



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

The Honorable William Proxmire
Committee on Banking, Housing and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Proxmire:

I am responding to your letter of February 16, 1982, regarding the concerns expressed by Royce O. Griffin, Colorado Securities Commissioner, in a letter to Senator Hart, dated January 13, 1982. In his letter, Mr. Griffin urges support for the efforts of the states to amend the Commodity Exchange Act to remove existing provisions in that law which prevent state authorities from pursuing certain types of commodities fraud under state securities or commodities laws. In this regard, I am enclosing a memorandum prepared by the Commission's Office of the General Counsel which discusses the impact of both the federal securities laws and the federal commodities laws on the jurisdiction of the states.

I hope that this information will be helpful to you. If I can be of further assistance, please do not hesitate to contact me.

Sincerely,

John S.R. Shad

Enclosure

MEMORANDUM

March 23, 1982

TO: Chairman John S.R. Shad

FROM: Office of the General Counsel *J. Shindler*

SUBJECT: Comparison of the impact of the federal securities and commodities laws on the jurisdiction of the states

Senator William Proxmire has referred a letter from the Colorado Securities Commissioner raising issues concerning the relationship between the federal commodities laws and state law. In that connection, this memorandum discusses the federal securities and commodities laws in terms of the impact of those statutes on the jurisdiction of the states.

I. Federal securities laws

The federal securities laws and the federal commodities laws are significantly different in terms of their impact on state law. As a general matter, the federal securities laws expressly recognize and preserve the role of the states in regulating the issuance and trading of securities. ^{1/} Under so-called "blue sky" laws, the states have regulated securi-

^{1/} Section 18 of the Securities Act of 1933 (the "Securities Act") provides that nothing in that Act shall affect the jurisdiction of any state securities commission (or any agency or office performing a like function) over any security or person. Section 28(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 50 of the Investment Company Act of 1940 similarly preserve the jurisdiction of the states over persons and securities insofar as the exercise of such jurisdiction does not conflict with the provisions of either act or the rules, regulations or orders thereunder. See note 8, infra.

ties activities in several respects. The most extensive state efforts to regulate securities activities relate to the issuance and distribution of securities within the state, and usually consist of subjecting newly-issued securities to some manner of registration. 2/ In addition, state blue sky laws often require the registration of broker-dealer firms (and their sales personnel) that are engaged in the sale of securities within the state 3/ and, in some cases, provide for the denial of such registration for failure to meet prescribed standards of integrity or financial responsibility. 4/ States also may require the registration of investment advisors. 5/ Finally, the states generally prescribe criminal penalties for filing false or misleading documents with the state, 6/

2/ Registration can take one of several forms depending upon the state. Registration by "qualification" is similar to registration under the Securities Act and requires the filing of specific information with the state. See Pa. Stat. Ann. (Prudon) Tit. 70, §206. Registration by "notification" allows certain seasoned issuers to register merely by filing with the state a notification of the intention to issue securities within the state. See Uniform Securities Act §302. States allowing registration by "coordination" permit the registration statement and prospectus filed with the Commission pursuant to the Securities Act to be filed with the state in satisfaction of its registration requirements. See Cal. Corp. Code §25111.

In New York no registration is required, although all intrastate offerings must include an offering prospectus which makes full and fair disclosure of all material facts concerning the issue. N.Y. Gen. Bus. Law §359-ff. An issuer engaging in the sale of its own securities is deemed a dealer and must register as such with the state. N.Y. Gen. Bus. Law §359-e.

3/ See, e.g., Uniform Securities Act §201(a); N.Y. Gen. Bus. Law §359-e.

4/ See, e.g., N.Y. Gen. Bus. Law §352-k; Pa. Stat. Ann. (Prudon) Tit. 70, §303.

5/ See, e.g., Uniform Securities Act §201(c).

6/ See, e.g., Uniform Securities Act §409.

and civil liability 7/ for material misstatements or omissions in connection with the offer or sale of securities. 8/

II. Federal Commodities Laws

The federal commodities laws reflect a different philosophy with respect to the allocation of federal and state authority. In particular, as Mr. Griffin's letter points out, the authority of the states is preempted in areas where the jurisdiction of the Commodity Futures Trading Commission ("CFTC") is exclusive. When established in 1975, the CFTC was vested with exclusive jurisdiction over accounts, agreements (including options) and transactions "involving contracts of sale of a commodity for future delivery" traded or executed on a designated contract market, or any other board of trade, exchange or contract market; 9/ and any transaction in the nature of a

7/ See, e.g., Uniform Securities Act §410. See also, Cal. Corp. Code §§25400-25402, which make it unlawful for any person, directly or indirectly, to engage in the manipulation of securities prices or for corporate insiders to trade on material non-public information.

8/ We believe that state regulation of securities activities generally serves as a useful adjunct to the efforts of Commission. Moreover, with certain limited exceptions, it has not been our perception that concurrent federal and state jurisdiction over the issuance of securities and over securities professionals necessarily has been burdensome to securities market participants. With respect, however, to the regulation of the terms and conditions of national tender offers, the potential for conflict has resulted in a federal preemption of state law, as well as judicial declarations that such laws violate the Commerce Clause. See e.g., MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980), prob. juris. noted sub nom. Edger v. MITE Corp., 101 S. Ct. 2043 (1981); Great Western United Corp. v. Kidwell, 577 F.2d 1256 (5th Cir. 1978), rev'd on venue grounds sub. nom. Leroy v. Great Western United Corp., 443 U.S. 173 (1979).

