound outside arbitration. Statutes are a different matter. This is, after all, a common law country where statutes are drafted in broad terms of "artifices to defraud," "misrepresentations," and "material facts." When the interpretation of such terms is left to private forums, the ethical are left to flounder and the unethical are turned loose. Could securities claims ever be effectively arbitrated if, immediately after passage of the Securities Act, all controversies had been subject to private litigation?

producers and users of a regulated commodity crosses the line between legal and illegal conduct. When does the public's need for definable standards of conduct under the governing federal statute override the policy encouraging arbitration? Perhaps, in the final analysis, the HTA controversy does not present such an overriding need. However, can such a question of first impression, that lies at the very heart of a broad statutory scheme, be entirely ignored, as it was in the HTA cases?

## XI. CONFUSING CONTRACT MARKET ARBITRATION WITHIN THE SCOPE OF THE CEA

*Shearson Hayden Stone, Inc. v. Scrivener*[127] is the first decision to limit the scope of § 180.3 and, in so doing, became the exception that proved the protections afforded by § 180.3 could be narrowed only by narrowing the reach of the CEA. In the final analysis, the plaintiff is denied the protection of § 180.3, not because the claim fell outside the scope of the rule, but because *Scrivener* determined that she failed to state a claim under the CEA.[128] The claim in *Scrivener* was, to say the least, unusual. The plaintiff's husband, a former employee of the brokerage firm, transferred his wife's stock brokerage account from the Hong Kong office of his former employer to his new employer.[129] The stock account had been used to margin a separate commodity account and, as a result of the stocks being transferred, the commodity account generated a margin call which went unanswered causing the account to be liquidated for a substantial loss.[130] The wife sued her husband's new employer alleging that the brokerage firm had reneged on its promise to accept both the stock and commodity accounts that, in turn, had resulted in the liquidation of the commodity account by her husband's first employer.[131] The firm moved to compel arbitration in one of three venues, none of which was a contract market.[132]

The *Scrivener* court concluded that the claim of failing to transfer an account did not fall within the definition of a "claim or grievance" in § 180.1(a) *because no transaction had ever taken place*.[133] While *Scrivener* uses very broad language to

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127. Shearson Hayden Stone, Inc. v. Scrivener, 671 F.2d 680 (2d Cir. 1982).

128. *See id.* at 683 n.2. Since the CFTC's jurisdiction is limited to claims arising under the CEA, why Scrivener felt the need to proceed further is puzzling.

129. *See id.* at 681.

130. *See id.* Why the wife never met the margin call from other funds or attempted to mitigate her damages by opening a commodity account at another firm was never discussed.

131. *See id.* at 682.

132. *See id.* at 682 n.1. The three arbitration forums included the Committee of the Chamber of Commerce of the State of New York, the American Arbitration Association, and the New York Stock Exchange.

133. *Id.* at 683-84. The Second Circuit stated: "[w]e agree that Scrivener's complaint is devoid of any cause of action under the Commodities Act and therefore focus, as did Judge Goettel ultimately, on the language and history of the CFTC regulations." *Id.* at 683 n.2.

arrive at that conclusion,[134] there is no question that if there was never a transaction or no damages were incurred, there can be no "claim or grievance" under the CEA. However, to the extent that *Scrivener* attempts to restrict the reach of the CEA to claims or grievances as defined by § 180.1, *Scrivener* is clearly erroneous in employing an agency's regulation designed to define *a contract market transaction* to define the entire reach of a statute designed to regulate *all* commodity futures transaction.[135] As the Supreme Court later stated in *Schor*, the CEA prohibits any fraud related to any commodity futures transactions.[136]

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134. The *Scrivener* court stated:

> We can find no reference to the opening of commodities accounts in either the regulations or in the CFTC's comments which introduced them. Quite to the contrary, the language of the regulations consistently refers to arbitration of events occurring after the opening of a commodities account. For example, the cautionary language which must appear in the customer agreement to create an enforceable arbitration clause includes: WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) RECOGNIZES THE BENEFITS OF SETTLING DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name].....
> 17 C.F.R. § 180.3(b)(4) (emphasis added). Thus, we believe that the CFTC had in mind arbitration relating only to events occurring after the account was opened.

*Id.* at 683-84. If, by "events," the Second Circuit meant misrepresentations occurring prior to the opening of an account, *Scrivener* cannot be reconciled with the Second Circuit's own opinion in *Saxe v. E.F. Hutton, Inc.*, 789 F.2d 105, 111 (2d Cir. 1986) (stating "fraudulent conduct may occur during the solicitation of *potential* customers . . . .") (emphasis added). Since the purpose of § 180.3 is, in large measure, to preserve the right to reparations, a fact that is increasingly lost sight of, § 180.3 must be viewed as co-extensive to the right to proceed in reparations. The extent to which such reparations liability exists for misrepresentations made prior to the opening of an account has recently been underscored in *Knight v. First Commercial Financial Group, Inc.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,942, at 44,556 (C.F.T.C. Jan. 14, 1997) (stating misrepresentations of risk prior to opening account by the customer's unregistered agent who was neither paid nor controlled by broker and whom the customer never believed was speaking for the broker actionable against the broker because it had sent account opening documents to the customer's agent, thereby making him the broker's agent for the purposes of risk disclosure).

135. The full portion of the Federal Register cited by the Second Circuit clearly establishes that the definition of claim or grievance in § 180.1(a) is less than the full extent of claims under the CEA:

> One commentator stated that it appeared that proposed § 180.3 would encompass the arbitration of disputes on foreign exchanges such as the London Metals Exchange. The Commission's rules relating to arbitration and other dispute settlement procedures were intended to be and are applicable only to claims or grievances arising out of transactions effected contract markets – that is, boards of trade designated as contract markets by the Commission under the Act. To make this absolutely clear, the Commission is concurrently amending § 180.1 so as to clarify the scope of the terms 'claims or grievance' and 'customer.'

41 Fed. Reg. 42,942, 42,946 (1976) (footnote omitted). *Scrivener* quotes only the second sentence of this passage. *See Shrivener*, 671 F.2d at 684-85. Placed in context, it is clear that the CFTC was narrowing the definition of "claim or grievance" in § 180.1(a) to conform to the limited use of arbitration which, two paragraphs later, it noted was not available to commodity trading advisors or commodity pool operators. *See* 41 Fed. Reg. at 42,946.

136. CFTC v. Schor, 478 U.S. 833, 836 (1986).

## XII. AN OMINOUS PORTEND OF THE FUTURE FOLLOWING *MITSUBISHI*

*Nilsen v. Prudential-Bache Securities*[137] involved allegations of fraudulent representations made to induce the plaintiff to trade London futures options and relied upon *Scrivener* to compel the claim to arbitration.[138] Decided after Congress amended 7 U.S.C.§ 6b to specifically include off-exchange transactions of the very nature at issue,[139] *Nilsen* is hopelessly misguided. Since the *Nilsen* plaintiff had alleged both futures options transactions and the loss of considerable sums of money as a result,[140] the facts are inapposite to those in *Scrivener* where no transactions were deemed to have occurred.[141] Misrepresentation of risk in the solicitation of commodity accounts is definitely actionable under the CEA[142] and the fraud alleged in *Nilsen* was particularly proscribed by CFTC regulations.[143] Therefore, unlike

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137. Nilsen v. Prudential-Bache Sec., 761 F. Supp. 279 (S.D.N.Y. 1991).

138. *See id.* at 286-87.

139. *See id.* at 282.

140. *See id.* at 279. Like *Scrivener*, the facts in *Nilsen* are unusual. The plaintiff, a citizen of Monaco, opened his account in Monte Carlo, and the transactions at issue relating to the § 180.3 issue were affected in London. *See id.* at 282-83.

141. *See Scrivener*, 671 F.2d at 683 n.3. Fraudulent risk disclosure during the solicitation of commodity accounts is a central feature of the CFTC's antifraud and customer protection measures. *See* 43 Fed. Reg. 31,886, 31,888 (1978). Section 1.55 of Title 7 of the Code of Federal Regulations requires written disclosure of risks to prospective customers and was adopted "to advise new customers of the substantial risks of loss inherent in trading commodity futures." *See* 17 C.F.R. § 1.55 (1998). This protection extends to both domestic and foreign options trading. *See id.* § 32.5 Section 32.5 prescribes the risk disclosure that must be made to prospective customers relative to domestic options. *See id.* Section 30.6 prescribes the disclosure requirements for foreign options and futures customers which includes the requirement to furnish such customers a § 1.55 risk disclosure statement. *See id.* § 30.6.

142. *See* Berisko v. Eastern Capital Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,772, at 31,223 (C.F.T.C. Oct. 1, 1985); Reed v. Sage Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. ¶ 23,943, at 34,299 (C.F.T.C. Oct. 14, 1987); Clayton Brokerage Co. v. CFTC, 794 F.2d 573, 579 (11th Cir. 1986) (minimizing risks during account solicitation can vitiate written risk disclosure statement); Knight v. First Commercial Fin. Group, Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,942, at 44,553 (C.F.T.C. Jan. 14, 1997). *See also* Rosenthal & Co. v. CFTC, 802 F.2d 963, 967-68 (7th Cir. 1986) (finding FCM liable for fraud committed by its agent in soliciting accounts).

143. At the time the *Nilsen* plaintiff opened his account, the following regulation was in full effect:

> It shall be unlawful for any person, by use of the mails or by any means or instrumentality of interstate commerce, directly or indirectly, in or in connection with any account, agreement or transaction involving *any foreign futures contract or foreign options transaction*:
> (a) To cheat or defraud or attempt to cheat or defraud any other person;
> (b) To make or cause to be made to any other person *any false report or statement* thereof or to enter or cause to be entered for any person any false record thereof;
> (c) To deceive or attempt to deceive any other person by any means whatsoever in regard to any such account, agreement or transaction or the disposition or execution

*Scrivener*, in which the Second Circuit determined the plaintiff had no claim under the CEA, the *Nilsen* plaintiff most certainly had alleged a claim arising under the CEA.

*Nilsen* never reviewed the legislative intent or regulatory history pertaining to the plaintiff's claim.[144] If *Nilsen* had, the court would soon have realized that something was seriously amiss with the brokerage firm's argument. *Nilsen* clearly stated a claim under 7 U.S.C. § 6b and under the CFTC regulation pertaining to fraudulent statements made relative to foreign options.[145] He also fell within the broad definition of "customer," as defined in the CFTC's Customer Protection Rules.[146] Since the *Nilsen* defendant was presumably registered, the plaintiff would

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> of any such account, agreement or transaction or in regard to any act of agency performed with respect to such account, agreement or transaction; or
>
> (d) To bucket any order, or to fill any order by offset against the order or orders of any other person or without the prior consent of any person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

17 C.F.R § 30.9 (1988) (emphasis added).

144. The *Nilsen* court does make a reference to a sentence of the regulatory history, which is more than the eight HTA cases make combined. *See Nilsen*, 761 F. Supp. at 286-87 (citing 41 Fed. Reg. 42,942, 42,946 (1976)). The *Nilsen* court apparently did not search the Federal Register because this is the same reference quoted in *Shearson Hayden Stone, Inc. v. Scrivener*, 671 F.2d 680, 684-85 (2d Cir. 1982) (citing 41 Fed. Reg. 42,942, 42,946 (1976)). The portion of the Federal Register cited was simply the CFTC's response to concerns that the regulation was attempting to require foreign venues such as the London options market to adopt arbitration procedures consistent with CFTC regulations and not a limitation on the prohibition against all arbitration agreements except as permitted by the regulation. *See* 41 Fed. Reg. 42,942, 42,946 (1976). Furthermore, reparations claims were being filed by the score concerning the very type of London options complained of by the plaintiff. For examples of cases involving these claims, see *Tucker v. Economic Systems, Inc.*, [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,480 (C.F.T.C. Initial Dec. Aug. 25, 1977); *Prochniak v. First Commodity Corp.*, [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,501 (Initial Dec. Oct. 7, 1977); *Coffman v. Economic Systems Commodities, Inc.*, [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,581 (C.F.T.C. Initial Dec. Mar. 28, 1978); and *Akmajian v. International Commodity Options, Ltd.*, [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,584 (C.F.T.C. Initial Dec. Mar. 29, 1978). If, as *Nilsen* holds, § 180.3 only applies to transactions designated by the CFTC as contract markets, then a pre-dispute waiver of the plaintiff's right to reparations would also be enforceable since § 180.3(b)(3) would likewise not be applicable. That is something the CFTC has never permitted.

