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## COMMERCE AND TRADE

### *Commodity Contracts: Provide for Enforcement*

CODE SECTIONS:	O.C.G.A. §§ 10-5A-1 to -31 (amended)
BILL NUMBER:	HB 1366
ACT NUMBER:	1414
SUMMARY:	The Act specifies unlawful commodity activities and provides for investigation of violations by the Secretary of State. The Secretary of State, or his appointee, is authorized to refer violators to appropriate law enforcement agencies and to order civil and criminal penalties.
EFFECTIVE DATE:	July 1, 1988

#### *History*

Prior to the enactment of O.C.G.A. § 10-5A-1, the Secretary of State attempted to regulate commodities fraud under Georgia securities law.<sup>1</sup> O.C.G.A. § 10-5A-1 establishes civil remedies and criminal penalties for specified unlawful practices in commodities activities.<sup>2</sup> However, this state regulation conflicted with the federal Commodities Exchange Act of 1974 (CEA).<sup>3</sup>

The Commodities Futures Trading Commission (CFTC), which was created by the CEA, is charged with exclusive jurisdiction of commodities regulation.<sup>4</sup> The CEA was amended in 1978 to allow state officials to seek civil damages and injunctive relief and to enforce state civil or criminal antifraud laws for "off-exchange" commodities activities.<sup>5</sup> A 1982 amend-

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1. O.C.G.A. §§ 10-5-1 to -24 (1982).

2. O.C.G.A. § 10-5A-1 (Supp. 1988).

3. Telephone interview with Wayne Howell, Deputy Secretary of State (Apr. 6, 1988) [hereinafter Howell Interview].

4. Commodities Exchange Act § 2, 7 U.S.C. § 2 (1982). The statute provides: [T]he Commission shall have exclusive jurisdiction [of commodities regulation and] . . . , except as hereinabove provided, nothing contained in this section shall (i) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State . . . .

*Id.*

5. Futures Trading Act of 1978, 7 U.S.C. § 13a-2 (1982). See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982) for a survey of commodities regulation since 1921. The Court permitted a private cause of action for a violation of the CEA by implication despite legislative silence on the availability of private remedies.

ment to the CEA once again expanded the role of the states in enforcement of commodities regulation by permitting states to regulate the fraudulent activities of persons who are required to, but do not, register with the CFTC and to punish fraudulent "off exchange" activity.<sup>6</sup>

Tension remains, however, between the exclusive jurisdiction of the CFTC over commodities regulation and expansion of state regulatory authority. Case law has attempted to distinguish between those activities that fall within the CFTC's exclusive jurisdiction and those that may be regulated by the states.<sup>7</sup> Ultimately, the cases have attempted to resolve the ambiguity, holding that even though federal commodities law affords preemption of regulatory authority, states have the authority to regulate commodity activities fraud that falls outside the purview of CFTC jurisdiction and to hear private actions for commodities fraud based on state common law or statute.<sup>8</sup> HB 1366 is considered to fall within this exemption to CFTC jurisdiction by excluding from its provisions persons<sup>9</sup> and activities that are exclusively federally regulated, and by containing no registration requirements.<sup>10</sup>

In addition to the legislators' desire to regulate commodities activities without preemption by federal law, another motivation for HB 1366's passage is the inability of the federal government to enforce its regulations effectively on a local level.<sup>11</sup> For example, the National Futures Association (NFA) is the regulatory agency charged with carrying out the

*Id.* at 367, 393—94.

6. Futures Trading Act of 1982, 7 U.S.C. § 16(e) (Supp. 1988).

7. Most case law is concerned with a private cause of action brought under some statutory scheme that arguably is preempted by CFTC's exclusive jurisdiction. *See, e.g., Taylor v. Bear Stearns & Co.*, 572 F. Supp. 667 (N.D. Ga. 1983). "[I]f there is a nexus between a private action and a state regulation which conceivably could conflict with the role of the Commission, preemption would be proper." *Id.* at 674; *McCarthy v. Painewebber, Inc.*, 618 F. Supp. 933 (D. Ill. 1985). "There is no logical reason not to permit the range of traditional common law actions to be expanded by state statute, so long as the Act's regulatory scheme is not impaired as a consequence." *Id.* at 943; *Mallen v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 605 F. Supp. 1105 (N.D. Ga. 1985). "[T]he savings clause was meant to protect . . . state court jurisdiction over the contracts claims which form the basis of a futures contract . . . and to preserve private causes of action in federal courts under the commodities laws." *Id.* at 1113. It will be interesting to see if the courts distinguish the preemption issue now that an arm of the state is empowered to bring suit for commodities fraud.

8. *See supra* note 7. *See also* 7 U.S.C. § 25(a) (Supp. 1988) for provisions regarding preservation of private causes of action as an exclusive remedy for violations of the CEA.

9. A person is defined in the Act as "an individual, a corporation, a partnership, an association, a joint-stock company, a trust . . . , an unincorporated organization, a government . . . ." O.C.G.A. § 10-5A-1(11) (Supp. 1988).

