UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

NO. 86-4175

MANNING STOLLER,

Petitioner,

v.

COMMODITY FUTURES TRADING COMMISSION,

Respondent.

ON PETITION FOR REVIEW OF AN ORDER OF THE COMMODITY FUTURES TRADING COMMISSION

PETITION FOR REHEARING AND SUGGESTIONS FOR REHEARING _EN BANC_ OF RESPONDENT COMMODITY FUTURES TRADING COMMISSION

I. PRELIMINARY STATEMENT

Pursuant to Rules 35 and 40, Fed. R. App. P., the Commodity Futures Trading Commission ("Commission"), respondent in this appeal, respectfully requests that this Court grant rehearing _en banc_ of an opinion of a panel of this Court issued November 23, 1987. That opinion reversed the Commission's determination in two orders that petitioner Manning Stoller ("Stoller") violated the anti-wash sales provisions of section 4c(a) of the Commodity Exchange Act (the "Act"), 7 U.S.C. § 6c(a) (1976).

Rehearing is warranted because the opinion is susceptible to a construction that an administrative agency may not institute an enforcement proceeding against a perceived statutory violation unless it has previously articulated by regulation or interpretation that the conduct at issue is violative of the statute. Such a proposition, if intended by the Court, is contrary to well-settled principles of administrative law established by the Supreme Court in SEC v. Chenery 1/ and its progeny, and potentially would imperil the enforcement programs of numerous federal agencies with statutory responsibilities comparable to the Commission's.

The panel's decision considers issues raised for the first time in petitioner's reply brief and thus not specifically briefed by the Commission. Consequently, the panel has misapprehended the record and relevant case law insofar as it holds that petitioner could not have had adequate notice that his conduct was unlawful, and that the Commission exacerbated matters by suddenly "shifting its views" on illegal wash sales in the midst of this proceeding. In actuality, the wash sales interpretation followed in this case by the Commission is the interpretation established and explained on the public record by its predecessor agency, the Commodity Exchange Authority ("CEA") almost forty years ago in In re Goldwurm, 7 A.D. 265 (1948). Throughout, the Commission's focus here was on the statutory prohibition against intentionally structuring transactions so as to avoid market risk, regardless of the market nomenclature for these transactions. The panel, however, misapprehended that focus, and instead erroneously concentrated on the irrelevant issues of whether trades called "roll forwards" or "behind the line" were legitimate

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1/ 332 U.S. 194 (1947) ("Chenery II").

under the Act and whether petitioner could have been aware of the Commission's view on this question.

Finally, as will be shown, no prejudice resulted to Mr. Stoller in any event. Established law was applied, and Stoller initiated transactions prohibited by that established law. To the extent that the Commission disagreed with the CEA's per se condemnation of Stoller's intention to delay delivery, the Commission's view was more lenient language. Thus, this case presents issues of exceptional importance warranting en banc consideration by this Court.

II. FACTUAL BACKGROUND

In early May 1976, petitioner Stoller held long positions in the May 1976 Maine potatoes futures contract traded on the NYMEX. He believed that there was a temporary artificial depression in the market price for Maine potatoes that would soon be corrected, resulting in rising prices in the final days of trading for that contract. Because NYMEX regulations provided that deliveries pursuant to futures contracts were to be made first to the traders holding the oldest long positions, and because those traders who were among the last to accept delivery stood to profit the most from a price rise during the delivery period, Stoller desired to replace all his preexisting contracts with later contracts. He accomplished this by entering sell and buy orders for the same amounts, virtually simultaneously. His broker was instructed to execute these orders at prices as near to each other as possible, and when this had been accomplished, to use the new short positions as offsets to close out the preexisting long positions, rather than for the new long and short positions to offset each other as a "day trade."[2/]

The Commission in June 1977 issued an administrative complaint against Stoller, charging, inter alia, that this trading activity constituted "wash sales" absolutely prohibited by section 4c(a)(A) of the Act. An Administrative Law Judge subsequently granted summary disposition in favor of Stoller. He found in effect that because Stoller had demonstrated a legitimate market purpose for the transactions, the challenged trading activity fell outside the wash sales prohibition of the Act. The agency's Division of Enforcement appealed this ruling to the Commission.