145. *See Nilsen*, 761 F. Supp. at 288-89.

146. *See* 17 C.F.R. § 166.1(c) (stating "the term customer as used in this part means *any* person trading, intending to trade, or receiving or seeking advice concerning *any commodity interest*, including any existing or prospective client or subscriber of a commodity trading advisor or existing or prospective participant in a commodity pool, but the term does not include a person who is acting in the capacity of a Commission registrant with respect to the trade") (emphasis added). The term "commodity interest" to which the definition of "customer" is pegged is defined by 17 C.F.R. § 166.1(b) (1997) as follows:

> The term *commodity interest* as used in this part means—
>
> (1) Any contract for the purchase or sale of any commodity for future delivery, traded on or subject to the rules of a contract market or a foreign board of trade.

have had equal access to either reparations or to federal court, thereby bringing the claim squarely within the regulatory purpose of § 180.3(b). The *Nilsen* court's determination to achieve the preferred result of arbitration jumped on "the easy answer" which would accomplish this end rather than question how such a holding possibly could be correct and still effectuate the congressional purpose in amending the CEA to assure that foreign options were not excluded from the statute's anti-fraud provisions and the CFTC's adoption of a specific anti-fraud rule relating to such options.

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> (2) Any agreement or transaction subject to Commission regulation under section 4c of the Act, including *any such contract or transaction made or to be made on or subject to the rules of a foreign board of trade*; or
> (3) Any contract or transaction subject to Commission regulation under section 19 of the Act (7 U.S.C. [§] 23).

*Id.* § 166.1(b) (emphasis added).

## XIII. THE APPLICABILITY OF § 180.3 TO OFF-EXCHANGE FUTURES CONTRACTS ALLEGEDLY SOLD BY UNREGISTERED ENTITIES

*Breyer v. First Nat'l. Monetary Corp.*,[147] like the HTA cases, involved the sale of allegedly off-exchange futures contracts labeled as "'cash forward' contracts" by an unregistered, non-exchange member. Accepting arguendo that § 180.3(b) applied only to futures contracts and not to "leveraged contracts," which the CFTC had alleged the instruments to be in a parallel enforcement proceeding,[148] *Breyer* ruled that CEA claims, like Securities Act claims, were not subject to arbitration.[149] *Breyer* is, of course, wrong and its reliance on *Wilko* is misguided. Other than the possible exceptions discussed in *Marchese*, claims arising under the CEA are arbitrable, as evidenced by 7 U.S.C. § 7a(11), the CFTC's promulgation of its Arbitration Rules, and the 1982 amendment to the CEA, which provide an express private right of action.[150] However, *Breyer* is correct in its general approach of identifying the arbitrability issue in terms of whether the plaintiffs' claims arise under the CEA and not whether the particular "contracts" at issue ultimately prove to violate the CEA.[151]

## XIV. A MISTAKEN QUESTION OF PROCEDURE

*Marshall v. Green Giant Co.*[152] involved a situation somewhat analogous to that presented by the HTA cases.[153] In *Green Giant*, the farmers were not alleging

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147. Breyer v. First Nat'l Monetary Corp., 548 F. Supp. 955, 957 (D.N.J. 1982).

148. *See id.* at 965.

149. *See id.* at 959-60.

150. Section 25 unambiguously states that such claims can be made the subject of an arbitration agreement: "[n]othing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration." 7 U.S.C. § 25(a)(2) (1994).

151. *See Breyer*, 548 F. Supp. at 961-62 (emphasis added). If 17 C.F.R. § 180.3(b) is co-extensive with the right to file a reparations claim as it must be to preserve that right as the CFTC intended, *Breyer*'s result is correct. Claims involving allegations of fraud relating to the sale of off-exchange futures contracts are subject to reparations complaints. *See* Lobb v. J.T. McKerr & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,568, at 36,438 (C.F.T.C. Dec. 14, 1989). This was a reparations case involving the sale of off-exchange futures contracts which was ultimately decided on grounds of agency but which accepted the alleged vehicles as off-exchange futures transactions. *See id.*

152. Marshall v. Green Giant Co., 942 F.2d 539 (8th Cir. 1991).

153. While *Green Giant* involved allegations very similar to those made in the HTA cases, the type of grain contract at issue was very different. *See id.* at 541-42. Unlike the HTA contracts, the *Green Giant* contracts did not involve rolling or, apparently, cross-crop margining ("spreading") of futures contracts and actual crop. *See id.* at 542. Instead, the processor paid the price quoted on the CBOT on a specified day to the farmers with a price adjustment made months later based on the then prevailing price of CBOT futures. *See id.* at 542. After the initial payment, the price of corn fell sufficiently so that this first advance exceeded the value due for the farmers' entire crop when the second price adjustment was made and the defendant sought repayment of the excess paid the farmers. *See id.* at 542-43. The farmers sued and two claims survived a motion to dismiss—a simple contract

that their contracts were illegal but that the defendant had acted as an FCM,[154] and in that capacity was obligated to provide them with proper risk disclosure in accordance with 17 C.F.R. § 1.55.[155] That regulation, unlike 7 U.S.C. § 6(a) and § 6(b), which form the basis of the HTA claims, is specifically limited to FCMs and introducing brokers.[156] The farmers also alleged that the defendant's status as an FCM was also central to the issue of whether the pendent breach of contract claim could be compelled to arbitration.[157] Therefore, the district court "concluded that issues of fact needed to be resolved in an evidentiary hearing" before the issue of arbitrability could be determined.[158] *Green Giant* never states why the farmers believed the defendant had acted in the capacity of an unregistered FCM even though that question became the focus of the lower court proceedings.[159] Both parties agreed that if the defendant had acted in the capacity of an FCM, the arbitration agreement was unenforceable relative to the farmers' CEA claims.[160] The farmers then argued to the district court that the evidentiary issue to be decided was whether the defendant

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count and a claim for misrepresentation arising under the CEA. *See id.* at 543. The defendant moved to compel arbitration which the farmers opposed alleging that the arbitration agreement failed to comport with 17 C.F.R. § 180.3(b)(1981). *See id.* While disagreeing whether 17 C.F.R. § 180.3 applied to the contracts, the parties agreed that if the defendant "was required to comply with that regulation the arbitration agreements were void and unenforceable." *Id.*

154. The CFTC defines an FCM as:

> (1) Individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee or secure any trades or contracts that result or may result therefrom . . . .

17 C.F.R. § 1.3(p) (1998). IBs also accept orders for commodity transactions but, unlike FCMs, cannot accept customer funds. *See id.* § 1.3(mm). It is not unusual for an FCM or IB to also be registered as a commodity trading advisor or commodity pool operator or both.

155. *See Marshall*, 942 F.2d at 543.

156. *See* 17 C.F.R. § 1.55 (1998). While selling off-exchange futures contracts, *ipso facto*, confers FCM status since the defendant allegedly accepted orders for contracts for commodities for future delivery while extending credit or accepting funds, the grain elevator's *status* as an FCM is not the basis for the HTA farmers' claims of violating the CEA's prohibition against off-exchange futures contracts and its anti-fraud provision which, respectively, are directed at "any person." *See* 7 U.S.C. § 6(a)-(b)(1994). The HTA farmers, unlike those in *Green Giant*, alleged that the defendant grain elevators' conduct directly violates the statute. *See* Iavarone, *supra* note 10, at 402-03.

157. *See Marshall*, 942 F.2d at 547. *Green Giant* never discusses the reasons why the farmers took this position.

158. *Id.* at 543.

159. The opinion never makes clear if the farmers were alleging that the contracts they entered into were really off-exchange futures contracts or whether the farmers were alleging that the processor was acting as an FCM by permitting them to effectively trade futures through its hedge account. *See generally In re* Bucyrus Grain Co., 127 B.R. 45 (Bankr. D. Kan. 1988), *appeal dismissed*, 905 F.2d 1362 (10th Cir. 1990) (noting the district court found that grain elevator that entered trades for customer in the elevator's commodity account acted as an FCM).

160. *See Marshall*, 942 F.2d at 543.

had acted in the capacity as an FCM.[161] After a four-day evidentiary hearing, the district court concluded that the defendant had not acted as an FCM,[162] compelled the contract claim to arbitration, and dismissed the CEA claim.[163] The farmers appealed the dismissal alleging that they were denied the right to a jury trial when the district court decided the ultimate factual issue of whether the defendant acted as an FCM in determining whether their contract claims were arbitrable.[164] The Eighth Circuit, while agreeing with the farmers' contention that the district court need not have ruled on the defendant's status as an FCM to compel the contract claim to arbitration, nonetheless affirmed the trial court holding that sometimes ultimate factual issues must be decided in determining arbitrability and, having urged upon the district court the crucial nature of the inquiry, could not find that the court committed error by acting on the plaintiffs' contention.[165]

Since *Green Giant* never discusses the underlying facts that led the district court to conclude the defendant had not acted in the capacity of an FCM nor discusses whether the district court was correct in making that finding, the case provides no insight into determining the scope of § 180.3(b). Still, *Green Giant* was deleterious to the HTA plaintiffs since it could be read to suggest that a hearing to

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161. *See id.*

162. *See id.*

163. *See id.* at 548. A test case proceeded to arbitration and the farmer prevailed. *See id*. at 544. When the farmers returned to court to enforce the award, the defendant argued that the collateral estoppel effect of the test case on the remaining cases was a question for the arbitrator to determine. *See id.* The district court agreed. *See id.* The farmers returned to arbitration and prevailed again. *See id*.

164. *See id*. at 544. The farmers, for whatever reason, had urged that the defendant's status as an FCM was relevant to the determination of arbitrability. *See id.* Not surprisingly, when the farmers argued that their right to a jury trail had been infringed by deciding the issue, the Eighth Circuit was not disposed to provide them with "two bites at the apple." *See id.* at 548.

165. The Eighth Circuit held:

> The district court was obligated to determine whether the arbitration agreement was enforceable. *See AT & T Technologies v. Communication Workers of Am.*, 475 U.S. 643, 649, 106 S.Ct. 1415, 1418-19, 89 L.Ed. 2d 648 (1986); *I.S. Joseph Co. v. Michigan Sugar Co*., 803 F.2d 396, 400 (8th Cir.1986). This obligation did not disappear merely because the topic of enforceability involved issues or facts that were likely to arise again elsewhere in the proceedings. The growers' contention that prior opinions from both this court and the Supreme Court prohibit the district courts from deciding 'the merits' when deciding whether to stay proceedings pending arbitration is misguided. The decisions relied upon by the growers warned district courts not to decide the merits of the dispute headed for arbitration; none of those decisions prohibit a district court from addressing the arbitration clause's enforceability merely because the issues involved may recur elsewhere in the case. *See AT & T*, 475 U.S. at 649-50, 106 S.Ct. at 1418-19; *I.S. Joseph*, 803 F.2d at 399*; Contracting Northwest, Inc. v. City of Fredericksburg*, 713 F.2d 382, 385 (8th Cir.1983). Having been assured that the enforceability of the arbitration clause turned on whether Green Giant was an FCM, the district court was not prohibited from deciding that issue merely because Green Giant's status as an FCM was relevant to other claims, even though those claims were themselves nonarbitrable.

