"Front-Running" – Insider Trading Under the Commodity Exchange Act

Jerry W. Markham
“FRONT-RUNNING”—INSIDER TRADING UNDER THE COMMODITY EXCHANGE ACT

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On “Black Monday,” October 19, 1987, “perhaps the worst day in the history of U.S. equity markets,” the Dow Jones Industrial Average fell by 508 points, representing a loss of approximately $1 trillion1 in the value of all outstanding United States stocks. In the wake of the crash, numerous studies were conducted and reports published in which a host of regulatory issues were considered,2 including a disturbing phenomenon called “front-running.”3

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1. REPORT OF THE PRESIDENTIAL TASK FORCE ON MARKET MECHANISMS 1, 36 (Jan. 1988) [hereinafter BRADY REPORT].


3. SECURITIES EXCHANGE COMMISSION (SEC) STAFF REPORT, THE OCTOBER 1987 MARKET BREAK (Feb. 11, 1988) [hereinafter SEC REPORT]; DIVISION OF ECONOMIC ANALYSIS AND DIVISION OF TRADING AND MARKETS, CFTC, FINAL REPORT ON STOCK INDEX
Simply stated, the practice of front-running involves a transaction in a commodity futures contract\(^4\) or a stock option contract\(^5\) by a trader with "material" nonpublic information concerning a "block" transaction\(^6\) in the

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\(^{4}\) Approaches and Their Conflicts, generally

\(^{5}\) REGULATIONS OF THE COMMODITIES FUTURES AND OPTIONS MARKETS, futures exchanges.

\(^{6}\) The Structure of the Options Market, 10 J. CORP. L. 141 (1984).

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AND CASH MARKET ACTIVITY DURING OCTOBER 1987 TO THE COMMODITY FUTURES TRADING COMMISSION (Jan. 1988) [hereinafter CFTC FINAL REPORT].

4. A commodity futures contract is simply an obligation on the part of the purchaser (the "long") to take delivery of a specified amount of a specified grade and quantity of a commodity at a specified date in the future. Conversely, the seller (the "short") is required to make delivery on the contract. Commodity futures contract terms, however, are standardized so that the traders may close out their positions at any time before delivery by entering into offsetting obligations. When this occurs, the futures contracts are liquidated and the trader will have an overall gain or loss from the transaction. See generally Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 357-60 (1982); British American Commodity Options Corp. v. Bagley, 552 F.2d 482, 484-485 (2d Cir.), cert. denied, 434 U.S. 938 (1977); Cargill Inc. v. Hardin, 432 F.2d 1154, 1156-57 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972); S. REP. NO. 850, 95th Cong., 2d Sess. 128 (1978); CHICAGO BOARD OF TRADE, COMMODITY TRADING MANUAL 8 (1973); M. MAYER, MARKETS, xiv-xv (1988). Some futures contracts are settled by cash settlement rather than delivery of the underlying commodity. Even where actual delivery is provided for, however, deliveries are taken in only about 3% of all futures transactions. See Curran, 456 U.S. at 359 n.9; see also Hardin, 452 F.2d at 1156 n.2.

Futures contracts are traded on margin. An initial margin must be posted when the customer opens a futures contract. This is usually a small percentage of the contract price. Thereafter, additional margin must be posted each day there is an adverse movement in the futures contract that causes one trader or the other to suffer a loss. Margin for futures contracts is distinguished from margin for securities. In the latter case, margin means simply a good faith deposit on the value of the contract so as to assure performance. See generally Katara v. D.E. Jones Commodities, Inc., 835 F.2d 966 (2d Cir. 1987); CHICAGO BOARD OF TRADE, COMMODITY TRADING MANUAL 10 (1982); Corcoran & Ervin, Maintenance of Market Strategies in Futures Broker Insolvencies: Futures Position Transfers from Troubled Firms, 44 WASH. & LEE L. REV. 849, 854 n.28 (1987); Rogers & Markham, The Application of West German Statutes to United States Commodity Futures Contracts: An Unnecessary Clash of Policies, 19 LAW & POL’Y INT’L BUS. 273, 275 (1987).

5. In brief, a "call" stock option permits investors to pay a fee or "premium" for the right to purchase a specified number of shares of a given security, such as IBM, at an agreed upon "strike" price. This option right is limited in duration, and the option is standardized so that contracts can be offset in the event that the purchaser of the option wishes to liquidate the option position, rather than to exercise the option and purchase the underlying security. Similarly, a put option allows the purchaser to sell or "put" securities to the writer of the option at a specified price, even if the value of the securities decline below that price. Stock options are traded over-the-counter and on securities exchanges where they may be offset, much like a futures contract. Options on commodities and options on futures contracts are traded on futures exchanges. See Markham & Gilberg, Stock and Commodity Options—Two Regulatory Approaches and Their Conflicts, 47 ALB. L. REV. 741, 742-43 (1983). See generally T. Russo, REGULATIONS OF THE COMMODITIES FUTURES AND OPTIONS MARKETS, § 1.01 (1983); Seligman, The Structure of the Options Market, 10 J. CORP. L. 141 (1984).

6. A block trade has been defined as follows:

Block In the stock market, a large number of shares to sell; today, conventionally, 10,000 or more. Blocks may be inconvenient to sell in the course of an auction market, because the heavy supply presses the price down. Brokers for the holder of the block (usually some fund or institution) thus try to sell it away from the market, over
commodity or security underlying the futures or options contract.\textsuperscript{7} To be material, the block transaction must be of such a size that it will cause a price change in the futures or options contract and thereby allow the front-runner to profit from the offsetting options or futures position.\textsuperscript{8}

In actuality, front-running is more complex than this definition suggests. It encompasses at least three forms of conduct, each of which raises different regulatory and policy issues.\textsuperscript{9} They are: (1) trading by third parties who are tipped on an impending block trade ("tippee" trading); (2) transactions in which the owner or purchaser of the block trade itself engages in the offsetting futures or options transaction as a means of "hedging" against price fluctuations caused by the block transaction ("self-front-running"),\textsuperscript{10} and (3) transactions where a broker with knowledge of an impending customer block order trades ahead of that order for the broker's own profit ("trading ahead").

This Article will explore the background of front-running, and its regulation in the securities industry. The Article will then focus on the spread of the practice to the commodity futures industry and the regulatory and policy issues raised by various forms of front-running. It will then address whether the present statutory framework is adequate to prohibit undesirable front-running practices. The Article proposes legislation to restrict such practices, and identifies surveillance methods that are needed to detect violations of necessary restrictions.

the telephone, to known possible large customers. If the stock sells, the broker is usually paid commissions on both the buy and the sell side. Large brokerage firms will often complete such deals by purchasing a part of the block for themselves, Positioning it until another purchaser can be found. When blocks listed on a U.S. stock exchange are sold in this manner, brokers who are members of the exchange must bring the transaction to the attention of the Market Maker at the exchange, and cause the sale to be published on the ticker tape or the computer screen like the sales accomplished by normal bidding in the open market.

A block already traded upstairs and carried to the exchange floor as a done deal is said to be CROSSED. If all the shares have been bought by public customers, rather than the broker himself, it is a "clean cross."

M. Mayer, supra note 4, at 282.


\textsuperscript{9} Id. at 5-6.

\textsuperscript{10} Id. The concept of hedging entails a producer or processor of the commodity underlying the futures contract taking an offsetting position in the futures market. For example, a "farmer who takes a 'short' position in the futures market is protected against a price decline; a processor who takes a 'long' position is protected against a price increase." Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 358 (1982); see also T. Hieronymus, Economics of Futures Trading 107-08 (2d ed. 1977) (providing a brief definition and example of hedging).
I. EMERGENCE OF FRONT-RUNNING ON SECURITIES OPTIONS MARKETS

The practice of front-running first appeared on the Chicago Board Options Exchange (CBOE), the world's first and largest organized stock options exchange.11 The CBOE was created by the Chicago Board of Trade to apply commodity futures trading principles to securities transactions.12 This resulted in some regulatory confusion because trading in commodity option and futures contracts was regulated, under the Commodity Exchange Act,13 by an agency in the Department of Agriculture, while securities and traditional stock options were regulated by the Securities and Exchange Commission (SEC) under the federal securities laws.14 This situation was compounded by the fact that, originally, regulation of options trading under the Commodity Exchange Act applied exclusively to options on certain agricultural commodities.15 The Commodity Exchange Act barred options trading only on those commodities.16 On the other hand, the federal securities laws did contain a provision that allowed the SEC to regulate trading in stock options, trading which was then being conducted in the over-the-counter market.17 It was unclear, however, whether the SEC, or any other regulatory agency, had authority to regulate trading in options in other areas, such as an option on a security traded on a futures exchange.18 Conse-
frequently, the manner in which the CBOE would be regulated was uncertain. Rather than confront that issue, however, the Chicago Board of Trade registered the CBOE as a national securities exchange subject to SEC regulation.19

As a part of its development efforts for the CBOE, the Chicago Board of Trade commissioned a study by Robert R. Nathan Associates, Inc. (Nathan Study).20 Among other things, the study considered the possibility that CBOE options could be used by large block traders to avoid price pressures from their trading. It had been suggested that institutional investors and other large traders could use such options to hedge against changes in stock prices caused by their large block transactions. The Nathan Study, however, concluded that there was a great deal of over-optimism as to the extent to which an options exchange would allow institutional investors to reduce the difficulties and costs of engaging in large block trading. The study noted that there had been suggestions that options could be used to distribute or accumulate large block positions in a stock without causing a market break.21 These statements, however, were thought to exaggerate the amount of price pressure caused by large block transactions, except possibly in thin markets. The Nathan Study expressed the view that organized options trading would not solve the latter problem because exchange-traded options would primarily involve highly liquid common stocks.22

1105-08; Markham & Gilberg, supra note 5, at 759-61; Schobel & Markham, Commodity Options—A New Industry or Another Debacle?, Sec. Reg. & L. Rep. (BNA) No. 347 (April 7, 1976) (Special Supplement).