In an opinion issued on April 6, 1986 ("Collins I")[3/] the Commission, after considering the relevant legislative history and case law, concluded that section 4c(a)(A) was intended to prohibit all futures transactions that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market, regardless of the motivation for the transaction. The Commission considered immaterial Stoller's claim that "rolling forward" was a common industry practice, both because prior CEA decisions did not treat the purpose for the wash sales as a relevant factor to a participant's liability, and because it found no congressional intent to exempt from the statutory prohibition wash sales having a legitimate

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2/ A "day trade" is a transaction in which a trader enters and exits the market in the same day. It is accomplished by buy and sell orders for the same account, and the positions so executed are offset against each other, leaving the trader with no open position at the end of the day. See In the Matter of Lincolnwood Commodities, Inc. of California, [1982-1984 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶ 21,986 at 28,226 (1984). See also 17 C.F.R. § 1.46 (1987). A trader profits or loses from the transaction depending upon the net market movement between the time he initiates his position and the time he liquidates it by offset.

3/ In re Collins, [1986-87 Transfer Binder] Comm Fut. L. Rep. (CCH) ¶ 22,982 (Apr. 6, 1986) ("Collins I").

market purpose. Having found that Stoller admitted facts that supported a finding that he initiated the transactions at issue without the intent to make a genuine bona fide trading transaction, the Commission concluded that the transactions were prohibited wash sales in violation of section 4c(a)(A). Collins I, at 31,903.

Following the issuance of Collins I, the Chicago Mercantile Exchange ("CME") requested clarification on the theory that the Collins I seemed to prohibit transactions in which traders seek to minimize market risk. The Commission, in Collins II,4/ reaffirmed Collins I and explained, inter alia, that if a trader did not structure his transaction to negate risk, he would not violate Section 4c(a) merely because he sought to delay delivery. The Commission specifically stated:

> transactions structured to minimize rather than negate risk or price competition in the futures market do not violate Section 4c(a)(A) merely because the transaction serves to change the individual's position in the delivery line.5/

Moreover, after affording Stoller an opportunity to show cause why sanctions should not be imposed against him, the Commission ordered Stoller to cease and desist from further violations of section 4c(a)(A) of the Act, and ordered his associated person registration suspended for twenty days. This appeal followed.

On review, a panel of this Circuit reversed the Commission's determination that Stoller could be found in violation of section 4c(a)(A) of the Act. The court found that "the public was not adequately apprised that the Commission views 'roll forward' trading to be encompassed within the 'wash sale'

4/ In re Collins, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,401 (Nov. 26, 1986) ("Collins II").

5/ Id. at 33,078.

prohibition." (Slip op. at 6060-61.) In this regard, the court observed that the term "wash sale" is not defined in the Act, the Commission's regulations, or in any interpretative release. Moreover, the court considered the Commission's finding of wash sales violations to be a sudden change of view with respect to what are bona fide trading transactions. (Id. at 6057.) Shifting its focus to the question of the agency's view of the legitimacy of the practice of trading to delay delivery, the panel acknowledged that the CEA had previously advised futures commission merchants and floor brokers that it considered trading to get behind the delivery line to be improper in a memorandum circulated to them in 1948. The panel also noted that this position was restated in a 1955 internal memorandum, a 1959 unpublished memorandum to brokers, and a 1971 letter to the CME. Nevertheless, the panel stated that it did not consider these documents to be sufficient to apprise the public at large of the CEA's view, particularly when the policy apparently remained unenforced for years and the allegedly proscribed conduct apparently remained commonplace, as was asserted in this case. (Id. at 6057.)

III. ARGUMENT

POINT I. The Panel's Opinion Is Susceptible To An Interpretation That An Agency Cannot Enforce A Statutory Bar Absent Prior Articulation By Regulation Or Interpretation, And As Such Clearly Departs From Well-Settled Judicial Precedent.

The panel recognizes that an agency is free to interpret its governing statute case-by-case through adjudicatory proceedings, rather than rulemaking,[6/] and that it may announce and apply a new standard of conduct. (Slip

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6/ Chenery II, 332 U.S. 194 (1947); NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974).

op. at 6057.)[7/] However, the panel states in the penultimate sentence of the opinion that "because we hold that the public was not adequately apprised that the Commission views "roll forward" trading to be encomposed within the 'wash sale' prohibition, we hold that Stoller may not be held liable under that interpretation for his alleged violation with respect to the contracts at issue herein." (Id. at 6660-61.) Thus, the opinion could be read to stand for a troubling proposition, viz., that before a particular theory can be relied on by a law enforcement agency, or before a particular fact pattern can be the basis of a violation of federal law, there must first be a previous enforcement action or some public agency statement reciting that the pattern of conduct in question is unlawful. The former is completely illogical, as there must always be a case that comes first; and the second nearly as much so, because, as the Supreme Court has recognized in Chenery II, agencies cannot, through prior public interpretations, presuppose every conceivable fact pattern violative of law. 332 U.S. at 202-03; see also Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971) ("[t]he method and techniques of manipulation are limited only by the ingenuity of man").