*Id.* at 547.

determine whether the defendant acted in the capacity of an FCM was required on the issue of arbitrability under § 180.3 and therefore provide sufficient impetuous for a court to find a way out of such a procedure through "interpretation" of the regulation.

## XV. THE INCESTUOUS NATURE OF THE HTA DECISIONS

The mandate facing the eight district courts in construing the applicability of the CFTC's Arbitration Rules was clear and unambiguous. The district courts avoided constructions that might work at cross-purposes to the intent of Congress,[166] or which created a regulatory loophole,[167] or which might have a 'crippling effect' on the regulatory scheme,[168] and were not to reject "plain evidence of congressional intent," or "manufacture . . . restriction[s] on the CFTC's jurisdiction . . . [not] contemplated by Congress. . . ."[169] Specifically regarding the issue of arbitrability, the Supreme Court stated in *Gilmer* that to determine whether Congress intended to restrict the use of arbitration for specific statutory claims whether such an intention exists, "it will be discoverable in the text . . . [of the legislation at issue], its legislative history, or the inherent conflict between arbitration and [the statute's] underlying purposes."[170] The HTA decisions do not pay heed to any of these mandates. Instead, the decisions variously restrict the scope of the CFTC's rules and question the CFTC's authority, despite the Supreme Court's admonition that the due deference generally accorded an agency's interpretation of the legislation that it is charged with enforcing was "especially warranted."[171] Adding insult to injury, they ignore both the legislative history of the CEA and the express statutory provision.

Though ostensibly construing the CFTC's intent as to applicable range of its regulations, not once do the HTA courts venture into the Federal Register, the legislative history of the CEA, or the reported cases on § 180.3.[172] Nor do the HTA

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166. *See* CFTC v. Schor, 478 U.S. 833, 846 (1986); CFTC v. P.I.E., Inc., 853 F.2d 721, 725-26 (9th Cir. 1988).

167. *See In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941, at 20,981 (C.F.T.C. Dec. 6, 1979).

168. *See Schor*, 478 U.S. at 843.

169. *Id.* at 847.

170. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991).

171. *See Schor*, 478 U.S. at 845.

172. *Hodge Brothers* made the following comment concerning *Felkner*:

> According to plaintiffs, the arbitration regulations that are a part of plaintiffs' and defendants' hedge-to-arrive contracts are not as complete as the CFTC's arbitration regulations and therefore are void. *See, e.g., Felkner v. Dean Witter Reynolds, Inc.*, 800 F.2d 1466, 1468 (9th Cir. 1986) ('[F]or purposes of claims covered by the CFTC regulations, arbitration agreements that do not conform to section 180.3(b) are void.'); *Nilsen v. Prudential-Bache Securities*, 761 F. Supp. 279, 286 (S.D.N.Y. 1991).

Hodge Bros. v. DeLong Co., 942 F. Supp. 412, 417 (W.D. Wis. 1996). *Felkner*'s holding that all statutory claims relating to commodity trading fell within the scope of § 180.3 is not discussed. The only other mention made by *Hodge Brothers* concerns *Green Giant*:

cases look elsewhere in the CFTC's regulations to determine how words are used or what meanings are ascribed to them. The HTA cases simply rely on each other, never venturing from the four corners of the Arbitration Rules. Not once do they ask how the decision to send a single HTA case down the flume of arbitrability might affect the health of the regulatory forest. Most disturbing, the HTA decisions avoid discussing the fact that Congress had provided the HTA defendants a specific right to proceed against the grain merchandisers in reparations under the CEA.[173] Since the purpose of § 180.3 is to preserve the right to reparations, it is impossible to rationalize any decision that fails to discuss this specific statutory provision in relation to the scope of § 180.3(b). The HTA decisions solve this "dilemma" by unanimously avoiding the issue.[174]

## XVI. *HODGE BROTHERS* AND THE "WHAT" QUESTION IN THE HTA DISPUTE

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> Plaintiffs contend that *Marshall v. Green Giant Co*., 942 F.2d 539 (8th Cir.1991), stands for the proposition that it is permissible to rule on the applicability of the CFTC's arbitration regulations even though doing so would require resolution of the central dispute in this case. In *Marshall*, the court of appeals noted that a district court is not 'prohibited' from 'addressing the arbitration clauses' enforceability merely because the issues involved may recur elsewhere in the case.' *Id*. at 547. In this case, however, determining the applicability of 17 C.F.R. § 180.3 would amount to more than simply resolving an issue; it would amount to resolution of the entire case in violation of both the *Prima Paint* rule and the strong federal policy favoring arbitration of disputes.

*Id.* As previously discussed, *Heithoff* also makes reference to *Green Giant* but only to comment that the decision stands for the proposition that a judge is entitled to do what the parties ask be done. *See* Heithoff v. Cargill Inc., No. 4: CV96-337, at 5 (D. Neb. Mar. 21, 1997).

173. *See* 7 U.S.C. § 6m(1) (1994). While exempting the grain merchandisers from formal registration, this provision of the CEA states:

> (1) It shall be unlawful for any commodity trading advisor or commodity pool operator, unless registered under this chapter, to make use of the mails or any means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor or commodity pool operator . . . . The provisions of this section shall not apply to any commodity trading advisor who is a (1) dealer, processor, broker, or seller in cash market transactions of any commodity specifically set forth in section 2a of this title prior to October 23, 1974 (or products thereof). . . if the advice by the person described in clause (1) or (2) of this sentence as a commodity trading advisor is solely incidental to the conduct of that person's business: *Provided*, That such person shall still be subject to proceedings under section 18 of this title.

*Id.* (emphasis added).

174. *Harris Farms* and *Heithoff v. Cargill Inc.* were decided in complete disregard of 7 U.S.C. § 6m(1) by stating that farmers do not have a right to proceed in reparations against the grain elevator defendants. *See* Harris Farms v. Continental Grain Co., No. 96 C 4369, 1997 WL 381853, at *1 (N.D. Ill. Mar. 19, 1997); Heithoff v. Cargill Inc., No. 4:CV96-337, at 5 (D. Neb. Mar. 21, 1997). In *Nagel v. ADM Investor Services Inc*., the court states that the farmers waived the right by filing suit and thus misses the issue completely. *See* Nagel v. ADM Investor Servs., Inc., Nos. 96CV 2675, 96 CV 2741, 96 CV 2879, 96 CV 2972, 96 CV 5215, 1998 WL 25208, at *3 (N.D. Ill. Jan. 12, 1998). The question is whether a person enjoys the right in the first instance and fell within the protective scope of § 180.3(b), not whether they exercised that right. *Id.* at *1. Applying *Nagel*'s logic, everyone who filed a lawsuit would be deemed to have "waived" the protection due them under § 180.3. *Id.* at *2.

*Hodge Brothers*,[175] the first of the written HTA arbitration decisions, sets the tone for the decisions that followed. Citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*,[176] *Hodge Brothers* framed the issue as an attempt by farmers to avoid arbitration through a general attack on the contract. In so doing, *Hodge Brothers* deprecated the farmers' claims into general attacks on the validity of the HTA contracts rather than the narrow attempt to invoke the protection of § 180.3(b) to void the arbitration clause.[177]

*Hodge Brothers* correctly deserves that *Prima Paint* prohibits general attacks on a contract's validity in opposing arbitration.[178] *Hodge Brothers*' shortcoming is its refusal to recognize that its plaintiff was doing both (i.e., challenging the general validity of the HTA contracts for liability purposes and questioning arbitrability within the context of § 180.3). Simply put, *Hodge Brothers* misunderstands the "what" question of illegal futures claims. Rather than relying on the allegations of the complaint to determine whether the plaintiff alleged a claim falling within the broad scope of the CEA's general anti-fraud net, *Hodge Brothers* loses itself on semantics. When the *Hodge Brothers* plaintiffs alleged "illegal commodity futures contracts," the court heard the words "illegal contracts" and interpreted them in the traditional sense. However, plaintiffs were really saying that they sought relief from having been sold an "illegal commodity."

The CEA is not a federal version of the Uniform Commercial Code but instead regulates how, where, and by whom "things" are sold, and therefore resides in the family of statutes that restrict the sale or distribution of "things," such as laws regulating the sale of prescription drugs.[179] If the HTA contracts if the allegations are true, are not illegal because they are futures contracts, but rather because they were not sold on a regulated futures exchange. The sale of a futures contract on a designated contract market is what makes the contract legal and not what makes it a futures contract.[180] Every claim alleging fraud in the purchase or sale of a

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175. Andersons, Inc. v. Horton Farms, Inc., No. 96-CV-171 (W.D. Mich. Aug. 26, 1996). *Horton Farms*, the first of the HTA decisions, is an oral ruling and is discussed below relative to *Harter*, *Herwig*, and *Hazlett Farms*.

176. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967).

177. *See Hodge Bros.*, 942 F. Supp. 416-17.

178. *See id.* at 417.

179. To determine whether the sale of HTA contracts violates the CEA requires answers to the same types of questions posed in determining whether a controlled substance statute has been violated: the first question is what was sold and the second was it sold in conformance with the applicable statute? In a controlled substance case the questions are: is it a controlled substance and was it sold by prescription—the "what" and "how" questions. The CEA asks the same "what" and "how" questions: is it a futures contract and was it sold on an exchange? Just as selling cocaine does not, in itself, violate a controlled substance statute, selling commodity futures contracts does not, in itself, violate the CEA. In both instances it is the answer to the how questions which governs what determines the legality of either transaction.

180. *See In re* Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 at 23,779 (C.F.T.C. Dec. 6, 1979).

commodity futures contract makes a general attack on the "contractual" obligation of the futures transaction. However, no court would attempt to apply *Prima Paint* to a more traditional commodity claim. *Hodge Brothers* did so by giving prominence to the grain merchandiser's defense rather than to the allegations in the complaint.

The real mischief wrought by *Hodge Brothers* is that it reduces the farmers' CEA claims from statutory ones to mere "contract" claims suspiciously wrapped in the wording of a federal statute merely to avoid arbitration.[181] The filing of the CFTC enforcement actions ultimately forced the courts to accept the fact that the HTA contracts might be something other than they appeared to be on their face and that the farmers might actually possess viable claims,[182] but the suspicions raised by *Hodge Brothers* remained.[183]

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181. Regarding the plaintiff's claim that the HTA contracts violated 7 U.S.C. § 6a, *Harter* stated: "[o]n that score, even though the contracts were cash market transactions, Harters contend that they were not really what they seemed but were instead akin to futures transaction entered into for risk hedging or speculative purposes." Harter v. Iowa Grain Co., No. 96 C 2936, 1996 WL 556734, at *2 n.5 (N.D. Ill. Sept. 26, 1996). In this footnote, *Harter* also appears to have confused the "what" question:

> That assumption in Harters' favor appears to give them something more than their due. That contention on their part is one that attacks the validity of the entire contract, not just the arbitration clause. And under those circumstances the case law from our Court of Appeals indicates that the entire matter should go to the arbitrators for resolution. *See, e.g.*, Flender Corp. v. Techna-Cuip Co. 953 F.2d 273, 278 & n.1 (7th Cir. 1992) and cases cited there.