19. See Chicago Bd. of Trade, 677 F.2d at 1140 n.2.
20. NATHAN STUDY, supra note 12.
21. Id. at 48-51.
22. Specifically, the Nathan Study stated that:
[There] appears to be a good deal of misunderstanding about the extent to which an organized option market would permit institutional investors to overcome what they regard as some of the difficulties and costs of large-block trading in equities. Many references are made . . . for example, to the use of puts and calls for distributing or accumulating large positions in a particular stock without breaking the market. These statements appear to rest among other things on a gross exaggeration of the amount of “price pressure” involved in large transactions even under existing institutional arrangements . . . . Admittedly, market thinness and price pressure may well
Some three years after this report, the CBOE began trading in stock options.\textsuperscript{23} It was an almost immediate success and was quickly copied by other exchanges.\textsuperscript{24} Initially, as predicted by the Nathan Study, trading by institutional customers and large block traders did not raise concerns on the CBOE because they accounted for only between five and ten percent of total customer activity.\textsuperscript{25} This limited institutional use was due to concern that the CBOE could not handle orders of block size. In addition, unresolved questions regarding the regulatory dimensions of use of the CBOE by various institutions and the tax consequences of options transactions restrained institutional trading. Nevertheless, the CBOE reported early in its existence that "members ha[d] reported receiving and being able to execute within a single day's trading a number of orders to buy or sell 100 or more options contracts, (representing options on 10,000 or more shares [of securities])."\textsuperscript{26}

The CBOE was subsequently able to remove several impediments to institutional trading. Liquidity and institutional participation increased substantially as volume virtually exploded.\textsuperscript{27} With increased volume and liquidity, a number of abuses developed in connection with listed options trading. One such abuse was "front-running," which the SEC in 1977 identified as:

[T]he practice of trading a security while in possession of unreported information concerning a block transaction in the same or a related security. Because of the derivative nature of the pricing of

\textit{Id.} at 48-49.

\textsuperscript{23} See \textsc{Chicago Board Options Exchange (CBOE): The First Three Months} 5 (1973) [hereinafter CBOE: \textsc{First Three Months}].

\textsuperscript{24} Within a year after the CBOE's initial trading, four other securities exchanges announced plans for the development of exchange-traded option markets. See \textsc{Chicago Board Options Exchange 1973 Annual Report} 3 (1973).

\textsuperscript{25} CBOE: \textsc{First Three Months}, supra note 23, at 34-35.

\textsuperscript{26} Id. at 35.

\textsuperscript{27} See \textsc{SEC Options Study}, supra note 11, at 165-68. Volume in exchange-traded options contracts increased from the 911 contracts traded by the CBOE on the day it opened in April 1973 to over 3.3 million contracts per week on all exchanges in 1983. See CBOE: \textsc{First Three Months}, supra note 23, at 7, app. 7; \textsc{Chicago Board Options Exchange 1973 Annual Report} 1 (1973), Seligman, supra note 5, at 147. The total combined volume of the options exchanges exceeded 287 million contracts in 1986. \textsc{SEC Report}, supra note 3, at 8.
options, . . . [front-running] is usually associated with the trading of options based upon knowledge of an unreported block transaction in the underlying security which presents an opportunity to take an options position at a more favorable premium than would be available immediately after the publication of the block transaction. The knowledge may relate to a transaction which has not been finally agreed to but which in the relevant circumstances is nonetheless almost certain to go through, or it may relate to a transaction which has been consummated, but not yet reported.28

To stop this practice, in 1977 the CBOE proposed rule 4.18, a new exchange rule that would have prohibited trading in "options with knowledge of a block transaction in an underlying security or, . . . [conversely,] trading [in the] underlying security with knowledge of a block transaction in . . . option[s] . . . on the [security], prior to the time information as to the block [became] publicly available."29 Proposed rule 4.18 would have prohibited such trading for a proprietary or discretionary account of a member, or person associated with a member, "after the terms of the relevant block transaction had been agreed to by all parties to that transaction."30 A block was defined by the proposed rule as 10,000 or more shares or options covering that number of shares.31

The proposed rule was submitted to the SEC pursuant to rule 19b-4, promulgated under the Securities Exchange Act of 1934,32 which required SEC approval of exchange rules. Thereafter, in a letter to the CBOE dated November 9, 1977, the SEC expressed approval of the CBOE’s effort to restrict this practice, stating that "it seems evident that such behavior on the part of persons with knowledge of imminent transactions which will likely affect the price of the derivative security constitutes an unfair use of such knowledge."33 The SEC, however, was critical of the limited scope of the CBOE’s proposed rule, and expressed the view that several modifications were necessary before it could approve adoption of the new rule. For example, the rule proposed “that knowledge of an individual within a member organization should not be imputed to the organization or to other individuals.”34 The SEC believed that this limitation was, "unwarranted and raised fundamental questions as to the proposed rule's effectiveness."35 In addi-

29. Id.
30. Id.
31. Id.
34. Id. at 663.
35. Id.
tion, it found that the proposed rule failed to prohibit front-running for the accounts of customers tipped by a CBOE member on a forthcoming block trade. The SEC also asserted that the rule should apply to blocks of less than 10,000 shares. The SEC additionally recommended that the CBOE publish examples of front-running activities that would violate the proposed rule so as to make clear its prohibitions.  

The SEC stated that front-running may constitute violations of the Securities Exchange Act of 1934 and that it could take enforcement action itself. The SEC also believed that existing CBOE rule 4.1 already prohibited front-running because such transactions were inconsistent with the just and equitable principles of trade standards already contained in that rule.

In response to the SEC's criticism, the CBOE withdrew its proposed front-running rule. Instead, it issued an educational circular for its members asserting, as suggested by the SEC, that front-running violated existing CBOE rule 4.1 which prohibited conduct by members inconsistent with just and equitable principles of trade. The circular gave examples of front-running. Among other things, it noted that tipping a customer of an impending block trade could be a violation of exchange rules. The circular stated, again reflecting the SEC's comments, that transactions of over 10,000 shares are conclusively deemed to be blocks and that transactions of less than 10,000 shares may be deemed to blocks in appropriate cases.

The circular stated that front-running would include knowledge of less than all terms of a block transaction, if there was knowledge that all material terms of the transaction had or would be agreed upon. Other exchanges trading securities options also subsequently published similar educational circulars on front-running.

At the time the CBOE was addressing front-running, the SEC was also conducting a broad investigation of the options market (SEC Options Study), and it later filed a voluminous report on these markets. Among other things, the SEC Options Study found that the leverage offered by stock

36. Id. at 661.
37. Id. at 663.
38. Id.
41. Id.
42. Id.
43. Id.
44. These exchanges included the NYSE, the Philadelphia Stock Exchange, the National Association of Securities Dealers, the American Stock Exchange, and the Pacific Stock Exchange. See SEC REPORT, supra note 3, at 3-30 & n.81. Some broker-dealers also adopted in-house rules prohibiting front-running. See SEC OPTIONS STUDY, supra note 11, at 186.
45. SEC OPTIONS STUDY, supra note 11.
exchange traded options created new opportunities for trading on the basis of nonpublic market information, including front-running.\footnote{The SEC Options Study found that: The leverage offered by options, which permits substantial percentage gains on a small capital investment, and the existence of a liquid market for options[,] have created new opportunities for profitable options trading based on non-public market information. One method of taking advantage of this information is “front-running” which the Commission has defined as the practice of trading a security while in [the] possession of unreported information concerning a block transaction in the same or related security. [sic]. \textit{Id.} at 183.}

The SEC Options Study gave an example of front-running in which a block positioner (i.e., a person seeking to place the sale of a large block of stock held by an institutional investor) obtained market information concerning a potential block transaction as the result of his positioning activities.\footnote{\textit{Id.}} The block positioner, aware that the forthcoming block would be reported at less than the current market price, would write call options before the price of the call reflected the block transaction. As a consequence, the block positioner would receive a greater premium for the option by writing those calls before the price dropped to reflect the depressive effect the block sale would have on the price of the stock and its related options.\footnote{\textit{Id.} at 183-84.}

The SEC Options Study noted that the use of such market information gave the block positioner an advantage over other market participants. The SEC asserted that trading on such market information was “inconsistent with the notion[s] of fair and honest markets and just and equitable principles of trade.”\footnote{\textit{Id.} at 184.} It noted, however, that it had not specifically considered whether “self-front-running,” front-running by the block owner, would also be inconsistent with such principles. The SEC acknowledged that such trading could constitute an unfair use of such knowledge.\footnote{\textit{Id.} at 184 n.75.}

The SEC also indicated that front-running could occur even without specific information of a particular trade, such as in instances where it was known that there was a large buyer or seller of a block in the market. The SEC stated that front-running would occur where a firm effecting options

\textit{Id.} at 183.
transactions had sufficient market information concerning a particular potential block trade to permit it to have a material advantage over other market participants.\textsuperscript{51}

The SEC Options Study found that the various exchanges had taken no disciplinary actions for front-running, even though exchange surveillance systems had detected such practices. The American Stock Exchange, for example, had declined to institute front-running cases because it “accepted the argument that [the] option[s] transaction[s], when executed prior to [a] block transaction, [were] an appropriate hedging strategy by the block positioner.”\textsuperscript{52} Under this analysis, the premium from the options could legitimately be used to offset, in part, the drop in market value caused by the large block sale. Later, however, the American Stock Exchange revised its position and concluded that it no longer viewed such front-running as appropriate hedging.\textsuperscript{53} The SEC Options Study, however, suggested that such hedging may have a beneficial effect on the market: “Listed option trading may have reduced somewhat the amount of price movement associated with stock transactions in underlying stocks because of the ability of block positioners to reduce risk by using options, although no conclusive evidence is yet available.”\textsuperscript{54}

The uncertainty on this issue was compounded even further in 1981 when the CBOE issued a clarification of its educational circular on front-running, indicating that CBOE members “could position the option side of a customer’s block size stock/option order with knowledge that the material terms of the stock side of the transaction have been or will imminently be agreed upon. The exception would also permit the positioning of the stock side first.”\textsuperscript{55} The CBOE appeared tacitly to recognize that block traders did use the options market to hedge their trades and that such self-front-running was permissible.

Following the SEC Options Study, other stock markets, including the New York Stock Exchange (NYSE) and the National Association of Securi-
ties Dealers (NASD), began trading options. They too adopted front-running prohibitions through the publication of circulars such as that used by the CBOE. But options trading on the NYSE and the NASD raised particular front-running concerns on the part of the SEC because traders on those markets sought to engage in so-called "dual" or "side-by-side" trading, defined as trading both the options and underlying stock on the same market. This gave rise to greater front-running opportunities due to the increased accessibility to block transaction information. To prevent such misconduct, certain exchanges and the SEC announced prohibitions that proscribed trading by a member with knowledge of a block trade in the option or the security, and condemned "tippee" front-running.

In 1982, the Philadelphia Stock Exchange adopted intermarket surveillance efforts to detect front-running between currency options traded on the exchange and cash currency in the related underlying market. In 1984, concern also arose for the first time about possible front-running of options on stock indexes, a then relatively new and controversial product. This

56. See, e.g., supra note 40. See generally Seligman, supra note 5 (provides an overview of industry-wide practices).

57. Concerns arose that trading of options and the underlying security on the same exchanges could present a danger of misuse of "market information" concerning trading in the stock and options. Such concerns delayed options trading on the NYSE and the NASD market system for several years. See Securities Exchange Act Release, No. 16,701, 1979-1980 Fed. Sec. L. Rep. (CCH) ¶ 82,483 (Mar. 26, 1980); SEC Lobbied By NASD, NYSE for Options Approval, Sec. Week, Aug. 27, 1984, at 5. These concerns were later resolved, however, and both the NASD and the NYSE now trade options. See generally Seligman, supra note 5 (description of structure of options trading market).