Nor may the lapse of time between the enactment of a statute and the use of the statute to prosecute a particular theory or fact pattern be held against the government. Indeed, the prohibitions against securities fraud were enacted in the early 1930's, but it was nearly 30 years before the Securities and Exchange Commission brought its first enforcement case against insider trading. Cady, Roberts and Co., 40 S.E.C. 907 (1961).[8/] In any

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7/ Chenery II, 332 U.S. at 203.

8/ National Labor Relations Board v. Majestic Weaving Co., 355 F.2d 854 (2d Cir. 1966) cited by the panel, is not supportive. There, this Court raised the issue of whether agency articulation of a new rule may be arbitrary where the industry had relied on the agency initial rule for
(footnote continued)

event, it is important to recognize that wash sales may take many different forms, just as there are varied clever and sharp practices which defraud participants in the markets or can be used to manipulate markets. Cargill, supra. The Commission must be free to develop the law in this area through adjudication. Chenery II, at 201-202.

We will show in Points III and IV of this argument that the Commission did not change direction, and that Stoller was not prejudiced by the Commission's application of the law. But, for the purposes of this Point I, we stress that the lack of clarity in the panel's opinion as to when any shift of position may have occurred and how Stoller may have relied on prior interpretations, places in jeopardy the ability of law enforcement agencies to prosecute illegal activities which may be similar to but which may differ slightly from previously identified illegal activities.

POINT II. Contrary To The Panel's Finding There Was Adequate Public Notice Of The Commission's Views On Wash Sales.

The panel finds that even if Stoller had investigated the Commission's view of "roll forward" trading, it seems unlikely that he would have been able to tell from that inquiry alone that such action was impermissible. (Slip Op. at 6058.) As such, the opinion overlooks the significance of the CEA's seminal decision in In the Matter of Jean Goldwurm, 7 Agric. Dec. 265 (1948) ("Goldwurm"). In Goldwurm, the CEA expressly ruled that the essential characteristic of a wash sale, apart from (and without regard to) the ultimate goal or motivation for a wash sale transaction, is the "intent not to make a

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fifteen years; however, it determined not to decide that issue. 355 F.2d at 861. Moreover, as will be shown in Point IV, the principle is in any case inapplicable here as the Commission has not changed its rule to petitioner's detriment in this case.

genuine bona fide trading transaction."9/ As noted in Collins I at 31,901 n.17, the floor broker in the transaction in Goldwurm was held responsible for the wash sale violation in the absence of any evidence he was aware of the customer's motivation in initiating the transaction.10/

In addition to being publicly reported, the Goldwurm decision has been cited by the Ninth Circuit as authority for the definition of one type of trade prohibited by section 4c of the Act. See, CFTC v. Savage, 611 F.2d 270, 284 (9th Cir. 1979) ("The essential and identifying characteristics of a 'wash sale' seems to be the intent not to make genuine bona fide trading transactions in stocks or commodities.")11/ In light of these public pronouncements, it was plainly a misapprehension for the panel to find that petitioner could not reasonably have learned of the Commission's position on such trades.

POINT III. Contrary To The Panel's Interpretation, The Commission's Orders Under Review Are Not At Variance With Either Prior CEA Precedent Or One Another.

As noted, the opinion strongly suggests that the prejudice to petitioners caused by the purported lack of notice was, if anything, further exacerbated by the Commission's departure from previous CEA policy or precedent. As the panel construes the orders under review, the Commission first held that "all transactions which give the appearance of a bona fide purchase or sale, while

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9/ 7 Agric. Dec. at 274.

10/ Indeed, in Goldwurm, the CEA expressly declined to consider the lawfulness of the tax-motivated transactions, stating "[o]f course, the legitimacy of the tax purpose cannot be conceded, denied, or decided here." 7 Agric. Dec. at 272 n.1.