*Id.* at *3 n.5. *See* Hazlett Farms v. Andersons, Inc., No. IP 97-346-C-D/F, at 5 (S.D. Ind. Sept. 18, 1997). *Harter*'s willingness to accept the defendant's characterization of the HTA contracts at face value fails to consider that, if labels controlled, few violations of the CEA's prohibition against off-exchange futures contracts would proceed. Therefore, the question is one of economic reality and not labels. *See generally* Precious Metals Assocs., Inc. v. CFTC, 620 F.2d 900, 908 (2d Cir. 1980) (finding that economic reality, not the name or characterization of an instrument, determines its legality). The "over-all effect" of the transaction must be assessed to determine the parties' intention. 55 Fed. Reg. 39,188, 39,190 (1990) (citing CFTC v. CoPetro Mkt. Group, Inc., 680 F.2d 573, 581 (9th Cir. 1982)).

182. As mentioned at the beginning of this Article, shortly after the *Harter* decision, the CFTC filed three enforcement actions against grain merchandisers alleging that the HTA contracts offered by the merchandisers were actually off-exchange futures contracts. *See In re* Grain Land Coop., No. 97-1, 1996 WL 655809 (C.F.T.C. Nov. 13, 1996) (complaint and notice of hearing); *In re* Wright, No. 97-2, 1996 WL 655807 (C.F.T.C. Nov. 13, 1996) (complaint and notice of hearing); *In re* Southern Thumb Co-op, Inc., No. 97-3, 1996 WL 655804 (C.F.T.C. Nov. 13, 1996) (complaint and notice of hearing). None of the five decisions after the filing of the CFTC enforcement actions mention the CFTC's action. *See In re* Grain Land Coop., No. 97-1, 1996 WL 655809 (C.F.T.C. Nov. 13, 1996) (complaint and notice of hearing); *In re* Wright, No. 97-2, 1996 WL 655807 (C.F.T.C. Nov. 13, 1996) (complaint and notice of hearing); *In re* Southern Thumb Co-op, Inc., No. 97-3, 1996 WL 655804 (C.F.T.C. Nov. 26, 1996) (complaint and notice of hearing); *In re* Competitive Strategies for Agric., Ltd., No. 98-4, [Current Transfer Binder] ¶ 27,215 (C.F.T.C. Dec. 22, 1997) (complaint and notice of hearing); Schaefer v. Cargill, Inc., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,962 (C.F.T.C. Feb. 27, 1997) (order denying motions to dismiss and order staying reparations proceedings). None of the five decisions decided after the filing of the CFTC enforcement actions mention them. Doing so would make justification of the decision in favor of arbitrability much more difficult. This reluctance to recognize what may, initially, have appeared to be spurious claims, are cognizable and is not limited to the question of arbitrability. *See generally In re* Grain Land Coop., 978 F. Supp. 1267 (D. Minn. 1997)

## XVII. THE CREATION OF THE STANDING FICTION

*Harter*, as previously discussed, places little esteem in the farmers' claim that their HTA contracts are really commodity futures contracts.[184] Unlike *Hodge Brothers*, the *Harter* court confronted the plaintiff's contention that § 180.3(b) voided the arbitration clause without citing a single prior decision or bothering to look beyond § 180.1 to any other source.[185] Instead, *Harter* seized upon the definition of claim or grievance in § 180.1(a).[186] Unlike *Scrivener* that erroneously used the regulatory definition of "claim or grievance" in § 180.1(a) which was intended to define the scope of arbitration claims that could be initiated against contract market members to limit the scope of the CEA and, in effect, made the regulation be the tail that wagged the statutory dog,[187] *Harter* used that definition to limit the reach of § 180.3 while leaving the scope of the CEA intact.[188] Seizing upon this definition,

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(finding the HTA contracts at issue did not violate the CEA because the "indefinite rolling" alleged by the farmers was not indicative of futures, as opposed to cash contracts). In so doing *Grain Land* states that the farmers' reliance on the CFTC's May 1996 Guidance Statement is "misplaced" because the CFTC stated that "it was not taking a position as to the legality of any individual contract." *Id.* at 1277. What *Grain Land* fails to mention is that the CFTC had spoken, and spoken emphatically, on the exact HTA contracts at issue by initiating an enforcement action against them. *Compare* Grain Land Coop. v. CFTC, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,240 (D. Minn. Jan. 7, 1998), *with* Eby v. Producers Co-op, Inc., 959 F. Supp. 428, 433 (W.D. Mich. 1997) (holding the farmer's allegation of the ability to indefinitely "roll" the delivery obligation in the HTA contract was precisely what "the CFTC listed as proof of potentially indefinite rolling of HTAs a factor in deciding that they should institute public administrative proceedings."). The *Grain Land* defendant's motion to dismiss the enforcement action on collateral estoppel grounds was denied by a different district court in *In re Grain Land Coop*. *See* Grain Land Coop. v. CFTC, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,240 (D. Minn. Jan. 7, 1998). Ultimately, the CFTC administrative law judge found these same HTA contracts that the district court found to be cash forward contracts to violate the CEA's provision against off-exchange futures contracts. *See In re* Grain Land Coop., No. 97-1, 1998 WL 770595 (C.F.T.C. Initial Dec. Nov. 6, 1998).

183. *See, e.g., Hazlett Farms, Inc.*, No. IP 97-346-C-D/F, at 5 (questioning whether the pleading is "a tactic designed to avoid arbitration . . . .").

184. *See Harter*, 1996 WL 556734, at *3.

185. *See id.* at *2.

186. *See id.*

187. *See* Shearson Hayden Stone, Inc. v. Scrivener, 671 F.2d 680, 682 (2d Cir. 1982).

188. *See Harter*, 1996 WL 556734, at *2 (quoting 17 C.F.R. § 180.1(a) (1997)). Section 180.1(a) states:

> The term *claim* or *grievance* as used in this Part shall mean any dispute which arises out of any transaction on or subject to the rules of a contract market executed by, or effected through, a member of that contract market or employee thereof which dispute does not require for adjudication the presence of essential witnesses or third parties over whom the contract market does not have any jurisdiction and who are not otherwise available. The term claim or grievance does not include disputes arising from cash market transactions which are not a part of or directly connected with any transaction for the purchase or sale of any commodity for future delivery or commodity option.

17 C.F.R. § 180.1(a) (1997) (emphasis added).

*Harter* cites the obvious fact that a defendant is an essential party to any action filed against it and that its employees, by definition, must be considered essential witnesses.[189] *Harter* reasoned that since the plaintiffs could not possibly have a "claim or grievance" within the meaning of section 180.1(a), they lacked standing to challenge the arbitration agreement under § 180.3(b).[190]

*Herwig*, the first of *Harter*'s progeny, accomplished the same result by holding that its plaintiff failed to meet the definition of a "customer" in § 180.1(b).[191] *Herwig* also does not bother to review any other portion of the regulations.[192] *Horton Farms*, imposed a similar § 180.1 standing requirement.[193] Since the standing requirement developed by *Harter*, *Herwig*, and *Horton* would apply to *every* non-exchange member, the effect of this new-found standing requirement would disenfranchise every person dealing with a non-exchange member registrant.

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189. *See Harter*, 1996 WL 556734, at *3.

190. *See id.*

191. *See* Herwig v. Hahnoman-Albrecht, Inc., 1997 WL 72079, at *3 (N.D. Ill. Feb. 13, 1997).

192. *See id.* Section 180.1(b) states: "[t]he term *customer* as used in this part includes an option customer (as defined in §1.3(jj) of this chapter) and any person for or on behalf of whom a member of a contract market effects a transaction on such contract market, except another member of that contract market." 17 C.F.R. § 180.1(b) (1998). The CFTC has explained that the second sentence of section 180.1(a) excludes "cash market transactions which are not a part of or directly connected with "a futures transaction acts only" to exempt from the scope of this rule transactions which relate *entirely* to cash market activities. 41 Fed. Reg. 27,520, 27,523 (1976) (emphasis added). As previously discussed, the CFTC's Customer Protection Rules expansively define customer as *any* person holding any commodity interest, as that term is all-inclusively defined in § 166.1(b). *See* 17 C.F.R. § 166.1(c) (1978). Likewise, the CFTC defines an option customer in terms of "any person." In addition, 7 U.S.C. §§ 6b, 6o 18, and 25, employ the term "person," as does 17 C.F.R. § 30.9 (foreign options) and § 31.3 (leverage transactions).

193. *Horton Farms* states:

> In the court's opinion there is no genuine issue of fact with respect to the arbitration clause. The court finds that this clause is not unenforceable under any contract principle or other defense raised by the corporate defendant in this case. *This arbitrability clause is not arbitrable under 17 C.F.R. Section 180.1*. Furthermore there has been no showing that these contracts are covered by the Commodity Exchange Act as a *matter of law*. Furthermore, it is clear to this court that the arbitration clause is an enforceable part of the contract between the corporation and the plaintiff under Michigan UCC Section 2-207. Finally, there has been no showing made by the corporate defendant in this case that the arbitration procedure, itself is manifestly unfair simply because it is conducted pursuant to the rules of the National Grain and Feed Association.

Andersons, Inc. v. Horton Farms, Inc., No. 96-CV-171, at 7 (W.D. Mich. Aug. 26, 1996) (emphasis added). *Horton Farms* obviously placed a § 180.1 standing requirement on the plaintiff since the decision states that it is that section, rather than compliance with § 180.3(b). *Horton Farms* also appears to labor under confusion over both the "what" question and over the court's function in the determination of arbitrability. Whether the HTA contracts are futures contracts and therefore covered by the CEA as a matter of law is the very determination that *Horton Farms* refused to undertake. *Horton Farms*' statements concerning the fairness of the NGFA proceeding is discussed in other sections of this article. *Horton Farms* is currently pending before the Sixth Circuit (Appeal Nos. 96-2287; 96-2353 and 97-1010 consolidated), which, given *Curran*, should provide a thorough consideration of the arbitrability issues in HTA cases.

*Hazlett Farms* finally placed the § 180.1 standing requirement in its proper context by stating "[h]owever, as noted above, *§ 180.3 cannot apply unless Andersons, was a member of a contract market.*"[194]

As discussed previously, the CFTC had originally exercised its general grant of regulatory authority embodied in 7 U.S.C. § 12a(5) to extend the scope of arbitration to non-exchange FCMs. In explaining its contemporaneous amendment of § 180.1(b) the CFTC explained:

> The Commission adopted § 180.3 in order to make arbitration voluntary on the part of *all customers without regard to whether the futures commission merchant or other registered person was a member of the contract market*. Under a literal interpretation of § 180.1(b), however, only customers of members would be "customers" for purposes of the Commission's rules, so *customers of non-members technically would not have been protected by* § 180.3.[195]

*Horton Farms*, *Harter*, *Herwig*, and *Hazlett Farms* are wrong. Their rulings are the direct legacy of *Mitsubishi Motors*. Unlike *Ames*, *Curran*, *Felkner*, and *Breyer* that had confronted the applicability of § 180.3 prior to *Mitsubishi Motors* and *McMahon*, these four HTA courts do not make even the slightest attempt to discern what the CFTC (and for that matter Congress) intended. They simply turn a collective blind-eye to everything save the preferred result arbitrability ordained by Supreme Court.