60. A stock index options or futures contract represents an underlying portfolio of common stocks, i.e., the Standard & Poor's 500. The contract's value fluctuates as the value of the underlying portfolio changes. With the S & P 500, these changes are reflected in changes in the S & P 500 Stock Price Index. A seller of the contract will deliver, and a buyer will accept delivery, of the value of the stock portfolio at a certain date for a specific price. Unlike commodity futures and options, stock index options and futures always settle in cash. The actual underlying stocks are not delivered. However, similar to commodities options and futures, the parties may offset their contracts prior to the delivery date. See Katara v. D.E. Jones Commodities, Inc., 835 F.2d 966, 967 (2d Cir. 1987); Markham & Gilberg, Washington Wash: Stock Index Futures, 6 CORP. L. REV. 59 (1983). In 1982, Congress determined that the CFTC, which otherwise has exclusive jurisdiction over the regulation of commodity futures contracts, see 7 U.S.C. § 2 (1982), would be required to share jurisdiction with the SEC in stock index contracts. The SEC was given authority over options on such indexes, and, in
concern was engendered by unusual trading activities on the CBOE on April 19, 1984. Preliminary indications suggested that the unconventional trading involved front-running. The CBOE conducted an investigation of this activity and Congress also expressed its concern. Although apparently no charges were ever brought, this activity heightened the awareness that front-running could pose a threat to market integrity. Thereafter, the NASD announced the creation of a surveillance system designed to detect front-running in its stock index contracts. In addition, the SEC created an Intermarket Surveillance Group composed of the NASD and the securities exchanges. It acted to tighten front-running prohibitions and improve detection methods. A committee of the Securities Industry Association, how-


61. Bonner, Options Inquiry Continues, N.Y. Times, May 4, 1984, at D14, col. 1; Bonner, Arbitrage Trading Examined, N.Y. Times, May 3, 1984, at D20, col. 1; Williams, S.E.C. Studying Trades on the S. & P. 100 Index, N.Y. Times, Apr. 26, 1984, at D1, col. 1. One author has stated with respect to this trading activity that:

[T]he only demonstrated example of deliberate abuse in the relations between the options market and the underlying stocks was an oddity on April 19, 1984, when the small New York house of Miller Tabak Hirsch bought $100 million worth of stock on the NYSE to push into the money a bunch of previously worthless (and thus virtually free) call options on the S & P 100 at the Chicago Board Options Exchange, the lack of hard evidence of manipulation between markets may well mean only that the SEC put little effort into looking at possible excesses by the big brokerage houses after 1981, when John Shad of E.F. Hutton became chairman. The failure of the SEC to move against Miller Tabak Hirsch conveyed the message that fair would be foul and foul would be fair: A little manipulation was okay.

M. Mayer, supra note 4, at 130.


65. Id.; Release No. 24,622, supra note 58. The NYSE also issued a memorandum to its members on November 6, 1985, which stated:

The exchange wishes to emphasize to all members and member organizations the applicability of the front-running prohibition to both over-the-counter options and index options. With respect to index options, when a member or person associated with a member or member organization is in possession of material non-public market information concerning a block-size transaction in the component stock of an index, the execution of which affects the value of the index, trading in options on that index before information concerning the block transaction has been made publicly available, to take advantage of the non-public information, may violate just and equitable principles of trade, Exchange Rule 476.

New York Stock Exchange Information Memo No. 85-36 (Nov. 6, 1985) (Prohibition Against
ever, criticized some of the efforts of this group as constituting improper rulemaking. 66

These self-regulatory efforts did not result in a great number of disciplinary proceedings. Apparently, only three such cases have been brought by the CBOE. All were settled by consent. In the first of these, In re Gruntal & Co., 67 the CBOE Business Conduct Committee charged that an agent of Gruntal & Co. entered an order to sell 100 American Telephone & Telegraph Co. (AT & T) call option contracts while in possession of material nonpublic information concerning a block transaction in AT & T common stock. 68 It is unclear from the decision whether the conduct at issue involved trading ahead of a customer’s order, “tippee” information, or self-front-running.

In a second case, In re Prudential-Bache Securities, Inc., 69 the Business Conduct Committee charged that an employee of Prudential-Bache, entered and executed two orders to sell Federal Express (FDX) calls while aware of the material terms of an impending block transaction involving 93,000 shares of FDX common stock, prior to the public dissemination of information concerning the block transaction in the underlying security. 70 Prudential-Bache responded that it entered the option transactions to partially hedge a previously established “long” position in FDX shares arising from an earlier purchase of a large block of FDX common stock. 71 The scope of this decision is also unclear. The Business Conduct Committee rejected the assertion that the options trades were a legitimate device to hedge a previously existing position. 72 The Committee did not specify whether the “impending” 93,000 share block transaction was for the respondent’s own account or otherwise. This uncertainty is compounded by the fact that the employee of the brokerage firm was also charged with the same violation for executing the orders at issue, suggesting that more than self-front-running was involved. 73

Front-Running of Blocks). At about the same time, the Philadelphia Stock Exchange issued a similar warning to its members. Philadelphia Stock Exchange, Circular 85-82 (Dec. 3, 1985).
68. Id.
70. Id. at 2.
71. Id.
72. Id.
The third case, *In re K & M Investments Co.*, also raises questions as to whether hedging activities constitute improper self-front-running. On February 19, 1986, at approximately 2:08 p.m. Chicago time, a broker for K & M Investments Co. entered and executed an order to sell 100 AT & T call option contracts. About three minutes later, the NYSE reported a 352,700 share block transaction involving AT & T common stock, in which K & M Investments Co., through the same broker who entered the call option order, purchased 45,000 shares of AT & T stock. Based on these circumstances, the Business Conduct Committee charged that the broker entered and executed the option order while in possession of material nonpublic information concerning the 352,700 share block transaction.

This decision is also confusing in that it appears that the block trader is the respondent and that it sold the options while in the process of purchasing the block. This would seem to be some form of hedging transaction, unless the trader intended that the options sale have a depressing effect on the market. In any event, the sanctions in these cases were not particularly large. Fines ranged from $5,000 to $15,000. For example, in the Prudential-Bache transaction, the employee was fined $5,000 while the brokerage house was fined $15,000. The paucity of cases also suggests that either these practices were not widespread or that they were not being detected. With regard to detection, in early 1987 the CBOE adopted tougher investigatory procedures in order to detect front-running more readily, and proposed a change in its front-running circular specifically targeting self-front-running.

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75. *Id.* at 2.
76. *Id.*
77. *Id.*
Regarding self-front-running, if a firm's options trading prior to effecting proprietary block transactions was found to have been calculated to take advantage of options participants who were unaware of the market impact of the impending proprietary transaction, the Exchange may find that this constituted front-running. Similarly, options trading designed to take advantage of the options market prior to proprietary index-related programs—for example, trading options prior to unwinding proprietary arbitrage programs that "move the market" at expiration, could be interpreted as front-running. Such findings, would depend on all of the facts of the specific case and would of course, be decided on a case by case basis.
Regulatory Division, CBOE, Education Circular No. 23 (revised): Front Running Blocks 5,6 (July 22, 1987).
CBOE's concern with respect to self-front-running seems to have been engendered by an increase in large block trading activity that involves option strategies.

A. Front-Running as Insider Trading, Fraud or Manipulation Under the Securities Exchange Act

As discussed above, the SEC has for the most part deferred to the exchanges in seeking to restrict front-running activities in markets under its jurisdiction. As will be shown by the following analysis, this position may be due to uncertainty as to whether the federal securities laws are broad enough to apply to front-running activities.

I. Insider Trading

The SEC Options Study premised its criticism of front-running on the ground that the practice was based on "non-public market information." The SEC had long sought to prohibit the use of "inside" information by traders, charging that such conduct violated, among other things, rule 10b-5, promulgated under section 10(b) of the Securities Exchange Act of 1934. The SEC's initial effort in this area came in In re Cady Roberts & Co., where the SEC held that corporate insiders were obligated either to disclose material nonpublic information before trading or to abstain from trading altogether. The SEC, however, required the existence of a relationship between the insider and the corporation affording access to inside information intended to be available only for a corporate purpose. It premised its decision on the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure to the investor.

Subsequently, in SEC v. Texas Gulf Sulphur Co., the United States Court of Appeals for the Second Circuit adopted the Cady Roberts prohibition, stating that "anyone" in possession of material inside information:

81. SEC OPTIONS STUDY, supra note 11, at 183.
83. 15 U.S.C. § 78(b) (1982). Section 10(b) and rule 10b-5 thereunder are the most widely litigated provisions of the federal securities laws. See generally 5, 5A-5D, A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5 (1986) (treatise volumes on 10b-5 pleading and practice). The courts have also upheld private rights of action under rule 10b-5. Ernst & Ernst v. Hochfelder, 425 U.S. 185, reh'g denied, 425 U.S. 986 (1976); 5 A. JACOBS, supra §§ 8.01-8.04.
85. Id. at 912.
“must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.”

In Texas Gulf Sulphur, officials of the company purchased stock with inside information about the company’s oil discovery activities. The court held that this violated rule 10b-5 and section 10(b) because the officials traded before the news could reasonably have been expected to appear over the “media of widest circulation.” The Texas Gulf Sulphur decision placed no limits on the reach of its insider trading prohibition. The court referred to “anyone” in possession of material inside information. Specifically, it did not exclude persons who were not insiders but had obtained inside information through their own resources.

The SEC thereafter sought to apply this insider trading concept to non-public market information, i.e., material information not held by a corporate insider but obtained by someone outside the corporation. The United States Supreme Court, however, did not adopt the SEC’s market information theory. In Chiarella v. United States, the Supreme Court held that “[a] duty to disclose under section 10(b) does not arise from the mere possession of nonpublic market information.” Rather, such a duty arises from the existence of a fiduciary relationship between the trader and the source of the information. Consequently, an investor having no fiduciary relationship need not disclose nonpublic market information and may trade upon it, even

88. Id. at 848.
89. Id. at 854.
90. Id. at 848.
91. In SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963), the United States Supreme Court found that the defendant violated an antifraud provision under the Investment Advisors Act of 1940, 15 U.S.C. § 80b-6 (1982). There, the defendant was “scalping” by purchasing shares of a security before recommending it to its customers. The firm would then sell the shares after the customer’s purchases caused the price of the shares to increase. The Supreme Court’s decision was not premised on “inside” information. That is, the investment adviser did not have nonpublic information concerning the activities of a particular issuer. Rather, the advisor’s own trading position was the significant market information. The failure to disclose this material information constituted fraud in that case. Capital Gains Research Bureau, 375 U.S. at 181.