10. Howell Interview, *supra* note 3. It is thought that lack of registration requirements in the state statute is one way to avoid the ambiguity in the CEA concerning federal preemptive regulatory authority. *Id.*

11. *Id.*

CFTC's duties in connection with the investigation and punishment of commodities fraud,<sup>12</sup> but the NFA does not have an office in Georgia.<sup>13</sup> While this lack of federal involvement does not justify state regulation of federally preempted regulatory power, it is a reason to have statutory provisions empowering a state agency to regulate in the areas that are not preempted.<sup>14</sup>

The primary purpose behind the Act is to protect investors from the increased "boiler-room"<sup>15</sup> activity and other fraudulent investment schemes which annually defraud investors of thousands of dollars.<sup>16</sup> The Act is designed to protect investors from commodities activities which do not conform to federal regulations and are not required to be registered.<sup>17</sup>

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The Act amends Georgia's securities law by adding statutory authority allowing enforcement of sanctions for illegal commodity activities.<sup>18</sup> Commodity contracts or commodity options may not be sold or purchased within the state unless the seller, purchaser, or transaction is controlled by federal regulatory authority.<sup>19</sup> A purchase or sale made within the state includes an offer or acceptance made in the state to buy or sell a commodity.<sup>20</sup> Neither party to the agreement need be present in the state if the offer originates from within the state or the correspondence is directed to an address within the state.<sup>21</sup> Arrangements are not considered made in the state, for example, when a publisher circulates a newspaper not published in the state or a radio or television broadcast originates outside the state and is received within the state.<sup>22</sup>

The Act does not apply to those registered with the CFTC, the Securities and Exchange Commission, financial institutions, and precious metal dealers with a net worth of \$500,000 or more.<sup>23</sup> Transactions excluded from the Act include those regulated by the CFTC, those between the

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12. *Id.*

13. *Id.*

14. *Id.*

15. Boiler-room transactions are defined as the "[h]igh-pressure selling of stocks of doubtful value, usually over the telephone. Sometimes [the transactions are] associated with sales of 'hot issue' securities." BLACK'S LAW DICTIONARY 159 (5th ed. 1979).

16. Howell Interview, *supra* note 3; see also O.C.G.A. § 10-5A-9 (Supp. 1988).

17. Howell Interview, *supra* note 3.

18. O.C.G.A. §§ 10-5A-1 to -31 (Supp. 1988). Terms such as "commodity," "commodity contract," and "commodity option" are defined in O.C.G.A. § 10-5A-1(3), (4), (9) (Supp. 1988).

19. O.C.G.A. §§ 10-5A-2 to -4 (Supp. 1988). The Act, by express exclusions, is designed to cover only those persons or activities that are not preempted by the CFTC's jurisdiction of commodities regulation.

20. O.C.G.A. § 10-5A-27(a), (b) (Supp. 1988).

21. O.C.G.A. § 10-5A-27(c) (Supp. 1988).

22. O.C.G.A. § 10-5A-27(e)(1), (2) (Supp. 1988).

23. O.C.G.A. § 10-5A-3(a)(1), (2), (5), (7) (Supp. 1988).

final user and merchant, and those which involve investment advisors and insurance companies.<sup>24</sup>

The Act requires a commodity merchant to register with the CFTC or to obtain temporary licensing from that body.<sup>25</sup> Fraudulent commodities activities are expressly prohibited,<sup>26</sup> and liability for fraud extends to principals for the acts and omissions of their agents.<sup>27</sup>

The Act gives broad discretionary power to the Secretary of State, as Commissioner, or his appointee to investigate commodities fraud and to hold hearings in furtherance of the investigation.<sup>28</sup> The Commissioner may take administrative action when there are violations of the Act, including issuing a cease and desist order and imposing civil sanctions in the amount of \$10,000 for each violation or \$100,000 for multiple violations.<sup>29</sup> The Act also specifies legal and equitable remedies available to a superior court which hears a commodities fraud action.<sup>30</sup> Willful violators of the Act are to be imprisoned for not more than ten years, fined not more than \$50,000 for each violation, or both.<sup>31</sup>

Initially, HB 1366 required persons summoned to an investigative hearing to forego their privilege against self-incrimination.<sup>32</sup> The House Committee on Judiciary offered a substitute which deleted this portion of the bill and replaced it with a requirement that a transcript of the hearing be made available to the parties.<sup>33</sup> This change was adopted by the legislature.<sup>34</sup>

The Act provides for cooperation with all other law enforcement agencies<sup>35</sup> and gives the Commissioner broad discretion to adopt rules and regulations necessary to enforce commodities fraud.<sup>36</sup>

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24. O.C.G.A. § 10-5A-4(a)(1), (3), (4) (Supp. 1988).

25. O.C.G.A. § 10-5A-5(a)(1) (Supp. 1988).

26. O.C.G.A. § 10-5A-6 (Supp. 1988).

27. O.C.G.A. § 10-5A-7(a) (Supp. 1988).

28. O.C.G.A. § 10-5A-20(a)(1), (e), (f) (Supp. 1988).

29. O.C.G.A. § 10-5A-21(a)(1), (2) (Supp. 1988).

30. O.C.G.A. § 10-5A-22 (Supp. 1988).

31. O.C.G.A. § 10-5A-31(a) (Supp. 1988). Federal statute permits private actions for commodities violations for actual damages. *See* 7 U.S.C. § 25(a) (Supp. 1988). However, failure to complain within three days of the trade indicates assent, thereby ratifying the contract, unless the ratification is induced by fraud. *Robertson v. Clayton Brokerage Co. of St. Louis*, 587 F. Supp. 678, 684—85 (N.D. Ga. 1984).

32. HB 1366, as introduced, 1988 Ga. Gen. Assem.

33. HB 1366 (HCS), 1988 Ga. Gen. Assem.

34. O.C.G.A. § 10-5A-20(d) (Supp. 1988).

35. O.C.G.A. § 10-5A-25 (Supp. 1988). The Act authorizes the sharing of confidential information with other agencies, both on the state and federal level. Congress has encouraged this by empowering the CFTC to do the same, thereby "making information sharing a two-way street." *Futures Trading Act of 1982*, 7 U.S.C. § 12(a) (Supp. 1988).

36. O.C.G.A. § 10-5A-26 (Supp. 1988).