## XVIII. *HARRIS FARMS* AND *HEITHOFF*: THE REGISTRATION REQUIREMENT

After *Harter* and *Herwig* (soon to be joined by *Hazlett Farms*) removed all non-exchange members from the penumbra of § 180.3(b),[196] *Harris Farms* added registration as an obstacle to invoking the protection of § 180.3(b). [197]

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194. Hazlett Farms, Inc. v. Andersons, Inc., No. IP 97-346-C-D/F, at 8 (S.D. Ind. Sept. 18, 1997) (emphasis added).

195. 41 Fed. Reg. 42,942, 42,942 (1976) (emphasis added). In a later amendment, explaining why the phrase "contract market, if available" was used in 17 C.F.R. § 180.3(b)(4)(i)(A) (1997), the CFTC explained:

> The Commission recognizes that a contract market is generally available only when the registrant is a member of the contract market where the contracts in dispute are traded. *A contract market forum is thus more likely to be available to customers of a clearing FCM than to customers of an IB, CTA or CPO. Because of this the Commission included the words 'if available' when referring to a contract market as an appropriate forum in Rule 180.3(b)(4*).

54 Fed. Reg 1682 (1989) (emphasis added).

196. *See* Harter v. Iowa Grain Co., No. 96 C 2936, 1996 WL 556734, at *2 (N.D. Ill. Sept. 26, 1996); *Herwig*, 1997 WL 72079, at *3.

197. *See* Harris Farms v. Continental Grain Co., No. 96 C 4369, 1997 WL 381853, at *1 (N.D. Ill. Mar. 19, 1997).

Misapprehending the significance of the defendant's status as a grain elevator as an entity held to answer in reparations, *Harris Farms* erroneously applied a ruling on the supremacy of federal laws over state statutes to promote the Arbitration Act's supremacy over the CFTC's regulation:

> Because defendant Continental is neither a registered Futures Commission Merchant (FCM) nor a Commodity Trading Advisor (CTA) with the Commodity Futures Trading Commission (CFTC), 17 C.F.R. § 180.3 does not govern the contracts containing the arbitration agreements to which the parties agreed in this case. . . .
>
> Plaintiffs' argument that they have a right to commence a reparations proceeding before the CFTC is incorrect, again, because defendant is not a registered entity. Additionally, 17 C.F.R. § 12.24(c) provides that the right to such a proceeding before the CFTC is waived when the claimant commences a court action or arbitration proceeding.
>
> Moreover, consistent with the Supreme Court's rational in Doctor's Associates, Inc. v. Casarotto, 116 S.Ct. 1652, 1656 (1996), an agreement to arbitrate can be invalidated under section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, only on grounds that apply to all contracts. To invalidate the contracts at issue here under 17 C.F.R. § 180.3 would allow the CFTC to exceed its authority. The Court need not address that issue where the section is otherwise inapplicable to the parties' agreement.[198]

*Harris Farms* does not review either the regulatory history of § 180.3(b),[199] the regulatory environment surrounding the promulgation of the regulation,[200] or the

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198. *Id.*

199. As originally proposed, § 180.3(b)(4)(i) (1997) read:

> (4) The agreement must advise the customer that, at such time as he or she may notify the futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor or associated person that he or she intends to submit a claim to arbitration, or at such time as such person notifies the customer of its intent to submit a claim to arbitration, the customer will have the opportunity to elect a qualified forum for conducting the proceeding. Within ten business days after receipt of such notice from the customer, or at the time the futures commission merchant, introducing broker, floor broker, commodity pool operator, commodity trading advisor or associated person so notifies the customer, the futures commission merchant, introducing broker, commodity pool operator, Commodity Trading Advisor or associated person must provide the customer with a list of three or more organizations whose procedures qualify them to conduct arbitrations in accordance with the requirements of § 180.2 of this part, together with a copy of the rules of each forum listed. The list must include: (1) The contract market, if available, upon which the transaction giving rise to the dispute was executed or could have been executed, or a registered futures association designated by such contract market.

CFTC decisions that, as previously discussed, had rejected earlier attempts to define registrants so narrowly. While *Harris Farms* never states the basis for its registration requirement, *Heithoff* subsequently did "[b]y reading the plain words of 17 C.F.R. § 180.3 – applying the term registrant – it is apparent that the rule does not pertain to Cargill since it is undisputed that Cargill was not in fact registered with the CFTC."[201] The court further noted that "17 C.F.R. § 180.3(b)(4)(i) refers to futures commission merchants and others as "a registrant" when imposing upon those parties the obligation to give customers information about arbitration."[202] Like *Harter*'s standing requirement, *Harris Farms*' red-herring registration requirement will not leave easily.[203]

The Customer Protection Rules, from which neither *Harris Farms* nor *Heithoff* sought guidance, define "registrant" to include both actual and required registrants.[204] Likewise, the CFTC's Bankruptcy Rules,[205] which the CFTC also classes generically within its customer protection rules, define the term "commodity broker" as "any person who is registered . . . as a futures commission merchant under the Act . . . ."[206] A review of these rules would certainly have alerted either court that something was seriously awry with an argument attempting to singularly narrow the applicability of § 180.3 to only actual registrants. Nor, does *Harris Farms* consider how a registration requirement would be consistent with the CFTC's determination that a private right of action be only knowingly and voluntarily waived.[207]

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53 Fed. Reg. 24,954, 24,954-56 (1988). When the regulation was adopted, the CFTC stated that it was adopting it as "essentially as proposed." 54 Fed Reg. 1682, 1682 (1989). The adopted regulation contained the word "registrant." *See id.* at 1684.

200. For example, during the time period when § 180.3 was being promulgated, the sale of off-exchange futures and futures option increased dramatically and the CFTC was under severe criticism as a result. *See, e.g.*, Liest v. Simplot, 638 F.2d 283, 319 (1980), *aff'd sub nom. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1981); *see also* S. REP. NO. 95-850, at 13-16 (1978) (discussing the concerns expressed by Congress in this area and the fact that generally the CFTC only learns of such unregistered activity after they inflict "substantial losses by the public" as a result of "pervasive fraudulent practices" engaged in by these unregistered purveyors of off-exchange contracts and options). Since Congress had amended the CEA at the very time such infractions were occurring to hold such individuals answerable to reparations claims, it would indeed be anomalous that the CFTC would permit such entities to escape the requirements of § 180.3, the only provision that would have prevented such unregistered persons from having their victims waive the right to reparations in their arbitration agreements. *See id.* at 38.

201. Heithoff v. Cargill Inc., No. 4:CV96-337, at 3 (D. Neb. Mar. 21, 1997) (footnote omitted).

202. *Id.* at 3 n.1.

203. Even if *Harris Farms* and *Heithoff* found the history of the Arbitration Rules to be too befuddling a morass, they must have noticed that every subsection of § 180.3(b) speaks in terms of *persons*, save the one cited by *Heithoff*. *See* 17 C.F.R. § 180.3(b)(4) (1998).

204. *See id.* § 166.1(a).

205. 17 C.F.R. pt. 190 (1998).

206. *Id.* § 190.01(f).

207. Since an agreement that fails to conform with section 180.3(b) is void, what *Harris Farms* and *Heithoff* would say is that persons who register and make a good faith attempt to conform their arbitration agreements to the requirements of section 180.3(b) but fail, will see their arbitration

> *Heithoff* attempts to offer the right to reparations as an answer:
> [I]t would make little sense to apply section 180.3 because one of the explicit section 180.3 alternatives to arbitration is a reparations proceeding under CFTC supervision. 17 C.F.R. §§ 180.3(b)(3) and 180.3(b)(6). Normally, reparations proceedings may be brought only against a "registered" person. 7 U.S.C. § 18 (1997) ("Any Person complaining of any violation of any provision of this chapter, or any rule, regulation, or order issued pursuant to this chapter, *by any person who is registered . . .*" may seek reparations before the CFTC.") (Emphasis added.) *It would be strange indeed to apply a rule regarding an alternative to arbitration when that remedy was in reality unavailable*.[208]

However, 7 U.S.C. § 6m(1) clearly holds the *Heithoff* defendant answerable in reparations. The CFTC Reparations Rules state:

> *Registrant* means any person who--
> (1) Was registered under the Act at the time of the alleged violation;
> (2) *Is subject to reparation proceedings by virtue of section 4m of the Commodity Exchange Act, regardless of whether such person was ever registered under the Act; or*
> (3) Is otherwise subject to reparation proceedings under the Act . . . .[209]

Since, as *Heithoff* acknowledges, one purpose of § 180.3(b) was to preserve the right to reparations, the CFTC could not intend for the term "registrant" in § 180.3(b) to have a more restrictive meaning than it does in its Reparation Rules.

Under *Heithoff* and *Harris Farms*, the specific entities Congress sought to hold liable to a reparations claim under 7 U.S.C. § 6m(1) would enjoy the ability to render that statutory provision meaningless, not just by obtaining a waiver of the

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agreements voided. *See* 41 Fed. Reg. 27,526, 27,527-28 (1976); 41 Fed. Reg. 42,942, 42,944 (1976); Smokey Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 720 F.2d 1446, 1450-51 (5th Cir. 1983); Wotkyns v. D.E. Jones Commodities, Inc., 791 F.2d 749, 751 (9th Cir. 1986) (per curiam); Felkner v. Dean Witter Reynolds, Inc., 800 F.2d 1466, 1469 (9th Cir. 1986); *In re* ContiCommodities Servs., Inc. Sec. Litig., 1987 WL 10987, at *5 (N.D. Ill. May 6, 1987). However, according to the HTA decisions, persons who purposefully fail to register can enforce non-conforming agreements. If someone was planning to engage in the sale of off-exchange futures contract that could bring prosecution from the CFTC, why would such persons virtually admit dealing in illegal futures contracts by conforming with the requirements of § 180.3?

208. Heithoff v. Cargill Inc., No. 4:CV96-337, at 3-4 (D. Neb. Mar. 21, 1997) (second emphasis added). *Heithoff* is half correct. Section 180.3 was also promulgated to protect the right. Since the private right of action that *can be waived* is *broader* than the right to reparations which *cannot* be waived, why would the CFTC promulgate § 180.3 based on meeting the *narrower* requirements of a reparations claim to protect the broader private right of action claims under 7 U.S.C. § 25 (1994), thereby disenfranchising those who need it most—persons who do not possess the absolute right to proceed in reparations?

209. 17 C.F.R. § 12.2 (1998) (emphasis added).

right to reparations, but merely by using a non-conforming arbitration clause.[210] Seizing upon an interpretation that might not advance the legislative or regulatory purpose to support a finding of arbitrability is one matter. Providing an interpretation that provides violators with a contractual weapon that completely abrogates a congressional mandate is quite another.[211] The nonchalance with which *Harris Farms*, *Nagel*, and *Heithoff* disregard the express terms of 7 U.S.C. § 6m(1) underscores a judicial reality: in cases in which a district court's concern over the state of a court's docket and the desired end, arbitrability triumphs over expressed legislative intent.

How deeply the Supreme Court's efforts to place the Arbitration Act and the "bargain" in a position of pre-eminence has infected the decisionmaking process in district courts is exemplified by *Harris Farms*' incredible assertion that *Doctor's Associates, Inc. v. Casarotto*, a decision that prohibits the use of state statutes to attempt to cancel the efficacy of the FAA to federal regulations, could work as a "super" statute to negate the expressed intent of Congress in 7 U.S.C. § 6m(1) and as further expressed in congressional comments.[212]

## XIX. THE ARBITRAL FORUM

The HTA courts, having disposed of § 180.3(b) as an obstacle to compelling arbitration, turned an equally deaf ear to the farmer contention that the NGFA would be an improper forum for resolving their claims. An arbitration venue controlled by the association to which the movant is a member, raises issues of partiality and bias that could prohibit enforcement of an arbitration agreement.[213] As the Ninth Circuit observed in *Marchese*, "[t]o force Marchese to have a broker interpret whether the brokers or their customers are entitled to the interest and increment on the broker's

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210. *See Heithoff*, No. 4:CV 96-337, at 4. *See also* Harris Farms v. Continental Grain Co., No. 96 C 4369, 1997 WL 381853, at *1 (N.D. Ill. Mar. 19, 1997).