93. Id. at 235.
94. Id. at 230.
if the information is obtained surreptitiously. In *Chiarella*, the trader was a printer who obtained nonpublic information from confidential financial reports being printed at the company where he worked.

Later, in *Dirks v. SEC*, the Supreme Court again rejected the SEC's attempts to regulate use of nonpublic information by persons who are not corporate insiders. In *Dirks*, the Court held that an investment advisor who obtained nonpublic information about a particular corporation had no duty to disclose that information before trading or tipping others.

Bloodied but unbowed, the SEC then sought to create a misappropriation theory under which inside traders could be prosecuted for "misappropriating" information from an employer. The most famous of these efforts was *Carpenter v. United States*, in which a financial columnist and a stockbroker used nonpublic market information that was to appear in a column in the *Wall Street Journal* and which almost inevitably would affect security prices. The reporter and the stockbroker used such information to trade their own accounts. The Supreme Court, by an equally divided vote, affirmed the conviction of the financial writer and the broker under section 10(b) for misappropriating the property of the newspaper publication, as opposed to that of the issuer. In addition, the Court unanimously upheld the convictions for this same conduct under the mail and wire fraud statutes as constituting a fraud upon the *Wall Street Journal*. The Court held that the *Wall Street Journal* had been deprived of its property right of making

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95. Id. at 235.
96. Id. at 224. In *Zweig v. Hearst Corp.*, 594 F.2d 1261 (9th Cir. 1979), it was charged that a financial columnist had violated § 10(b) of the Securities Exchange Act of 1934 by purchasing stock in a company at a discount, publishing a favorable column about the company, waiting for a resulting rise in the market, and then selling the stock at a profit. The United States Court of Appeals for the Ninth Circuit held that there was a triable issue: Whether the columnist, by trading in securities of a company on which he reported and then failing to disclose that fact in his column, intended to manipulate the market for his own personal gain by falsely creating an aura of unbiased advice. The court held this to be a conflict of interest that must be disclosed if it was not apparent to other investors. This decision, however, was subsequently questioned by the Ninth Circuit because of the Supreme Court's intervening decision in *Chiarella*. See Feldman v. Simkins Indus., 679 F.2d 1299, 1304 (9th Cir. 1982).

98. Id. at 656-57 n. 15, 667.
99. This "misappropriation" theory was based on language in *Dirks* where the Supreme Court noted that Dirks had not misappropriated or illegally obtained the information at issue. See *id.* at 665.
102. Id. at 320.
exclusive use of the confidential business information in its columns before publication.\textsuperscript{103}

It is difficult to tell how front-running would fall within this now convoluted law of insider trading and misappropriation.\textsuperscript{104} The answer largely depends on the station the front-running trader occupies, and the trader's source of the information. To illustrate, it could be charged that a handling broker positioning a block for a large trader misappropriates information that belongs to that trader where the broker trades for his own account. On the one hand, it is difficult to see how this theory would apply to the block trader itself\textsuperscript{105} or to someone who learns of the information but has no fiduciary or comparable relationship with the block trader. Moreover, if the block trader does not wish to pursue a claim against the broker, as where the block trader itself provided a tip, the absence of a victim would render it difficult to establish fraud. On the other hand, an employee of the block trader may be in a position similar to the \textit{Wall Street Journal} reporter in the \textit{Carpenter} case. That is, he has misappropriated confidential business information of his employer, assuming of course that the block trader is willing to so charge.\textsuperscript{106}

To the extent that a broker-dealer is front-running by trading ahead of a customer, either on the basis of inside information as to the customer's trading or otherwise, a recent SEC case is of interest. In \textit{In re Application of E.F. Hutton & Co.},\textsuperscript{107} the SEC, in a three to two decision, held that an exchange had properly disciplined a brokerage firm when the firm sold stock for its own account at a price better than a limit order the broker held for one of its customers.\textsuperscript{108} The SEC found that this violated the broker's fiduciary duty

\textsuperscript{103} \textit{Id.} at 320-22. \\
\textsuperscript{104} It should be noted that there are specific SEC provisions directed to particular forms of insider trading. For example, corporate insiders are prohibited from receiving short term profits from securities transactions where they have held a security for less than six months. \textit{See} Securities Exchange Act § 16(b), 15 U.S.C. § 78p(b) (1982). In addition, SEC Rule 14e-3 prohibits persons with material nonpublic information concerning a tender offer from trading unless they disclose the information. 17 C.F.R. § 240.14e-3 (1988). \\
\textsuperscript{105} \textit{See generally} Cohen, \textit{Business Week Case Liability to Come Down to Acts of Individuals, Not Companies}, Wall St. J., July 29, 1988, at 19, col. 3. \\
\textsuperscript{106} Also of consideration are state law doctrines that assert that corporate officers and directors are trustees of their company and stand in a fiduciary relationship to the company, which precludes them from profiting at the expense of the company and from diverting personal gain from the opportunities that belong to the company. \textit{See, e.g.}, Farber v. Servan Land Co., 662 F.2d 371 (5th Cir. 1981); Kidwell v. Meilke, 597 F.2d 1273 (9th Cir. 1979); City of Miami Beach v. Smith, 551 F.2d 1370 (5th Cir. 1977); Litwin v. Allen, 25 N.Y.S.2d 667 (N.Y. App. Div. 1940). \\
\textsuperscript{108} \textit{Id.} at 89,327.
to the customer because the broker was competing with the customer. The SEC noted that, in an analogous situation involving the trading of silver futures on the Chicago Board of Trade, the United States Court of Appeals for the Seventh Circuit had held, in *United States v. Dial*,110 that trading ahead of a customer, when done without disclosure to the customer, was contrary to a broker's fiduciary obligations and harmful to commodity futures trading because it meant that there was a conflict of interest between the broker and the customer.111

More difficult questions would be raised where the front-running stockholders of the block trader engage in front-running. Such traders are not corporate insiders in any traditional sense, unless the amount of stock they own makes them such. Under generally accepted accounting principles, however, certain transactions between a principal stockholder of a corporation and the corporation are presumed to be for the benefit of the corporation and, therefore, accounted for as capital transactions.112 Under this interpretation, it could be claimed that the principal's transactions should be for the benefit of the corporation and that the trading should, therefore, be done for the principal's benefit and not the stockholder's. In that regard, SEC rule 1-02(q) of Regulation S-X113 defines a principal owner of equity securities as a holder of record of more than ten percent of any class of equity securities. Generally accepted accounting principles use the same amount.114 Consequently, if the front-running trader owns more than ten percent of the stock, the company engaging in a block trade could assert a claim for misappropriation of proprietary information. In such a case, the front-running shareholder could be subject to criminal and civil sanctions by the government and a private suit by the company involved.

2. Fraud on the Market

Another possible theory of liability for front-running may be the so-called "fraud on the market theory" upheld in *Basic Inc. v. Levinson*,115 by four

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109. *Id.* at 89,239.
110. 757 F.2d 163 (7th Cir.), cert. denied, 474 U.S. 838 (1985); see also infra notes 173-79 and accompanying text (discussing *Dial*).
112. See *FIN. ACCT. STANDARDS BD., ACCOUNTING STANDARDS, ORIGINAL PRONOUNCEMENTS, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES: ACCOUNTING INTERPRETATIONS OF APB OPINION NO. 25,658* (1985).
114. *FIN. ACCT. STANDARDS BD., supra* note 112.
members of the Supreme Court. This fraud theory is based on the hypothe-
sis that, in an open and developed securities market, the price of a com-
pany’s stock is determined by the available material information regarding
the company and its business.\textsuperscript{116} Consequently, misleading statements will,
if publicly disseminated, affect all market prices and will defraud purchasers
of stock, even if they do not directly rely on the misstatements. The required
causal connection between damage and injury is established by the fact that
the affected investors were trading on an organized exchange that would
have reflected a true value if the misleading nature of the information was
known. The Court in \textit{Basic} held that there was a rebuttable presumption of
reliance where the presence of a fraud on the market is shown.\textsuperscript{117}

It could be claimed that front-running constitutes a fraud on the market
because the trader has an unfair advantage. That is, the front-running trader
has material information unknown to other purchasing and selling traders.
Consequently, the market price of the security being bought and sold does
not reflect the true value of the security. The front-running trader profits by
the discrepancy between the security’s true value and its market value. This
theory, however, makes a fundamental assumption. The assumption is that
trading merely on the basis of nonpublic market information constitutes
fraud, a perspective that appears to have been rejected in the \textit{Chiarella}
and \textit{Dirks} cases.\textsuperscript{118} The distinction between nonpublic “market” information
and so-called “inside” information is not easily drawn. Inside information
involves a trade secret or confidential information affecting the operations of
a specific company that is not publicly available to persons other than the
company’s employees or fiduciaries. Conversely, market information is in-
formation, even if known only by a few persons, obtained from publicly
available sources or even from, as in the \textit{Dirks} case, corporate insiders,\textsuperscript{119}
provided that the information is not misappropriated or otherwise illegally
obtained.

In addition, there is a question of whether at least some front-running
activities are desirable. As Congress has recognized, one of the legitimate
purposes of options trading is to provide a mechanism for the hedging of
securities positions.\textsuperscript{120} Such hedging activities could occur in a number of

\textsuperscript{116} Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986).
\textsuperscript{117} 108 S. Ct. at 991-92.
\textsuperscript{118} Dirks v. SEC, 463 U.S. 646, 654 (1983); Chiarella v. United States, 445 U.S. 222, 233
(1980).
\textsuperscript{119} 463 U.S. at 954-55.
\textsuperscript{120} In 1982, Congress adopted legislation that preempted state gambling laws to permit
stock options index transactions. Congress was concerned that such laws could be applied to
respects. For example, a trader holding a block position in a stock may write call options\(^{121}\) at a time when the trader believed that the market would be flat or would be dropping briefly, but would later recover. The trader may not wish to dispose of the stock, since he believes that it will recover its vitality later. By writing call options, the trader is avoiding the transaction costs of selling the block of stock; he is maximizing the return on this stock; and he is hedging against the possibility that the loss will not be recovered, as the loss in the value of the stock may be offset in part by the amount of the premiums received for the call option. On the other hand, if the trader is wrong, the stock will be called away and the trader will have foregone that return.\(^{122}\)

Further, block traders wishing to sell or buy stock need another form of hedging protection. A positioner, in selling a block of stock, can expect that in many instances the sale will result in depressed market prices for that stock. Conversely, a purchase of a block can itself result in increased prices. The block trader, therefore, may take a loss on the stock, if he is selling, or pay more than the market price, if he is buying, unless his block trading activity can be hedged. The selling trader may hedge against this reaction by purchasing a put option or by writing call options and using the premium received from the call option to offset, at least in part, the loss in the value of the stock. A purchasing trader, on the other hand, could purchase call options that would allow him to profit in the event of a market increase for the block purchase—profit which would offset, at least in part, the increased price paid for the block.\(^{123}\)

Speculators and other hedgers absorb market risks shifted by the block traders' hedging. Such traders, however, may contend that this activity is, if not fraudulent, unfair because they are required to pay for the effects on market prices resulting from block transactions. It has, however, traditionally been thought that an appropriate use of derivative markets, such as futures markets, is to facilitate cash market transactions by allowing the traders to hedge their large transactions so that they will not suffer a loss from the market effects of their activity.\(^{124}\) Therefore, the issue seems to be

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121. See supra note 5 (discussing call stock options).
122. See generally SEC OPTIONS STUDY, supra note 11, at 109-10.
123. Id. at 110-12.
124. See supra text accompanying notes 53-55; infra notes 147-48 and accompanying text.
more one of policy on the proper role of the markets rather than an issue of fraud.