11/ The panel also overlooked the public pronouncement by the CEA in its 1948 Annual Report To Congress that trading to get behind the delivery line constituted wash trading, which was cited at p. 33 of the Commission's Brief.

avoiding any actual change in ownership" are illegal, citing Collins I at 31,899.[12/] According to the panel, the Commission then "revised its interpretation, claiming that the statute only prohibits transactions that negate market risk," citing Collins II at 33,078. As will now be shown, the Commission's orders taken together in actuality follow CEA precedent on "wash sales" published almost forty years ago, are consistent with each other, and do not constitute a "backing away" in policy.

The Commission in Collins I adhered to the Goldwurm interpretation that the intent not to make a genuine bona fide trading transaction, as opposed to the intent to achieve a particular end (e.g., manipulation, fraud, tax avoidance, changing positions in the delivery line), is the essential characteristic of a wash sale violation. Equally significant, Collins I adhered to the Goldwurm view[13/] that it is not essential to a wash sale violation that the buy and sell orders be executed simultaneously. Finally, the Commission in Collins I followed the Goldwurm view[14/] that the initiation of transactions by near simultaneous entry of orders for futures contracts with instructions that they match each other with little or no price difference constitutes wash sales.

The prosecution of the Goldwurms was based on a virtually simultaneous entry of orders with instructions that there was an acceptable range of price differences. 7 Agric. Dec. at 275-76. This conduct was held to be the offending element, not the purpose for which the trades were done. Id. at 272

12/ Upon closer reading, the Court will see that this reference by the Commission in Collins I is to an argument made by a litigant before it, the Division of Enforcement, and was not, as the panel found, the holding adopted by the Commission.

13/ See 7 Agric. Dec. at 277.

14/ See id. at 276-77.

n.1; see note 10, supra. In the instant case, Stoller entered the orders virtually simultaneously with instructions to execute the orders at prices as near to each other as possible. Collins I, 31,898; see also J.A. 53. The Commission held this constituted a wash sale in violation of Section 4c(a).

While the Commission followed the CEA interpretation announced in Goldwurm, contrary to the panel's misapprehension, it never adopted the CEA's per se condemnation of all trades made to delay delivery. The panel ignores the Commission's clear expression in Collins I of its disagreement with the CEA's expression of a per se approach to "roll forward" trading. The Commission stated:

> To the extent that the CEA interpreted all trades motivated by a desire to get behind the delivery line to be wash sales or fictitious sales under Section 4c(a), we do not adopt its interpretation. We merely hold here that Stoller intended to avoid making a bona fide market transaction in entering the orders at issue. Unlike the CEA, we do not see a principled incompatibility between the motive of trading to get behind the delivery line and an intent to make a bona fide market transaction. Determination of a party's intent will inevitably turn on the particular facts and circumstances.

Collins I at 31,903 n.25. This language is completely consistent with the Commission's language in a procedural order issued after Collins I but before Collins II, which the panel mischaracterized as a "back[ing] away from the sweeping language of Collins I." Slip op. at 6059, citing ¶ 23,112 at 32,283 n.2.[15]

15/ There, the Commission stated:

> Indeed, the record includes a letter dated September 13, 1971 from the Administrator of the Commodity Exchange Authority to the president of the Chicago Mercantile Exchange expressing the view that all trading for the purpose of "getting behind the line" was in violation of Section 4c(a). The Commission did not adopt this per se approach and if that is one of the Exchange's concerns, it is misplaced.

Furthermore, the panel erred in asserting that Collins II "backed away" from Collins I. The Commission's discussion of negation of risk in Collins II is completely consistent with its discussion of that concept in Collins I. In Collins I, the Commission stated :

> the central characteristic of the general category of fictitious sales, is the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk or price competition incident to such a market. In wash sales, for example, purchases and sales are made in the pit, but the financial result is close to or equal to zero. By effectively buying from and selling to himself, a trader eliminates or sharply reduces his risk of loss. Moreover, because the price of the buy and sell orders is often of little consequence as long as a wash result is achieved, price competition may be negated. (Emphasis supplied.)

Id. at p. 31,902. The Commission relied on the risk negation standard as the critical inquiry in both Collins I and Collins II. Moreover, the panel's statement that Collins II adopts the position that section 4c(a) only prohibits transactions that do not expose the principals to any risk of market price fluctuation, or otherwise modified the holding of Collins I (Slip Op. at 6054), is clearly in error.

POINT IV. The **Collins** Decisions In Any Case Did Not Prejudice Stoller.