211. Unlike *Harris Farms* and *Nagel*, *Heithoff* never proclaims that its plaintiff was foreclosed from proceeding in reparation. Indeed, *Heithoff* uses the word "normally" to preface its declaration that reparations claims can only be filed against registered persons. *See id.* at *3. The *only* exception to the "normal" registration requirement is 7 U.S.C. § 6m(1). Yet, *Heithoff* studiously avoids discussing how this exception affects the arbitration decision. Further darkening *Heithoff* is the fact that a farmer alleging a violation of the CEA against the same defendant under the same HTA contract was declared to have specifically stated a reparations claim in *Schaefer v. Cargill, Inc.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,962 (C.F.T.C. Initial Dec. Feb. 28, 1997).

212. *See, e.g.*, H.R. REP. NO. 97-565, at 51 (1982), *reprinted in* 1982 U.S.C.C.A.N. 3871, 3900. The comments of Congress relative to a 1992 amendment of that very provision were:

> The amendment would narrow the definition to exclude under most circumstances those advisors who merely advise as to the cash commodities or to their value. The Commission, however, would *retain authority* to issue regulations which include within the new definition *any person* who gives *such advice* if that will effectuate the purposes of this provision . . . .

*Id.* (emphasis added).

213. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 30 (1991).

investment of the customers' funds would deny the customer the objectivity envisaged by legislation of this type."[214] With the brevity endemic to the HTA decisions, *Horton Farms*, the only HTA decision to mention the issue, simply comments that "[n]o showing made by the arbitration procedure itself is manifestly unfair because it is conducted pursuant to the rules of the National Grain and Feed Association."[215] None of the other decisions mention this as a consideration, even though, the Supreme Court in *Mitsubishi Motors* stated that arbitration is proper only "[s]o long as the prospective litigant effectively may vindicate [its] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."[216]

The purpose of 17 C.F.R. § 180.2 is to ensure "*minimum* requirements for a fair and equitable procedure" for contract market arbitration.[217] Section 180.3(b)(7) incorporates § 180.2 by reference and applies it to all arbitration forums,[218] and thereby: (1) requiring a panel to be composed of a majority of non-contract market members;[219] (2) ensuring both the right to counsel[220] and to personally appear at the hearing when the dispute exceeds $5000;[221] (3) providing that, while the formal rules of evidence need not be applied, "the procedure established may not be so informal as to deny due process;"[222] and (4) requiring the fees charged be reasonable.[223] Section 180.3(b)(4) imposes the following additional safeguards to non-contract market arbitration: (1) the right to select from a list of arbitration venues which includes a contract market (if available); (2) the National Futures Association (NFA); and (3) at least one organization that permits the customer to select the location of the hearing. The NGFA Arbitration Rules fail to meet any of these criteria.

## XX. THE NGFA ARBITRATION PROCESS

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214. Marchese v. Shearson Hayden Stone, Inc., 734 F.2d 414, 421 (9th Cir. 1984) (citations omitted).

215. Andersons, Inc. v. Horton Farms, Inc., No. 96-CV-171, at 7 (W.D. Mich. Aug. 26, 1996).

216. Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 637 (1985).

217. 17 C.F.R. § 180.2 (1998) (emphasis in original).

218. Section 180.3(b)(7) states: "**[**i]f the agreement specifies a forum for arbitration other than a contract market or registered futures association, the procedures of such forum must be fair and equitable as defined by section 180.2 of this Part." *Id.* § 180.3 (b)(7).

219. *See id.* § 180.2(a).

220. *See id.* § 180.2(b).

221. *See id.* § 180.2(d)(1).

222. *Id.* § 180.2(d)(2). Additionally, section 180(d) provides that: "[e]ach party must be given adequate opportunity to prepare and present all relevant facts in support of the claims and grievances, defenses, or counterclaims (permitted by section 180.4 of this Part), and to present rebuttal evidence to such claims or grievances, defenses or counterclaims made by the other parties." *Id.* Section 180.2(d)(3) further provides that "[e]ach party shall be entitled to examine other parties and any witnesses appearing at the hearing and to examine all relevant documents presented in connection with a claim or grievance, defense or a counterclaim applicable thereto." *Id.* § 180(d)(3).

223. *See id.* § 180.2(e). This section permits the shifting of these incremental costs only when the arbitration panel determines that the non-member acted in bad faith in initiating or conducting that proceeding. *See id.*

Arbitration between grain merchandisers probably originated from the same stimuli that motivated cotton merchants: "quite apart from the delay and cost involved, it would have been ridiculous to accept a jury decision, necessarily based on evidence from expert brokers, rather than to accept a direct decision of a panel of experts."[224] Not unexpectedly, the NGFA Arbitration Rules reflect the narrow scope one would anticipate in disputes between grain merchants and shippers (i.e., the quality, grade, and condition of the grain shipped or received, as well as tariffs and other transaction related issues) in the types of documents that the Association requires to be submitted with an arbitration complaint (i.e., weigh bills, invoices, inspection reports and the like).[225] Since such documents are in the hands of both parties or are easily obtained from shippers or inspectors, the NGFA Arbitration Rules do not provide *any* mechanism to obtain discovery from either an opposing party or from relevant non-parties.[226] And, while *evidentiary* hearings are available before self-regulatory bodies such as the NFA and NASD where fraud claims are routinely arbitrated, the NGFA rules merely provide that a party may request "an oral hearing."[227] The rules, however, do not set forth: (1) the procedures to be followed at the "oral hearing;" (2) a provision requiring testimony to be taken under oath; or (3) whether the submission of additional evidence not included with the pleadings is permitted. Furthermore, the NGFA arbitration procedures do not provide *any* procedure for compelling the presence of non-party witnesses or even of opposing parties or their employees at the "oral hearing." This total lack of procedure casts into serious doubt whether the NGFA provides an evidentiary hearing in the traditional sense. Certainly such a hearing could never fulfill the minimum fairness requirements of § 180.2(d).

Whatever else the "oral hearing" might be, it is expensive. Should a *non-member* of the NGFA demand an evidentiary hearing, the party must *advance*[228] to the NGFA the expected: (1) cost of the court reporter;[229] and (2) travel and hotel expenses of the three arbitrators, the National Secretary, and the NGFA's legal counsel.[230] Any appeal would require the same expenses[231] and a healthy appeal

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224. A.W. Brian Simpson, *Contracts for Cotton to Arrive: The Case of Two Shipless Peers*, 11 CARDOZO L. REV. 287, 321-22 (1989).

225. *See* NATIONAL GRAIN & FEED ASS'N, ARBITRATION RULES § 6(a) (1997). Section 6(a)(2) of the NGFA Arbitration Rules informs the parties that in addition to the clear and concise "statement of all that is claimed" required in section 6(a)(1), a party should submit "[t]he contract or contracts, if any, including all written evidence, letters, and telegrams, tending to establish the terms and conditions" of the contracts. *Id.* § 6(a)(2). Section 6(a) then instructs the parties to submit shipping, instructions, bills of lading, inspection certificates, freight expense bills, confirmation of freight rates, authority for freight rates and appropriate price bulletins or other proof of market difference. *See id.* § 6(a).

226. *See id.*

227. *Id.* § 8(f).

228. *See id.* § 8(g) (emphasis added). If the requesting party balks at the amount demanded by the NGFA as an advance, not only would the oral hearing be denied but such action serves as grounds for entry of a default. *See id*.

229. *See id.* § 8(h).

230. *See id.* § 8(j).

fee.[232] Unlike securities and commodities arbitrations that are conducted under the oversight of the federal agencies,[233] the NGFA operates privately and selects all arbitrators from the grain merchandiser defendant's peers.[234] Adjudication of statutory rights in a closed, industry-captive arbitration process that lacks even minimal due process safeguards raises serious concerns of structural bias.

## XXI. A TITLE VII DETOUR: *ROSENBERG V. MERRILL LYNCH*

*Gilmer*, a case involving a claim under the Age Discrimination and Employment Act of 1967, dismissed a plaintiff's general attack on arbitrability noting that the New York Stock Exchange, the arbitration forum at issue, had promulgated rules "[to] provide protection against biased panels."[235] *Rosenberg*[236] decided that *Gilmer* left open the possibility that some arbitration procedures could be systematically challenged.[237] The facts adduced during discovery caused the *Rosenberg* court to conclude that a "structural bias" existed in the New York Stock Exchange arbitration procedure.[238] *Rosenberg* found members of the exchange (including the president of the defendant) were generally employers who, for the most part, comprised the New York Stock Exchange's Board of Directors and essentially governed the arbitration process in which their employees would be required to litigate their claims.[239] *Rosenberg* determined that this could taint the selection of arbitration panels:

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231. *See id.* § 9(i). A party requesting an oral hearing of an appeal must advance all travel and hotel expenses of the Arbitration Appeals Panel, the National Secretary, and the association's legal counsel, together with the cost of the stenographic record. *See id*.

232. *See id.* § 9(c). The NGFA provides for an appeal of arbitration awards for fee ranging from $400 for claims up to $5000 to a fee of $3000 for claims in excess of $150,000. *See id*.

233. *See, e.g.*, Stipanowich, *supra* note 25, at 42.

> In securities arbitration, the primary responsibility for addressing policy and procedural issues has been in the hands of SICS. SICA is made up of securities industry self regulatory organizations (SROs), industry groups, and sponsors of arbitration, as well as four public interest representatives . . . .
>
> Another level of protection in this venue is governmental oversight. Securities arbitration, under sponsorship of SROs, is regulated by the SEC, which has virtually plenary authority over the SRO sponsored securities arbitration.

*Id.* at 68 n.52 (citation omitted). The CFTC has such plenary authority over the commodity SROs pursuant to 7 U.S.C. §7a(11) (contract markets) and § 21(b)(10) (NFA). *See* 7 U.S.C. §§ 7a(11), 21(b)(10) (1994).

234. *See* NATIONAL GRAIN & FEED ASS'N, ARBITRATION RULES, § 4(b) (1997).

235. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 30 (1991).

236. Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 995 F. Supp. 190 (D. Mass. 1998).

237. *See id.* at 201.

238. *See id.* at 207.