3. Manipulation

Section 9 of the Securities Exchange Act of 1934\(^{125}\) prohibits practices that could result in a manipulation of securities prices on a national securities exchange, a concept that has been incorporated into the Securities Act of 1933 for other securities transactions.\(^{126}\) Manipulation of securities prices often occurred in connection with option transactions.\(^{127}\) A leading author has noted that stock options may serve as legitimate "hedges against market movements," but that granting of options to pools and syndicates was at the bottom of most manipulative operations that led to the creation of the SEC because they allowed the operator to engage in large-scale manipulation with a minimum of financial risk.\(^{128}\)

Congress initially would have prohibited all option trading under the Securities Exchange Act of 1934.\(^{129}\) But testimony from dealers in over-the-counter options indicated that options served useful purposes,\(^{130}\) and thus should not be banned. For example, they offered "assurance against loss" for transactions in the underlying securities, had a "stabilizing quality," and permitted an "operator of moderate means to protect a position in the market at a minimum risk,"\(^{131}\) thereby serving as "insurance" in a manner similar to "hedging" operations that guard against price changes in commodity futures trading.\(^{132}\) Consequently, Congress did not ban option trading. Instead, it allowed the SEC to regulate such transactions under section 9.\(^{133}\) This statute was designed to give the SEC broad regulatory authority over option trading on securities exchanges, as well as to prohibit specific manip-

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\(^{126}\) As the court noted in SEC v. Resch-Cassin & Co., 362 F. Supp. 964 (S.D.N.Y. 1973), "it is well settled that the manipulative activities prohibited by § 9(a)(2) of the Securities Exchange Act with respect to a listed security are violations of § 17(a) of the Securities Act and § 10(b) of the Exchange Act when the same activities are conducted with respect to an over-the-counter security." Resch-Cassin & Co., 362 F. Supp. at 975.

\(^{127}\) 3 L. Loss, SECURITIES REGULATION 1529-30 (2d ed. 1961).

\(^{128}\) Id. at 1544.


\(^{130}\) 1934 Hearings, supra note 129, at 457-64.

\(^{131}\) Id. at 457-58.

\(^{132}\) Id. at 460. In fact, during congressional hearings in 1934 it was stated that stock options had "their origin in transactions involving the merchandising of commodities, and in this respect are closely akin to the futures contract system now in vogue and such an indispensable part of the marketing of all great staple commodities." Id. at 457-58.

ulative practices such as the spreading of rumors, wash sales and matched orders that seek to create a false or misleading appearance of active trading in a security.\textsuperscript{134}

The essential purpose of section 9 "is to prevent rigging of the market and to permit operation of the natural law of supply and demand."\textsuperscript{135} It sought to prevent the creation of a price "mirage" rather than the reflection of a genuine demand.\textsuperscript{136} Accordingly, the statute provides a specific private right of action for purchasers or sellers injured by violations of its terms\textsuperscript{137} as well as criminal penalties.\textsuperscript{138} It should be noted, however, that "'manipulation' is 'virtually a term of art when used in connection with securities markets' " and refers to practices such as "wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."\textsuperscript{139} To establish manipulation there must be a manipulative intent: "So long as the investor's motive in buying or selling a security is not to create an artificial demand for, or supply of, the security, illegal market manipulation is not established."\textsuperscript{140}

In the case of front-running, it does not appear that traders engaging therein intend to create an artificial price. To the contrary, they seek the advantage of existing market prices that presumably reflect supply and demand. In other words, they seek to withhold nonpublic material information that will affect market prices. By trading before that information comes to the marketplace, they attempt to profit. This does not fit the traditional concept of manipulation or a "price mirage." Further, while "[m]anipulative schemes may not be allowed to succeed solely because they

\textsuperscript{134} See infra notes 135, 139 and accompanying text.

\textsuperscript{135} United States v. Stein, 456 F.2d 844, 850 (2d Cir. 1972), cert. denied, 408 U.S. 922 (1973).

\textsuperscript{136} S. REP. No. 1455, supra note 129, at 54; see also Thornton v. SEC, 171 F.2d 702 (2d Cir. 1948). At least one court has found the prevention of price mirages to be a goal of laws applied to commodity futures trading. See Minpeco, S.A. v. ContiCommodity Servs., Inc., 552 F. Supp. 332, 337 (S.D.N.Y. 1982). In Minpeco, the district court stated that fraud prohibitions do not impose a duty to disclose to traders on the other side of the market information a trader may have, but a duty to speak does arise where the defendants have engaged in deceit. In this case, the district court held that, when defendants allegedly created a price mirage by their actions, there was a duty for them to disclose that fact to other traders in the marketplace.


\textsuperscript{138} Id. § 78ff(a) (Supp. II 1984) (willful violations); see also United States v. Projansky, 465 F.2d 123 (2d Cir. 1972), cert. denied, 409 U.S. 1006 (1973).


are novel[,]"\textsuperscript{141} it is unclear whether the antimanipulation provisions of section 9 can be stretched to fit front-running in securities. As will be discussed below, the same problem is present with respect to commodity futures transactions.

Nevertheless, in \textit{Margaret Hall Foundation v. Atlantic Financial Management, Inc.},\textsuperscript{142} a district court upheld, against a motion to dismiss, an allegation under section 9 that a company had manipulated the price of a stock by inducing the plaintiff to buy the stock with false statements while propping up its price through purchases with other clients' funds. At the same time, the defendants were selling their own shares of the stock to take advantage of the artificially inflated price.\textsuperscript{143} It could be claimed that this practice is similar to front-running, in that the front-runner is inducing a purchase or sale at a time when it knows that the market price is not a "true" one and that it does not reflect the knowledge upon which the defendant is trading. This is, however, a substantial extension of the types of practices that were apparently intended to be included within section 9.

In summary, the law is quite unclear as to whether, and under what conditions, front-running may constitute a violation of the federal securities statutes. If the information was in some way misappropriated or taken through a breach of a fiduciary duty, then an insider trading case might be sustainable. A fraud-on-the-market theory might also be upheld under such circumstances. It is doubtful, however, whether a manipulation claim could be proved even where there was fiduciary duty or insider trading.

\section*{II. FRONT-RUNNING IN COMMODITY TRADING}

Until the stock market crash in October, front-running was a relatively unknown concept in the commodity futures industry. A review of the history and nature of futures trading and the provisions of the Commodity Exchange Act also raises complex issues in determining whether front-running may be proscribed.

\subsection*{A. Background}

Commodity futures exchanges are old institutions in the United States, founded at about the time of the Civil War.\textsuperscript{144} Initially, trading on the ex-

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\textsuperscript{141} \textit{Crane Co.}, 419 F.2d at 793.
\textsuperscript{143} \textit{Id.}
\textsuperscript{144} See \textit{S. REP. No. 1131}, 93d Cong., 2d Sess. 11-13, \textit{reprinted in} 1974 \textit{U.S. CODE CONG. \& ADMIN. NEWS} 5843, 5852-56; \textit{COMMODITY EXCHANGE ADMINISTRATION, TRADING IN COMMODITY FUTURES} 2-3 (1938); \textit{2 FEDERAL TRADE COMMISSION, REPORT ON THE GRAIN TRADE} 70 (1920); \textit{T. HIERONYMUS, ECONOMICS OF FUTURES TRADING} 72-74 (1971).
\end{flushleft}
changes was limited to agricultural commodities. Their regulation, for that reason, was centered in the Department of Agriculture and later transferred to the CFTC.\textsuperscript{145} For the same reason, at least until the 1970s, the commodity exchanges and securities exchanges were considered to be two almost completely separate universes, having different regulators and distinctive classes of traders.\textsuperscript{146}

Sophisticated financial regulatory concepts such as those developed in the securities industry have for the most part been alien to the futures industry. Traditionally, there has been no insider trading concept comparable to that employed by the SEC. This is because the hedging function of futures exchanges that allows a user or producer of a commodity to, in effect, insure against adverse changes in prices,\textsuperscript{147} has long been considered legitimate,

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  \item \textsuperscript{146} The separate nature of the securities and futures markets is amply revealed in a footnote in the treatise by Louis Loss, perhaps the leading and most inclusive commentator on regulatory developments in the securities markets. His treatise notes that: "The regulation of the commodity markets is beyond the scope of this book." 2 L. Loss, supra note 127, at 1167 n.10. In the 1970s, this separation began to narrow as commodity futures exchanges began to trade securities-related products. See Markham & Gilberg, supra note 5.
  \item \textsuperscript{147} There are essentially two types of traders in the commodity futures markets: speculators and hedgers. A speculator is a trader who is simply taking a position and seeking to profit from a gain or loss on price changes in the underlying commodity. The speculator is viewed to be "crucial" in the commodity futures industry because his trading provides liquidity to the marketplace and is used to offset the risk of hedgers. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 359 n.11, 390 (1982); United States v. Dial, 757 F.2d 163, 165 (7th Cir. 1985); Commodity Futures Trading Commission, A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material Non-Public Information 14 (Sept. 1986) [hereinafter CFTC Insider Trading Report]. A hedger is a trader seeking protection against unfavorable changes in the underlying commodity's prices. Id. For example, the manager of a portfolio stock may be anticipating a decline in the stock market that will reduce the value of the portfolio. The portfolio manager, to avoid the effects of such a decline, could enter into stock index futures contracts that, in the event of a market decline, would allow the trader to receive a profit in the stock index futures contract that offsets the decline in the value of the portfolio, assuming that its value tracks that of the stock index upon which the futures contract is traded. This also allows the portfolio manager to avoid transaction costs from selling out the portfolio, as well as the depression of prices that could be caused by selling large amounts of stock. SEC Report, supra note 3, at 1-1, 1-2. In fact, hedging strategies are often much more complex than that described above. For example, so-called "dynamic hedging" may be used to constantly adjust portfolio components as the market fluctuates. Id.; see also M. Mayer, supra note 4, at 62.