The panel's opinion holds that the agency may not charge a knowing violation[16/] of a suddenly revised standard and thereby cause undue prejudice to a litigant who may have relied on the agency's prior policy or interpretation. As support for that view, the Court relies upon Ruangswang v. INS, 591 F.2d 39 (9th Cir. 1978) ("Ruangswang"), which held that agencies may not

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16/ The Commission must only prove that the respondent intended to engage in the conduct prohibited by law. It does not have to prove that the respondent knows his conduct violates the law. See Lawrence v. CFTC, 759 F.2d 767, 773 (9th Cir 1985); CFTC v. Savage, 611 F.2d at 282-84.

impose undue hardship by suddenly changing direction to the detriment of those who have relied on past policy.

Even if it is assumed that the Commission changed its view at some point in this proceeding, it does not necessarily follow that petitioner was treated unfairly as a result. Rather, the critical question is whether the purported change in the rule would have exposed the petitioner to new, previously unforeseen liability. Cf. Ruangswang, 591 F.2d at 440 (agency action invalidated where petitioner was exposed to new liability pursuant to later agency interpretation imposing an additional requirement).

Clearly, petitioner in this case was exposed to no such additional risk. If anything, the Commission's willingness to consider how Stoller structured his transactions and its refusal to limit its consideration solely to his motivation amounted to the application of a more lenient standard. Had the Commission simply followed the CEA per se rule of absolute liability, petitioner automatically would have been liable for a Section 4c(a) violation because he had repeatedly admitted that the challenged trades were designed to get behind the delivery line. In these circumstances, where petitioner could have reasonably known about the per se standard and the purported change benefited the litigant, the Commission's result should not be held unreasonable or unfair.

POINT V. The Panel Erred In Declining Either To Affirm The Commission's Ruling On Summary Disposition Or To Remand This Case For A Hearing.

The Commission continues to believe that petitioner's deposition testimony constitutes uncontrovertible proof that he engaged in wash trading, i.e., that he entered his May 1976 orders with the intent to avoid a genuine bona fide trading transaction. See Joint Appendix ("J.A.") at 32, 35, 36, 41, 47, 48, 52-54. This testimony clearly shows that: 1) petitioner entered orders simultaneously; 2) he bought and sold the same or similar prices; 3) he did not care about the particular price for this trades; 4) that his "market not held" instruction signalled to his broker that he had discretion to wait until trading activity in the pits was such that both buy and sell orders could be executed at a virtual price match; and 5) that his position in the market did not change in any material respect. This testimony clearly supports the Commission's inference that petitioner intentionally structured his buy and sell orders so that a virtual price match could be achieved.[17/] petitioner has claimed that, notwithstanding his "market not held" orders, he also instructed his broker to offset his preexisting long positions before establishing his new long positions. The Commission recognized that Stoller had given such an instruction so that his purchases and sales did not offset each other as day trades. Collins I at 31,898-99; J.A. 35-36. The existence of this instruction is not in dispute, and is in no manner inconsistent with the inference that Stoller intended to negate risk and to avoid any bona fide trading transaction. Absent a finding that the foregoing inferences by the Commission were unreasonable or arbitrary, these findings should have been permitted to stand. See, e.g., Quarles v. General Motors Corp., 758 F.2d 839, 840 (2d Cir. 1985).

If the court does not agree that this proof is dispositive of petitioner's intent to execute a wash trade, the appropriate course would be a remand of this case to the Commission for a hearing. The panel recognizes that under normal circumstances the improper resolution of a case on summary

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17/ Indeed, the testimony of petitioner at J.A. 53 demonstrates that petitioner intended to avoid precisely the price risk in the hypothetical "market sale followed by instructions" recited by the panel. (Slip Op. at 6060.)

judgment is grounds to remand the case for further proceedings. RKO General, Inc. v. FCC, 670 F.2d 215, 226 n. 32 (D.C. Cir. 1981). Nevertheless, the panel ruled that a remand is inappropriate here because the perceived absence of adequate prior notice of the Commission construction of the term "wash sale" constituted an incurable defect in the proceedings. Slip Op. at 6056.

As shown, the underlying principles which governed the Commission's disposition of the trades at issue here were in fact a matter of public record for almost forty years, and thereby satisfied any reasonable standard of adequate notice. In these circumstances, it was clearly error for the panel to have concluded that a remand would not be appropriate.

CONCLUSION

The Court should grant rehearing en banc and affirm the Commission's orders.

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