239. *See id.* The court particularly noted:

> The Chairman of the Board of Directors [of the NYSE] . . . shall appoint, subject to the approval of the Board of Directors, a Board of Arbitration to be composed of such number of *present or former members, allied members and officers of member corporations of the Exchange* n25 who are not members of the Board of Directors as

> The chief guarantor of arbitrators' fairness and competence is the parties' powers to appoint the panel. This power has been called the 'essence of arbitration' and a 'condition of [the parties'] trust' in arbitration. Alan Scott Rau, *Integrity in Private Judging*, 38 S. Tex. L. Rev. 485, 506 & n. 82 (1997) (*quoting* Sir Michael Mustill, *Multipartite Arbitrations: An Agenda for LawMakers*, 7 Arb. Int'l 393, 399 (1991) and Pierre Lalive, *Conclusions, in the Arbitral Process and the Independence of Arbitrators* 119, 123 (1991)); *see also* Martin H. Malin and Robert F. Ladenson, *Privatizing Justice: A Jurisprudential Perspective on Labor and Employment Arbitration From the Steelworkers Trilogy to Gilmer*, 44 Hastings L.J. 1187, 1204 (1993) (describing the power to appoint the arbitrator as a crucial check on arbitral discretion). Selecting the arbitrator is "the most important decision arbitrating parties can make." Ian Macneil et al., 3 *Federal Arbitration Law: Agreements, Awards, and Remedies under the Federal Arbitration Act* § 27.1, at 27.2 (1995 & Supp. 1997).[240]

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> the Chairman of the Board of Directors shall deem *necessary to serve at the pleasure of the Board of Directors . . . .* Rule 633, *NYSE Rules*, at 30 (emphasis added). The Chairman likewise appoints the Director of Arbitration, *who must be 'one of the officers or other employees of the exchange,'* Rule 635, *id*. (emphasis added) and who reports directly to the Senior Vice President and Secretary of the NYSE. *See* Buck Dep. at 67. Most disturbingly, the Chairman of the Board also recommends and appoints the arbitration pools from which individual arbitrators are chosen, including the pool of non-securities industry 'public' arbitrators. Rule 634 *NYSE Rules* at 30; Bales, *supra* at 93. The Director of Arbitration in turn directly appoints the arbitral panels and may also appoint the panel's chair. Rule 607, *NYSE Rules*, at 11-12. This 'creates an obvious appearance of potential bias.' Bales, at 95.

*Id.* at 210 (footnote omitted).

240. *Id.* at 208. As *Rosenberg* noted:

> Both state and federal courts have invalidated or reformed arbitration agreements that provided for a panel institutionally linked to or chosen by one party alone. *See McConnell v. Howard Univ.*, 818 F.2d 58, 68 n. l2 (D.C. Cir. 1987) ('Even if it could be said that the parties 'agreed' to make the [university] Board of Trustees' the arbitrator of their disputes, court would not defer to its decision*); Sam Kane Packing Co. v. Amalgamated Meat Cutters and Butcher Workmen of N. Am.*, 477 F.2d 1128, 1136 (5th Cir. 1973) (decision by a single, union-appointed arbitrator vacated, although allowed by the contract, as "in conflict with the concept of true arbitration"); *Bennish v. The North Carolina Dance Theater*, 108 N.C. App. 42, 422 S.E.2d 335, 337-38 (1992) (in order to 'preserve the purposes' of the FAA, the trial court must substitute a neutral arbitrator, in place of the panel designated in the parties' contract, which contained both a trustee and a staff member of the defendant); *Smith v. Rubloff*, 187 Ga. App. 317, 370 S.E.2d 159, 160 (1988) (arbitration agreement would be 'invalid' because it provided for a panel made up of an employee and two associates of one party); *Chimes v. Oritani Motor Hotel, Inc*., 195 N.J. Super. 435, 480 A.2d 218, 223 (App. Div. 1984) (following *Graham*); *Manes v. Dallas Baptist College*, 638 S.W.2d 143, 145 (Tex. Ct. App.—Dallas 1982) (an arbitration before the employer's Board of Trustees would be 'totally inconsistent with the theory of arbitration'); *Cross & Brown Co. v. Nelson*, 4 A.D.2d 501, 167 N.Y.S.2d 573, 576 (N.Y. App. Div. 1957) (an agreement designating one

The New York Stock Exchange, like other self regulatory organizations places non-industry arbitrators on its panels,[241] allows peremptory challenges as well as those for cause, and provides arbitrator biographies. However, *Rosenberg* found:[242] "[t]he NYSE cannot meet these minimal standards of arbitral independence. From the rules that govern arbitral procedure, through the selection of the arbitrators, to the details of discovery practice, the system is dominated by the NYSE itself. Merrill Lynch, in turn, helps govern the NYSE."[243] *Rosenberg*'s value lies more in its method than its result. Like the pre-*Mitsubishi Motors* arbitration decisions discussed earlier, *Rosenberg* undertook the type of analysis a federal court owes every litigant advancing a statutory rights claim who is confronted with a motion to compel arbitration. Had *Rosenberg* come to the opposite conclusion and found that the New York Stock Exchange's arbitration procedure satisfied *Gilmer*, the decisional process the court followed would still stand in stark contrast to the process of HTA arbitration decisions where expedience was permitted to rule the moment.

## XXII. THE QUESTION OF BIAS IN THE NGFA ARBITRATION PROCEDURE

The NGFA arbitration procedure suffers all of the infirmities discussed in *Rosenberg*. Generally, the NGFA is comprised generally of grain merchandisers and their affiliates, and was organized[244] to "*protect the common interests*" of its *members*.[245] Just as the defendant in *Rosenberg* was a member of the NYSE board of directors, of the seven HTA arbitration cases that are the subject of this Article, five involve defendants with members of senior management on the NGFA board

of directors[246] which, in turn, sets NGFA "rules."[247] And, unlike self-regulatory

party's Board of Directors as the arbitral panel, '[a]part from outraging public policy, . . . is illusory').

*Id.* at 209-10.

241. *See, e.g.*, NATIONAL ASS'N OF SEC. DEALERS, CODE OF ARBITRATION PROCEDURE §§ 10300-10485 (1996); NEW YORK STOCK EXCH., ARBITRATION RULES, RULE 600-637 (1995); NATIONAL FUTURES ASS'N, CODE OF ARBITRATION PROCEDURE §§ 6011-6082 (1997).

242. *See Rosenberg*, 995 F. Supp. at 210-11.

243. *Id.* at 210.

244. The NGFA has approximately one thousand grain merchandising and related companies as members who operate over five thousand facilities and represents 37 state and regional associations. *See Commodity Exchange Oversight: Hearing Before the Comm. on Agric., Nutrition, & Forestry*, 104th Cong. 96 (1996) (statement of Kendall W. Keith, President, National Grain & Feed Association).

245. NATIONAL GRAIN & FEED ASS'N, ARTICLES OF INCORPORATION art. V. (1996) (emphasis added).

246. The board of directors of the NGFA who are also grain merchandisers or their affiliates include: The Andersons, Inc.; Continental Grain Co.; Demeter, Inc.; and A. E. Staley Manufacturing

bodies, the NGFA takes sides in the disputes it is arbitrates, including the HTA controversy.[248]

While the New York Stock Exchange's arbitrator biographies and other disclosure materials were incomplete, inaccurate, and untimely in *Rosenberg*'s view,[249] arbitrator disclosures are non-existent for the NGFA. Nor does the NGFA permit any peremptory challenges of arbitrators.[250] Like the New York Stock Exchange, the President of the NGFA selects the pool of arbitrators[251] and the association's secretary selects the arbitration panel.[252] Unlike the New York Stock Exchange, the NGFA selects arbitrators exclusively from its membership.[253] Since the NGFA admits that forty-five percent of its membership wrote HTA contracts,[254] a farmer arbitrating before the NGFA is placed in the unenviable position of having to persuade NGFA members that a widespread practice of the association's membership is illegal. If that is not unsettling enough, the NGFA Arbitration Rules do not even disqualify arbitrators who have written HTA contracts but merely state that an arbitrator "should be commercially disinterested with respect to the *particular dispute*

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Co. *See NGFA Board of Directors to Meet Sept. 15-16*, NGFA NEWSLETTER (National Grain & Feed Ass'n, Washington, D.C.), Aug. 29, 1996, at 4-5. In addition, the named brokerage firm defendant in two of the arbitrations, ADM Investor Services, is represented on the NGFA board by the firm's president. *See id*. at 5.

247. NATIONAL GRAIN & FEED ASS'N, ARTICLES OF INCORPORATION art. VI, § 7(b) (1996).

248. *See, e.g.*, Michael D. Fibson, *Litigation Sprouts Between Farmers and Grain Co-op*, U.S. BUS. LITIG., Feb. 1997, at 19 (statement by NGFA's counsel for Public Affairs that HTA contracts fall within the cash forward exception to the CEA). When the HTA crisis broke, the president of the NGFA lobbied in favor of the HTA contracts before Congress. *See Commodity Exchange Oversight: Hearing Before the Comm. on Agric., Nutrition, & Forestry*, 104th Cong. 96-100 (1996) (statement of Kendall W. Keith, President, National Grain & Feed Association). Such evident impartiality renders particularly ominous the touting of *Protecting Your Company's Interests in Trading Agricultural Commodities*; *see also Hearing Before the Subcomm. on Risk Management & Speacialty Crops and the Subcomm. on Gen. Farm Commodities of the Comm. on Agric.*, 104th Cong. 68-71 (1996) (statement of JoAnn Brouillette, Vice President, Demeter, Inc.). *See generally* NATIONAL GRAIN & FEED ASS'N, PROTECTING YOUR COMPANY'S INTERESTS IN TRADING AGRICULTURAL COMMODITIES (1990) [hereinafter PROTECTING YOUR COMPANY'S INTERESTS]. After explaining that the Uniform Commercial Code's definitions of "[d]elay delivery or non-delivery" is the main issue in dispute with farmers which is the claim the grain merchandisers are making against the farmers in the HTA cases, the NGFA states that "[t]he language here [of the Uniform Commercial Code] actually confuses, rather than clarifies, the predictability of the outcome in the court system. It is actually better in arbitration than in court." *Id*. at 143.

249. *See* Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 995 F. Supp. 190, 210-11 (D. Mass. 1998).

250. *See* NATIONAL GRAIN & FEED ASS'N, ARBITRATION RULES § 8(a) (1996).

251. *See* PROTECTING YOUR COMPANY'S INTERESTS, *supra* note 248, at 120.

252. *See id.*

253. *See* NATIONAL GRAIN FEED & ASS'N, ARBITRATION RULES § 4(b) (1996). In fact, the NGFA selects arbitrators from its membership who are experienced in the type of disputes to be arbitrated. *See id*.

254. *See* RISK EVALUATION TASK FORCE ON HYBRID CASH CONTRACTS, NATIONAL GRAIN & FEED ASSOCIATION, A WHITE PAPER-HYBRID CASH GRAIN CONTRACTS: ASSESSING, MANAGING AND CONTROLLING RISK 6 (1996) [hereinafter WHITE PAPER].

intended to be presented to him for judgment."[255] If NGFA does not consider writing HTA contracts sufficient to render an arbitrator commercially interested, a farmer faces the statistical probability of having at least one arbitrator who has written the very type of contract the farmer alleges is illegal. Should the NGFA follow its arbitration rules and place arbitrators experienced with the type of dispute on the panel, the farmer will effectively be judged by his adversaries. As the *Rosenberg* court stated:

> Because of the importance of the appointment process to the fairness of any arbitration proceeding, some courts have refused to enforce arbitration agreements that designate a panel closely linked to one party, especially if that party drafted the underlying agreement. According to the leading treatise on federal arbitration, the FAA will not countenance agreements that allow one party to appoint an arbitral panel 'intimately connected to it.' MacNeil, et al., *Federal Arbitration Law* § 28.2.5.2, 28.36 & n.106.[256]

If *Rosenberg* is correct, the NGFA should be disqualified as an arbitrational forum for the HTA claims due to structural bias. Arbitration agreements are not confessions of judgment clauses. An arbitration forum must provide the parties with

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255. NATIONAL GRAIN & FEED ASS'N, ARBITRATION RULES § 4(b) (1996) (emphasis added).