Speculators and hedgers are essential to another important function of the commodity futures markets—price discovery. They both provide a constant and actively traded market that allows commercial users of the market everywhere to determine the given price of a commodity. These prices are quoted in newspapers and other media and are relied upon by businessmen as a means of setting prices for cash transactions. For example, a farmer in Illinois may decide to raise hogs instead of cattle because prices on the CME suggest that hogs would be a
Hedgers, almost by nature, engage in a front-running operation. That is, they know that their transactions will often have a price effect. If that effect is known to the rest of the marketplace, however, they would not be able to hedge effectively. To cite an example: assume that a large grain firm is selling a large amount of grain based on current prices. The grain firm does not own the grain and must go to the cash market to purchase it. But, if word of the grain purchases in the cash market leaks out, cash prices will increase. In such an event, the grain firm could suffer a loss or, at the very least, a substantial reduction of profits on the transaction. Instead, the grain firm secretly hedges the transaction on a commodity exchange so that, when the purchase becomes known, the grain firm will be protected on the basis of current prices. Such hedging has long been considered an essential function of the futures market. It effectively allows grain firms to market large amounts of grain and other commodities without having to do so with a large price risk that would dissuade most firms from operating effectively.

B. The Regulatory Structure: Front-Running Under the Commodity Exchange Act

Analysis of the Commodity Exchange Act reveals that Congress has not enacted any express provision that precludes front-running per se. Furthermore, many of the stumbling blocks to effective SEC regulation also exist under the Commodity Exchange Act. These limitations, coupled with the apparent intent of the Commodity Exchange Act to permit hedging activities, render efforts to control front-running in commodities futures markets problematic. A notable exception, is the forbidden practice of trading ahead of customer orders by a broker.


The sections under which front-running may be attacked under the Commodity Exchange Act are limited. Section 4(b) is the principal antifraud provision in that statute. The jurisdictional language of section 4(b), how-

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148. See supra note 132 and accompanying text.
149. See generally U.S.D.A., CIRCULAR No. 151, Hedging in Grain Futures (June 1931) (discussing various kinds of grain futures hedging techniques).
150. See supra notes 81-143 and accompanying text.
151. Section 4(b) of the Commodity Exchange Act states in part:
   It shall be unlawful (1) for any member of a contract market, or for any correspond-
   ent, agent, or employee of any member, in or in connection with any order to make, or
   the making of, any contract of sale of any commodity in interstate commerce,
ever, is in some respects incomprehensible. As the United States Court of Appeals for the Second Circuit has stated, “[w]hile the intent to outlaw fraud is clear,” section 4(b)'s “syntactical mess” and its “crabbed” language make it “difficult to answer some basic questions about coverage.” The antecedent language in section 4(b) does, however, state that its terms apply to “any person,” but the courts have not always found this language to broaden other restrictive provisions of the convoluted language contained in this statute. Where the statute applies, however, criminal penalties are available.

In *Leist v. Simplot*, the Second Circuit concluded that there was no


privity requirement in section 4(b), i.e., there need not be a direct privity between the injured party and the wrongdoer. On appeal in that case, the Supreme Court also held that under section 4(b), purchasers and sellers of commodity futures contracts can make claims against persons they are not dealing with but who are allegedly manipulating the market. The Court stated that "all purchasers and sellers of futures contracts—whether they be pure speculators or hedgers—necessarily are protected by section 4(b)." Furthermore, the Court stated that "privity of dealing or even personal contact, between potential defendant[s] or plaintiff[s] is the exception and not the rule." Accordingly, it rejected any privity requirement for liability under section 4(b).

Subsequently, however, Congress amended the Commodity Exchange Act to provide for express private rights of action and added a statutory provision requiring privity. Section 22 of the Commodity Exchange Act now states that persons who may sue for damages are limited to: (1) a person who has received trading advice from an individual for a fee; (2) a trader defrauded by his own broker; or (3) a trader suing for manipulation. Therefore, a person could not sue a front-runner unless: he had received trading advice from the individual conducting the front-running; his own broker engaged in front-running; or the front-running was viewed as per se manipulation.

If these hurdles are overcome, section 4(b)(A) makes it illegal for persons trading futures contracts to "cheat" or "defraud" other persons. If it could be shown that front-running constituted a fraud or that it was designed to cheat someone else, then that proscription could apply. As will be discussed below, however, the CFTC does not appear to be of the view that trading on material nonpublic information operates to cheat or defraud anyone unless the trader is an employee of a self-regulatory organization.

Section 4o, another antifraud provision in the Commodity Exchange Act, proscribes fraudulent practices on the part of commodity trading

158. Id.
159. Id. at 390-94 (quoting Blue Chips Stamps v. Manor Drug Stores, 421 U.S. 723, 745 (1975)).
162. 7 U.S.C. § 6b(A) (1982). There are criminal penalties under the Commodity Exchange Act for violations of § 4(b) as well as for manipulation. See id. § 13 (1982 & Supp. IV 1986). As will be discussed below, mail and wire fraud prohibitions may also apply. See infra note 174.
advisors and commodity pool operators. To the extent that someone engaged in front-running falls within those defined entities, consideration may be given to whether section 40 would establish liability. Section 40 contains the same antifraud language as does section 10(b) and rule 10b-5 under the Securities Exchange Act of 1934. Therefore, the analysis applied for determining whether the front-running could be attacked under those securities laws may apply equally to section 40. The case law, however, is not sufficiently developed to determine whether this approach will prevail. In any event, the CFTC will be reluctant to follow decisions under the federal securities laws if they are interpreted to find hedging activities to be illegal front-running. As discussed below, the CFTC views hedging activities as desirable and not as improper "inside" trading.

In 1975, the CFTC proposed an antifraud rule for commodity options transactions. Initially, it modeled that antifraud rule after rule 10b-5, the popular weapon used by the SEC to combat fraud and the basis for most of that agency's insider trading cases. The CFTC, however, later determined to revise the proposed rule. Instead, it modeled the antifraud rule provision to track section 4(b) under the Commodity Exchange Act. It did so because it was concerned that, if it adopted the same rule as that used by the SEC, insider trading principles developed in the securities law area, which are inapposite to the commodities futures market, would be applied automatically to futures trading. This apparently constituted a rejection of wholesale application of that provision to the commodity futures industry. Nevertheless, the CFTC chairman did sound a cautionary note in an

164. A commodity trading adviser is simply someone who is advising more than 15 customers as to the value of commodity futures prices. Certain persons, however, are exempted from that definition, such as newspapers, lawyers, and others. See CFTC v. Savage, 611 F.2d 270 (9th Cir. 1979); 7 U.S.C. § 2 (1982 & Supp. IV 1986). A commodity pool operator is someone operating a commodity pool, which is simply the commodity futures industry's analogue to an investment company. Investors contribute their funds to the pool and those funds are commingled and traded as a unit with other investors. See Lopez v. Dean Witter Reynolds, Inc., 805 F.2d 880 (9th Cir. 1986); 7 U.S.C. § 2 (1982 & Supp. IV 1986).


167. See supra notes 81-143 and accompanying text.

168. Cases that have considered § 4o, codified at 7 U.S.C. § 6o (1982), have analogized it to the federal securities laws. See, e.g., Messer v. E.F. Hutton & Co., 847 F.2d 673 (11th Cir. 1988); CFTC v. Savage, 611 F.2d 270 (9th Cir. 1979).


171. Specifically, the CFTC stated that it was "particularly concerned with the possibility that determinations reached on commodity cases might misapply non-disclosure-of-information standards taken from securities laws decisions, although it fully appreciates that a failure
address to the National Press Club:

Now, I recognize the vast difference between the securities market and the futures market in an approach to the "insider," but I'll bet you that the general public and the consumer want us to ask questions about the possibility of large cash traders and of employees and associates of large traders in the cash markets using their knowledge to play the futures market with perhaps an inordinate effect thereupon.  

There are other fraud theories upon which front-running liability could more certainly be imposed against persons other than someone who is hedging; for example, where a broker is front-running on the basis of information obtained from customers, i.e., "trading ahead." In that connection, in *United States v. Dial*, the United States Court of Appeals for the Seventh Circuit considered a criminal charge that a broker defrauded customers by soliciting them to participate in a block trade and then traded ahead of the orders, thereby allowing him to profit at the customer's expense. The court held this to be mail and wire fraud and sustained the criminal conviction. The court indicated that this type of trading was tantamount to insider trading. It may, however, be difficult to apply this theory under the Commodity Exchange Act. In fact, the court in *Dial* noted that there was no statute, regulation or exchange rule that specifically forbade inside trading, block trading, or trading ahead of customers in the commodity futures business, other than by floor brokers. The court held, however, that this was a scheme to defraud in a "classic" sense because the broker was representing to customers that he would obtain the best possible price for them but did not do so. By trading ahead of customers, the broker was misleading them for his own profit, and breaching his fiduciary duty. Later, an Administrative Law Judge at the CFTC concluded that the broker's conduct constituted a violation of the antifraud provisions of section 4(b) because it was a breach of fiduciary duty to his customers.

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176. *Id.* at 168.
177. *Id.* at 168.
178. *Id.*
179. *In re Dial*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,772 (CFTC Aug. 19, 1987). It should also be noted that the conduct in *Dial* seems to be comparable to...
Similarly, in *United States v. Sleight*, the United States Court of Appeals for the Third Circuit upheld a restitution order based on a criminal conviction for mail fraud. The defendant, an employee of a cocoa trading firm, received kickbacks under a scheme that allowed him to purchase cocoa at a price lower than the market price and then resell it to his employer at the market price. The court held that the employee's firm was entitled to the lower price. Although this case did not involve the Commodity Exchange Act, it would appear that an employee profiting from inside information concerning the trading activities of his employer could be subject to an antifraud standard. As noted by the court in *Dial*, CFTC regulation requires exchanges to adopt rules that prohibit floor brokers from purchasing futures contracts for their own accounts where they are holding customer orders for the purchase of futures contracts, or options subject to CFTC regulation. This rule is not, however, broad enough to apply to front-running where such a broker has information concerning a securities trade on a securities exchange. It applies only to trading ahead of futures

"scalping" found by the Supreme Court to be fraudulent in SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963); see also supra note 91. One author recently charged that such trading ahead activity is "fairly common" on the floors of commodity exchanges. M. Mayer, *supra* note 4, at 130.