9/ Section 2(a)(1) of the Commodity Exchange Act ("CEA"). This section defines the term "commodity" to mean certain specifically identified agricultural products and "all other goods and articles. . . and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in."

standardized leverage contract 10/ involving any "commodity" or involving silver bullion, gold bullion, bulk silver coins or bulk gold coins. 11/

The CFTC has taken the view that its exclusive jurisdiction applies not only to transactions in futures contracts and commodity options, but also to the regulation of futures commission merchants, commodity pools and commodity pool operators, 12/

10/ Section 19(a) of the CEA indicates that the CFTC's authority over leverage contracts encompasses any "standardized contract commonly known to the trade as a margin account, margin contract, leverage account, or leverage contract, or . . . any contract, account, arrangement, scheme, or device that the [CFTC] determines serves the same function or functions as such a standardized contract, or is marketed or managed in substantially the same manner as such a standardized contract."

11/ In addition, Section 4c(a) of the CEA makes unlawful options trading on certain agricultural commodities, and Sec. 4c(b) grants the CFTC plenary authority to regulate options on certain other commodities. In connection with granting the CFTC authority to regulate commodity options, Section 4c of the CEA was amended to delete a provision that provided that nothing in the section shall be construed to impair any state law applicable to any transaction to which the section applied. This has been interpreted as preempting the authority of the states to regulate commodity options trading. See, e.g., International Trading, Ltd. v. Bell, (Ark. Sup. Ct. Oct. 3, 1977) Comm. Fut. L. Rep. [Transfer Binder 1977-80] (CCH) ¶20,495.

12/ The CFTC has interpreted its exclusive authority with respect to commodity pools to encompass "the full range of activities related to commodity pools, including the solicitation of prospective participants in the pool as well as the pool's management and operation." See letter to Jamie A. Wade, NASAA Subcommittee Chairman, North American Securities Administrators Association, from Jane K. Stuckey, Secretary, CFTC, at 3 (February 27, 1981). The CFTC, however, has declined to assert that its exclusive jurisdiction over commodities pools preempts the applicability of registration provisions of the Securities Act to the organizational stage of commodities pools. CFTC Interpretative Letter No. 77-14, Comm. Fut. L. Rep. [1977-80 Transfer Binder] (CCH) ¶20,486 at 21,975.

and commodity trading advisors. 13/ Accordingly, the jurisdiction of the states is preserved only to the extent that it is not inconsistent with the CFTC's exclusive jurisdiction. 14/

During the CFTC reauthorization hearings in 1978, a number of state officials recommended that the grant of exclusive jurisdiction to the CFTC be modified. These officials testified that the Commodity Exchange Act deprived the states of the authority necessary to take effective action to protect their citizens against fraudulent activities occurring in connection with commodities trading, particularly against so-called "bucket shops" engaged in the purported sale of commodity options. In response, the Congress stated that, while it continued to believe that the CFTC "should continue to have sole authority for the creation of a nationally uniform body of standards governing activities relating to commodities futures trading, [i]t also is of the view that the States have an important role to play in protecting their citizens against fraudulent and illegal conduct." 15/ Congress, accordingly, amended the CEA to authorize state officials to investigate and institute civil actions in federal court on behalf of their citizens for violations of the CEA, or any rule, regulation, or order thereunder, either to obtain injunctive relief or for damages. 16/ In addition, a provision was added to clarify that a state was not prohibited from proceeding in state court, on the basis of "any general civil or criminal antifraud statute" of the state, against

13/ CFTC Interpretative Letter No. 76-20, Comm. Fut. L. Rep. [1977-80 Transfer Binder] (CCH) ¶20,214.

14/ According to the Conference Committee Report to Accompany H.R. 13113, the grant of exclusive jurisdiction to the CFTC "would preempt the field insofar as futures regulation is concerned" and, accordingly, it was not contemplated "that there will be a need for any supplementary regulation by the states." S. Rep. No. 1383, 93d Cong., 2d Sess. 35-36 (1974).

15/ H.R. Report to Accompany H.R. 10285, H.R. Rep. No. 1181, 95th Cong., 2d Sess. 15 (1978).

16/ Section 6d(1) of CEA. This provision, however, specifically prohibits state authorities from investigating or bringing actions against a designated contract market, a clearinghouse, or a floorbroker.

improper activity occurring in connection with commodities trading. 17/ However, the proscription against the prosecution of improper trading activities by state authorities under state commodities or securities laws continues. 18/

Notwithstanding these amendments to the CEA, the states, as indicated by Mr. Griffin's letter, continue to believe that their authority is inadequate. At the same time, there appears to be, on the part of the CFTC, a growing recognition of the role the states can play in preventing commodities fraud. 19/ In this regard, we understand that the CFTC, in connection with its reauthorization, is proposing to amend the CEA to provide that, with the exception of commodity futures and commodity options trading on a board of trade, and the offer and sales of dealer options or leverage contracts pursuant to rules promulgated by the CFTC, nothing in the CEA shall supercede or preempt any state statute that is "applicable to any transaction in or involving any commodity, product, right, service or interest." 20/ This proposed revision would enable the states, subject to the foregoing exemptions, to prosecute fraudulent activity in state court pursuant to any state statute or regulation. Accordingly, the appropriate role of the states in the regulation of commodities trading is currently the subject of Congressional consideration.

17/ Section 6d(7) of the CEA.

18/ See, e.g., Massachusetts v. Lloyd, Carr & Co., (Mass. Super. Ct. Jan. 18, 1978) Comm. Fut. L. Rep. [1977-80 Transfer Binder] (CCH) ¶20,561.

19/ See statement of Philip McB. Johnson, Chairman, CFTC, before the Subcommittee on Conservation, Credit and Rural Development of the House Committee on Agriculture, February 23, 1982.

20/ The proposed legislation also would continue the preemption of the states with respect to the regulation of commodity pools. See S. 2109 and H.R. 5447 [Futures Trading Act of 1982] 97th Cong., 2d Sess. (1982).