256. The NGFA may be more than merely biased. Prior to the HTA crises, only 16 requests were made for an award of attorney's fees in 872 cases in NGFA arbitration. *See generally* NATIONAL GRAIN & FEED ASS'N, NGFA ARBITRATION DECISIONS, 1975-1995 (1995) [hereinafter NGFA ARBITRATION DECISIONS] (outlining the facts and dispositions of arbitration decisions). Only one award of approximately $4,000 resulted. *See id.* at 243. In cases filed against farmers, no requests were made for attorney's fees. In *Harter*, the NGFA awarded the grain merchandisers the approximately $56,000 in damages it was seeking and $85,000 in attorney's fees. *See* Neil E. Harl, Update on Hedge-to-Arrive Cases (Feb. 14, 1998) (unpublished article, on filed with the *Drake Journal of Agricultural Law*). When the HTA crisis arose, things changed. Prior to *Harter* the largest total award issued by the NGFA was $138,000 and involved commercial entities. *See* NGFA ARBITRATION DECISIONS, *supra*, at 105 (1995) [hereinafter NGFA ARBITRATION DECISIONS]. Such results certainly raise the issue of whether the NGFA arbitration procedure is being used to "convince" farmers to pay the amounts being demanded of them by the NGFA. The NGFA suggests to its membership that only "manifest disregard of the law" is a grounds for vacating an award. *See* PROTECTING YOUR COMPANY'S INTERESTS, *supra* note 247, at 17-18 This statement was authored by the president of the firm that obtained the $85,000 in attorney's fees before the NGFA in *Harter*. Telling one's membership that errors, even gross ones, are permitted in arbitration is a strange tactic to use to promote arbitration unless, of course, one expects to win. *See id* at 17. Neil E. Harl, Charles E. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University and member of the Iowa Bar, stated after noting the names and industry affiliation of the panel in the NGFA arbitration of the *Harter* plaintiff:

> The make-up of the panel raise serious questions of due process. Producers may want to read the fine print before signing their contracts requiring arbitration before a panel of grain merchandisers One should be entitled to assume that arbitrators are objective individuals, free of bias. Grain buyers serving as arbitrators undoubtably try to be objective. But to be an acceptable alternative to litigation in court, it's important that arbitration panels be *perceived* as free of actual and potential conflict of interest.

Harl, *supra*.

an efficient, procedurally consistent, and fair process capable of routinely producing accurate and correct outcomes.[257]

## XXIII. DID THE PARTIES EVER REALLY CONTEMPLATE USING THE NGFA ARBITRATION PROCESS TO LITIGATE FRAUD CLAIMS?

The question arises whether the parties ever intended to arbitrate claims involving violations of the CEA or allegations of fraud before the NGFA.[258] Few would disagree with the following description of arbitration relative to the vindication of a statutory right:

> Arbitration is a system of adjudication which is built, like the public justice system, on the foundation of fundamental fairness. Parties are entitled to a hearing before an impartial panel and independent decisionmaker. The resulting award may be vacated if these basic entitlements are abridged; otherwise, it may be confirmed and enforced by a court in the same manner and to the same extent as any other judgment.[259]

Even assuming that the NGFA Arbitration Rules can avoid a challenge of structural bias, does such an arbitration procedure fulfill the term of "arbitration" as used in the contract? If the above definition of arbitration is reasonable, at least from the farmers' viewpoint, what they received is not what they "bargained for." Having "bargained" for one thing and having received something completely different places the farmer at a material disadvantage, who farmer could seek to void the contract under the common law.[260]

The NGFA Arbitration Rules also raise the question of whether either party intended to arbitrate statutory fraud claims. If the NGFA had adjudicated claims akin to fraud or misrepresentation prior to the HTA crisis, one might conclude that at least the NGFA member contemplated the arbitration clause to reach such claims.

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257. *See generally* Stephen Hayford & Ralph Peeples, *Commercial Arbitration in Evolution: An Assessment and Call for Dialogue*, 10 OHIO ST. J. ON DISP. RESOL. 343 (1995) (discussing contemporary commercial arbitration).

258. *See, e.g.*, Harter v. Iowa Grain Co., No. 96 C 2936, 1996 WL 556734, at *1 (N.D. Ill. Sept. 26, 1996). *Harter* dismissed an argument to this effect as "a less-than-make-weight-contention." *Id.*

259. Stipanowich, *supra* note 25, at 6.

260. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 153 (1981). Section 153 states:

> Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake under the rule stated in § 154, and (a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or (b) the other party had reason to know of the mistake or his fault caused the mistake.

*Id.*

On the other hand, if no claims approaching fraud or misrepresentation were submitted until the advent of the HTA crisis, one must question whether even the NGFA member intended the arbitration clause to extend to such claims.[261] A review of 862 claims arbitrated by the NGFA from 1975 through 1995[262] reveals that *not a single claim* involved any allegation resembling fraud filed before the NGFA.[263] If

261. Furthermore, the complete lack of such previous use of the arbitration system would also call into question the entire motivation of the arbitration process as it relates to HTA claims.

262. From 1975 to 1995 only six cases involved an "oral hearing" and the last one of those occurred in 1983. *See generally* NGFA ARBITRATION DECISIONS, *supra* note 256 (summarizing HTA arbitration decisions).

263. *See generally id.* The NGFA grouped the decisions by the following categories (numbers in brackets indicate number of decisions):

| Category | Number of Decisions | Category | Number of Decisions |
|---|---|---|---|

manifest intent was lacking "*at the time a contract was made*" to include such claims within the ambit of the arbitration clause, then no agreement to arbitrate the HTA claims ever existed.[264]

Placing the law of contracts aside, courts have voided arbitration clauses when a party establishes that: (1) he or she was unfairly surprised by the effect of the arbitration clause;[265] and (2) he or she was disadvantaged because the arbitration

| | | | |
|---|---|---|---|
| Aflatoxin | 6 | Court Orders Affecting Arbitration | 11 |
| Barge | 37 | Custom of the Trade/Industry Standards | 39 |
| Barge Freight | 3 | | |
| Billing Instructions | 15 | Default Judgment | 1 |
| Broker Trade | 38 | Documents - Timely Presentation | 12 |
| C.I.F. Terms | 10 | Expulsion of Member for Failure to Arbitrate | 3 |
| Commodity Certificates | 3 | | |
| Commodity Credit Corporation Related Transactions | 10 | F.O.B. Terms | 18 |
| | | Freight | 22 |
| Confirmations | 50 | Fumosin | 1 |
| Contamination | 16 | Grades - Appeal of FGIS Grades | 4 |
| Contract - Breach of | 85 | Grades - Type/Method of Inspection | 32 |
| Contract - Delay or Irregular Delivery | 11 | Grades - Quality Differences | 43 |
| Contract - Effect of Changes in Trade Rules | 1 | Jurisdictional Issues | 8 |
| | | Market Differences | 20 |
| Contract - Exchange of Futures and Cash | 1 | Milling Quality | 1 |
| | | Negligence | 15 |
| Contract - Extension | | Rail Shipment | 64 |
| Contract - Failure to Deliver | 20 | Rejection of Shipment - Notification | 22 |
| Contract - Forward Delivery | 34 | Rice/Rice Bran | 2 |
| Contract - Notification of Alterations | 15 | Settlements - Overfill/Underfill | 9 |
| Contract - Pricing | 21 | Shipping Instructions | 12 |
| Contract - Producer/Farmer | 20 | Storage Charges or Handling Rates | 7 |
| Contract - Storage | 18 | String Trade | 28 |
| Contract - Usual Terms | 2 | Sunflower Meal | 1 |
| Contract - Validity of Canceled Contracts | 1 | Switching Charges - Rail | 4 |
| | 13 | Truck Shipment | 14 |
| Cottonseed/Cottonseed Products | 3 | Weather/Force Majure | 16 |
| | | Weights - Types | 20 |

*Id.* at xx-xxvii. The negligence category refers to "negligence" in checking contracts or making notifications and similar acts. *See id*. Only 18 arbitrations (2.1%) of the 862 arbitrations filed in the 20 years prior to the emergence of the HTA controversy involved farmers. *Id.* The farmer prevailed twice but one of those victories was reversed on appeal, leaving a single farmer prevailing for $2247, or approximately 45% of the amount sought. *Id.* Another interesting fact is that 9 of the 18 cases were brought by the same grain merchandiser, meaning that prior to the eruption of the HTA crisis, only nine members of the NGFA had availed themselves of the Association's arbitration process. Also probative of whether fraud claims in which the farmer lost hundreds of thousands (and in some instances millions) of dollars, the largest award against a farmer had totaled approximately $52,000 and the next highest award was approximately $15,500. In arguments that the type of dispute was not contemplated to fall within the scope of a broadly-worded arbitration clause is foredoomed, even if true. For example, one of the HTA decisions analyzed in this Article characterized just such an argument directed at the NGFA arbitration clause as "a less-than-make-weight contention." *See Harter*, 1996 WL 556734, at *1 (N.D. Ill. 1996).

264. RESTATEMENT (SECOND) OF CONTRACTS § 152 (1981) (emphasis added). While the NGFA member would probably contend that it is arbitrating a simple cash forward contract which unquestionably was intended to be submitted to the NGFA, the HTA decisions compelled the farmers to arbitrate their claims of commodity fraud before the NGFA.

265. The proof that the contract was one of adhesion (i.e., that the party lacked a realistic choice) may be substituted for this element of the test. *See* Speidel, *Contract Theory*, *supra* note 23, at

process unduly favors the other party.[266] One may certainly dismiss the contention by those who sign a securities arbitration agreement that they are surprised that fraud claims are governed by the arbitration clause. However, it is quite another matter to offhandedly dismiss the contention that an arbitration clause in a cash forward contract was intended to encompass CEA fraud claims. Indeed, the failure of the elevators to inform the farmers of their right to reparations under 7 U.S.C. § 6m(1) would seem to prove that the grain merchandisers never contemplated arbitration of CEA claims until the HTA dispute arose.

## XXIV. CONCLUSION

Arbitration of public rights before strictly private associations controlled by the parties Congress intended the laws to restrain should give us serious pause. The Supreme Court's decision in *Mitsubishi Motors* and its adoption of a policy strongly encouraging a finding of arbitrability as the preferable result of a motion to compel arbitration, as a means to police federal dockets, has materially affected litigants in district court. The Arbitration Act, a relatively inconsequential piece of legislation when enacted in 1925, has been promoted through the fiction of "the deal" to pre-eminent status, such that all remedial legislative schemes from the New Deal through the burgeoning of statutes designed to discourage, if not eliminate, all forms of discriminatory practices, have become its vasa. District courts have been transformed from uninterested dispensers of justice to interested parties urged to police their dockets through the mechanism of arbitration without accountability. The HTA arbitration decisions prove that when fictions and expedience are the watchwords, justice must suffer. Regardless of whether a circuit court or even the Supreme Court, after reviewing the muddled history of § 180.3, eventually rules that the HTA decisions are correct, the manner in which the district courts arrived

1350-51. In the HTA controversy the arbitration contracts definitely are not contracts of adhesion. Unlike the securities industry, a variety of merchandisers who are not members of the NGFA are generally available in any given geographical area as the wide variety of pending federal and state court HTA cases prove. While delivery to such non-member merchandisers might be inconvenient or economically disadvantageous, the fact remains that these alternatives are available. Furthermore, it is frequently the case in HTA disputes that the farmer came to the merchandiser for the specific purpose of entering the disputed contract.

266. *See* Sosa v. Paulos, 924 P.2d 357, 362 (Utah 1996) (discussing this principle).

at their decisions is injurious to our concept of justice. Courts that choose to avoid the law, regardless of motive, lose the moral authority to command others to follow it. If the HTA arbitration decisions are an accurate reflection of the extent to which district courts will travel to engage in the self-help countenanced by *Mitsubishi* and its progeny, will this trend confine itself to issues of arbitrability?