180. 808 F.2d 1012 (3d Cir. 1987).
181. The employee was able to purchase the cocoa at a price lower than the market price because the cocoa he acquired was in a form that was valued at a price less than cocoa ordinarily sold on the market. *Id.*
182. *Id.* at 1022.
185. This regulation was passed as a part of the CFTC's efforts to deal with so-called "dual trading", where a broker is trading for his own account as well as the accounts of others. When the CFTC was created in 1974, Congress directed it to consider whether and under what conditions the Commission should permit dual trading. See 7 U.S.C. § 6j (1982). The CFTC determined not to ban this practice. Instead, it established regulations such as 17 C.F.R. § 155.2 (1988), designed to assure elimination of abuses. This included the prohibition against brokers trading for their own accounts ahead of customers. See generally *Adoption of Dual Trading Regulations*, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,242 (Dec. 23, 1976) (trading standards for floor brokers and futures commission merchants). In addition, the CFTC sought to enhance its audit trail so that it could detect such abuses. It principally focused upon requiring that execution times orders be timestamped in a more timely fashion. Initially, this involved a "bracketing" system whereby color-coded order tickets were used to allow a determination of execution time within a half hour. Later, as discussed below, the CFTC required up-to-the-minute timestamping. See generally J. Markham, *The History of Commodity Futures Trading and Its Regulation 90-92* (1987) (discussing evolution of current timestamping rule). The continuation of dual trading in parts of the stock index futures pit at the CME has been asserted to be the "single most indefensible practice in today's markets in the United States" because it allows these brokers to trade ahead of customer orders the brokers observe being transmitted to the pit. M. Mayer, *supra* note 4, at 258.
transactions. Similarly, regulation 155.3\textsuperscript{186}
 imposes requirements upon futures commission merchants who have information concerning customer orders. It too, however, is limited to activities in the futures markets. As such, neither rule addresses intermarket front-running, a practice causing increasing concern.\textsuperscript{187}

2. Manipulation

Still another provision of the Commodity Exchange Act prohibits manipulation,\textsuperscript{188} and would support an action against a front-runner if such activity was found to constitute manipulation. Manipulation, however, is not defined in the Commodity Exchange Act, and this has caused vexing problems for the CFTC, its predecessors and the courts.\textsuperscript{189} The result has been chaos and often conflicting decisions.\textsuperscript{190} Further, most manipulation cases have resulted in years of investigation and litigation, often without ultimate success. This effectively has nullified the reach of the antimanipulation provision.\textsuperscript{191}

Traditionally, manipulation cases arising under the Commodity Exchange Act involved the spreading of rumors\textsuperscript{192} or the use of a particular trader’s market power to artificially affect prices during delivery periods. When a trader holds a substantial portion or all of the deliverable supplies of the

\begin{itemize}
  \item \textsuperscript{186} 17 C.F.R. § 155.3 (1988).
  \item \textsuperscript{187} See infra note 275 and accompanying text.
  \item \textsuperscript{188} See 7 U.S.C. § 9 (1982).
  \item \textsuperscript{190} Compare Volkart Bros. v. Freeman, 311 F.2d 52 (5th Cir. 1962) (evidence insufficient to support charge of manipulation where corporation controlled “long” position on cotton exchanges) and In re Indiana Farm Bureau Coop. Ass’n, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,796 (CFTC Dec. 17, 1982) (price manipulation finding by lower official overruled due to presence of crop shortages) with Cargill, Inc. v. Hardin, 452 F.2d 1154 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972) (demand of artificially high wheat prices deemed manipulation where defendant controlled 62% of wheat futures) and In re David G. Henner, 30 Agric. Dec. 1151 (1971) (inflation of previous day’s futures settlement price deemed manipulation).
  \item \textsuperscript{191} See J. MARKHAM, supra note 185, at 161-64.
\end{itemize}
commodity subject to delivery under the commodity futures contract, he can "squeeze" or "corner" supplies, thus restricting the ability of traders to exit the marketplace without paying the price he demands. For example, in In re Cox, a case that took some sixteen years to conclude, CFTC enforcement authorities claimed that two traders manipulated the May 1971 wheat futures market on the Chicago Board of Trade by acquiring and holding substantially all of the available, deliverable supply of wheat, while simultaneously controlling a dominant long position in wheat futures. The enforcement division charged that the traders were able to demand an artificially high price for the liquidation of the futures contracts. The CFTC, however, reversing one of its administrative law judges, held that the presence of the essential elements of manipulation was unproven and it dismissed the case. In so doing, the CFTC defined manipulation to include the following elements: "(1) There must be an artificial price; (2) The actor must have had the wherewithal to have caused the artificial price; (3) The actor must have caused the artificial price; (4) The actor must have intended to cause the artificial price." Ascertaining each of these elements is particularly difficult. For example, determining whether an artificial price existed often results in a battle of the experts as to whether the price was, indeed, artificial. It is equally difficult, if not more so, to establish an intent to cause artificiality and, with actively traded "world" commodities, it is often claimed that the acting party did not have the wherewithal to effectuate an artificial price.

Assuming that all of these elements can be established, front-running still may not fall comfortably within the parameters of a manipulation charge.


195. Id. at 34,059.

196. Id. at 34,064.

197. Id. at 34,068.

198. Id. at 34,061.
As noted in connection with the above discussion in securities manipulation claims, the front-running party does not create an artificial price by engaging in a futures transaction. If anything, he takes advantage of an artificial price—a price which is artificial because the market is yet unaware of the fact that a large trade that will depress overall prices is coming.

Although it has been stated that the "methods and techniques of manipulation are limited only by the ingenuity of man" and that tests for identifying manipulation must be practical ones, labeling front-running as manipulation turns the CFTC's manipulation elements on their head. It would, therefore, be quite difficult to proceed under antimanipulation provisions of the Commodity Exchange Act.

3. Legislative Reform Efforts

The lack of specific prohibitions against front-running in the Commodity Exchange Act, or other concepts of insider trading, is not accidental. In fact, several legislative efforts to impose prohibitions have been attempted in this area. For example, in 1973, the House Committee on Agriculture solicited comments on whether Congress should add a provision to the Commodity Exchange Act providing a private remedy, including treble damages, in cases where a trader obtained and profited from insider information concerning proposed government action. This provoked numerous negative responses, with several commentators questioning what was meant by the term "insider information," and the provision was not adopted. Instead, Congress adopted a provision proscribing most futures trading by CFTC personnel.

Thereafter, in connection with the Futures Trading Act of 1978, Representative Neal Smith proposed an amendment to include a forty-eight hour export reporting requirement in the Commodity Exchange Act. This provision would have required firms engaging in large sales for exports of grain or other commodities to report that information to the CFTC within forty-eight hours of the sale. With this amendment, Representative Smith sought to stop international traders from avoiding speculative limits and

199. See supra notes 125-143 and accompanying text.
202. Review of the Commodity Exchange Act and Discussion of Possible Changes: Hearings
manipulating the market to their advantage. He gave the example of a large grain company taking futures positions with the nonpublic knowledge that it had agreed to make a major grain sale to the Soviet Union.\textsuperscript{206} Utilizing such information, the grain firm could “hedge” the sale and thereby shift the costs of the price increase caused by the large sale back to the United States markets. Consequently, when grain prices did rise as a result of the Soviet purchase, it would be American traders and the American public who would absorb those price increases. Another Congressman, Edward R. Madigan, suggested that this type of trading in the futures market might have a deleterious effect on small farmers selling their crops.\textsuperscript{207} This, however, is a classic example of hedging on the futures market. As the President of the Chicago Board of Trade Clearing Corporation also noted in the 1978 hearings, one of the “fundamental” differences between the securities and futures markets is that futures trading is not subject to insider trading restrictions.\textsuperscript{208} Although the House of Representatives adopted the Smith amendment,\textsuperscript{209} a House-Senate conference committee rejected it because the Department of Agriculture already had in place an agricultural commodity export sales reporting program.\textsuperscript{210}

In 1982, Congress again began pressing the CFTC to consider the application of insider trading concepts to commodity futures trading. Of particular concern to Congress were claims that conflicts of interest may have arisen on the boards of directors of various exchanges during the so-called “silver crisis” of 1979-1980, a period of volatile prices in the silver markets. This gave rise to the possibility that board members were trading on the basis of inside information gleaned from the members’ positions on the board.\textsuperscript{211} Repre-

\textsuperscript{206} Congressman Smith stated that if a large grain company has:

[S]ome secret information that only they and the state trading company in Russia or somewhere else has, they have information that others do not have indicating a change in the market. In that way, if they are getting a 2-or 3-week period to cover the sale, they can “hedge” and transfer back onto the American market, at enormous cost, the results from selling grain for less than it was really worth, due to the fact that only they and the state trading company in the country knew the real demand and the real value of the grain at that time.

\textit{Id.}

\textsuperscript{207} \textit{Id.} at 22,872.


\textsuperscript{209} 124 CONG. REC. 22,873 (1978).

\textsuperscript{210} \textit{Id.} at 33,886 (statement of Rep. Smith).

\textsuperscript{211} After an extensive investigation, the CFTC found no wrongdoing on the part of the exchanges. \textit{See Investigative Report of the CFTC Division of Trading and Markets, CFTC, The Silver Market of 1979/1980: Actions of the Chicago Board of Trade and the Commodity Exchange, Inc.} (undated); CFTC INSIDER TRADING REPORT, supra note 147, at 37-38 & app. 1-b.
sentative John B. Dingell also noted regulatory disparities between the SEC and the CFTC. He charged that trading in futures contracts on corporate securities, as in the case of stock index futures contracts, “would present very serious new manipulative possibilities (e.g., intermarket manipulation, trading on insider information, front-running, . . . etc.), engender extremely difficult surveillance problems and expose investors to sales practice abuses.” In addition, Morris Mendelson, a professor of finance at the Wharton School, noted that futures market professionals had a time and place advantage in executing transactions over the public investor. He stated that this was analogous to insider trading problems on the securities exchanges.

During the congressional hearings in 1982, the Chairman of the CFTC, however, boldly asserted that there were no insider trader prohibitions applicable to commodity futures trading and that none were needed. Specifically, he stated that “[t]here are no insider trading rules in the commodities industry. There is almost no way to trade insider information in the commodities industry.”

Nevertheless, Representative Neal Smith, undeterred by his lack of success in 1978, sought to add an amendment to the Commodity Exchange Act that would have prohibited persons having insider information from engaging in futures trading. The amendment defined an insider as any individual who had access to information not generally available to the public regarding present or anticipated cash or futures trading to which the individual was not a party. This would effectively allow a large firm to hedge, but

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213. Id. at 569. In fact, Professor Mendelson’s concerns appeared to be the same type of concerns expressed for many years with respect to trading on the floors of securities exchanges. See SEC REPORT ON THE FEASIBILITY AND ADVISABILITY OF THE COMPLETE SEGREGATION OF THE FUNCTIONS OF DEALER AND BROKER PURSUANT TO SECTION 11(E) OF THE SECURITIES EXCHANGE ACT OF 1934 (June 20, 1936).
215. The amendment proposed by Congressman Smith would have added a new § 8(d) to the Commodity Exchange Act. It would have provided:

(d)(1) As used in this subsection “insider” means any individual who has access to information, not generally available to the public, about present or anticipated cash of futures trading or present or anticipated cash of futures positions, to which such individual is not a party, in any commodity of any other person, where such trading or positions are in amounts at or above Commission designated reporting levels as specified pursuant to § 4i of this Act.
would have precluded trading employees or other persons from learning about the activities of the cash trader that could affect market prices. Thus, the amendment recognized the necessity of preserving hedging activity. A standard of materiality was also added to this provision and it was passed by the House of Representatives. The Senate, however, determined that the CFTC should first conduct a study on the nature, extent and effects of futures trading by persons possessing material and nonpublic information about cash or futures transactions to which they were not a party. The scope of inquiry thus was limited to exclude examination of hedging and self-front-running. The conference committee rejected the Smith amendment and adopted the Senate proposal instead.

Thereafter, the CFTC conducted a study and filed a report with Congress that essentially rejected the application of insider trading concepts to futures trading, except with respect to government and self-regulating organization officials.

4. The CFTC Insider Trading Study

The CFTC's Insider Trading Report made clear that the Commission did not consider hedging activities to constitute prohibited trading. In fact,
the report stated that it did not seek to address trading by persons with
knowledge of their own positions in the cash or futures market because it
would defeat the market's basic economic function of allowing traders to
hedge the risks of their commercial enterprises.\textsuperscript{222}

The CFTC noted that a securities insider owes a fiduciary duty to the
issuer of the security and to purchasers or sellers of the security.\textsuperscript{223} It is this
duty that gives rise to an obligation to disclose material inside information or
to refrain from trading. The CFTC asserted, however, that futures transac-
tions do not create a corresponding fiduciary relationship.\textsuperscript{224} The futures
markets are derivative, risk-shifting markets and it would defeat their eco-
nomic function of hedging risks to question whether trading based on knowl-
edge of one's own position was permissible. Consequently, the CFTC
accepted what the SEC might have rejected: Hedging activities involving
front-running would not be viewed by the CFTC to be illegal or improper in
any way.

The CFTC Insider Trading Report also noted the existence of various
forms of fundamental information that could be considered materially non-
public. For example, a decision by a large cash trader to sell from inventory
could affect commodity futures prices.\textsuperscript{225} In addition, private or govern-
mental reports on existing supply or demand could constitute material non-
public information,\textsuperscript{226} as could reports of the actual price of a commodity, a
forecast of that price, and other political and economic information.\textsuperscript{227} Fur-
ther, the CFTC noted that members trading on the floor of the exchanges
had a time and place advantage which gave an "insider" aspect to informa-
tion obtained on the floor allowing members to trade before anyone else
could react to the information.\textsuperscript{228}

In its report, the CFTC examined several instances where such material
nonpublic information could have been abused. For example, it cited a 1972
sale of wheat to the Soviet Union that caused dramatic increases in the price

\begin{footnotesize}
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\item his or her proprietary information is a traditional prerogative of commercial enter-
prise. Because the futures markets are derivative, risk-shifting markets, it would de-
feat the market's basic economic function—the hedging of risk—to question whether
trading based on knowledge of one's own position were permissible. Accordingly,
consistent with the congressional mandate, trading on the basis of one's own cash or
futures markets positions is exempt from any discussion of insider trading.

\textit{Id.} at 8.
\textsuperscript{222} \textit{Id.}
\textsuperscript{223} \textit{Id.} at 7.
\textsuperscript{224} \textit{Id.}
\textsuperscript{225} \textit{Id.} at 17-18.
\textsuperscript{226} \textit{Id.} at 39.
\textsuperscript{227} \textit{Id.} at 19.
\textsuperscript{228} \textit{Id.} at 24-25.
\end{itemize}
\end{footnotesize}
of grain in the United States. It concluded, however, that no abuses associated with the transaction were ever proven, and that the phenomenon appeared to be unique.229 In addition, the CFTC examined the trading in live cattle futures contracts that had caused Representative Smith to propose the insider trader prohibition in the Commodity Exchange Act. Representative Smith stated that empirical analysis by the staff of the House Committee on Small Business had indicated the existence of a trading system guaranteed to predict certain changes in live cattle futures contracts with absolute accuracy. These conclusions, the Commission noted, were never proven.230 The study also examined other major markets phenomena, such as the events in the silver market in 1979 and 1980. Once again, it found no specific abuses of inside information.231 The CFTC did not question governmental agencies' ability to prevent leaks of material information.232 It reached similar conclusions regarding reports from private entities.233

The CFTC found that insider information could reduce but not eliminate the risks associated with futures positions because other factors affected market prices concurrently.234 The CFTC also acknowledged, but ultimately found unpersuasive, arguments suggesting that trading or insider information could improve the pricing functions of futures markets by transmitting information to the market, thereby reducing future price variances.235

The CFTC Insider Trading Report considered the effects of the dissimilarity of the regulatory schemes of the SEC and the CFTC, that is, one prohibits the use of insider information while the other does not. The study expressed doubt whether insider information relevant to securities could be used to advantage in the futures markets.236 With respect to stock indexes, the report stated that all the common markets in the securities and futures areas are highly capitalized stock indexes on which specific inside informa-

229. Id. at 32-35. This was the so-called “Great Grain Robbery” that was “one of those economic events that, like the OPEC oil embargo . . . can truly be said to have changed the world.” D. Morgan, Merchants of Grain 120-21 (1979).


231. Id. at 37-38.

232. Id. at 38-42.

233. Id. at 42-43. The CFTC noted, however, instances where a firm could have profited from the release of information contained in private reports. For example, in August 1982, Henry Kaufman, chief economist for Phibro-Salomon, Inc., publicly announced his prediction that “interest rates would fall. The market response was a rapid and strong increase in activity in interest rate futures trading on the Chicago Board of Trade and the CME. Prior to the announcement, the firm reportedly purchased several million dollars of futures contracts on financial instruments. However, no connection between those purchases and the announcement has been demonstrated.” Id. (footnote omitted).

234. Id. at 46.

235. Id. at 50.

236. Id. at 58.
tion about particular issuers comprising the index can be assumed to have little effect. The CFTC noted in this regard that the Commodity Exchange Act requires a broad-based index, reflecting the market for all securities or a substantial segment thereof, to prevent manipulation of the underlying stocks. It did not, however, consider the effects of basket trading or intermarket front-running raised by the subsequent market crash in October 1987.

The CFTC conducted an additional study to determine the types of restrictions placed by cash market firms on their employees' trading. The study noted a total absence of governmental restrictions or prohibitions on personal futures trading by those who might possess nonpublic information of their employers' cash market activities. Nevertheless, the majority (fifty-three percent) of responding cash market firms indicated that they prohibit or restrict their officers or employees from trading futures. Forty-seven percent did not do so.

With respect to abuses of fiduciary duty in obtaining inside information, the CFTC stated that a fiduciary relationship generally arises in futures trading only in brokerage transactions where an agency relationship exists. A prime illustration of insider trading in futures involving a breach of fiduciary duty would be "an agent's trading based on knowledge of the principal's transactions without the principal's permission." In this connection, the CFTC sought better recordkeeping practices for the timing of transactions by floor brokers for their own accounts while concurrently having knowledge of customer orders they are filling—so-called "dual trading." The CFTC also considered the concept of "misappropriation" of information in connection with futures trading. It concluded that the misappropriation theory raised difficult problems of enforcement. For example, it is not always clear who was injured by such trading; a party that is injured may not even trade in the futures markets because it is only its cash position that is affected indirectly. Further, claims could be made that persons transacting business with the insider were harmed because they did not have access to the nonpublic information.

237. Id. at 58-59.
238. Id. The SEC had expressed concern that corporate inside information could be used to trade futures on stock indexes. This, however, did not deter the CFTC, except to the extent that it reached an agreement with the SEC to resolve differences on sub-index futures, contracts involving more narrowly-based indexes. See Note, supra note 219, at 146 n.134.
239. CFTC INSIDER TRADING REPORT, supra note 147, at 69.
240. Id. at 56.
241. Id. at 9-10, 102-07; see also supra note 185 and accompanying text.
242. CFTC INSIDER TRADING REPORT, supra note 147, at 57; see also supra notes 104-114 and accompanying text.
The CFTC Insider Trading Report concluded that additional controls should be placed on employees of contract markets who might have nonpublic information concerning the trading activities of large traders. With respect to trading on inside information by others, in particular those associated with cash markets, the CFTC did not find sufficient evidence to warrant the development of any recommendations to Congress. It found no significant evidence of existing insider trading by employees of firms related to the cash markets, or firms issuing reports that might affect those markets, or that limited instances of the practice, to the extent they existed, had harmed the futures markets.

5. CFTC Insider Trading Regulations

Following the issuance of its insider trading report, the CFTC adopted a new regulation which required self-regulatory organizations in the futures industry to adopt rules prohibiting trading by their employees in commodity interests traded on the exchange and in commodities traded on other exchanges where the employee, by virtue of his employment, had access to material nonpublic information concerning the commodity. This represented adoption of limited prohibitions against insider trading, particularly the use of nonpublic market information by a limited class of persons—exchange officials.

In adopting its regulation, the CFTC discarded a prior proposal that would have imposed prohibitions on governing members of self-regulatory organizations who possess material nonpublic information. The formerly

243. CFTC INSIDER TRADING REPORT, supra note 147, at 94-102.
244. Id. at 107.
246. Activities of Self-Regulating Organization Employees Who Possess Material, Nonpublic Information, 50 Fed. Reg. 24,533, 24,535-38 (1985) (proposed June 11, 1985) [hereinafter Proposed Rule]. Previously, in December 1980, the CFTC proposed regulation 1.57 that would have prohibited contract markets or clearing organization officers or employees from engaging in commodity futures transactions or investment transactions in actual commodities. Trading Restrictions Applicable to Certain Contract Market and Clearing Organization Employees, 45 Fed. Reg. 84,084 (1980) (proposed Dec. 22, 1980). The CFTC later decided not to adopt that proposal. Restrictions Applicable to Certain Contract Market and Clearing Organization Employees, 47 Fed. Reg. 7300 (1982) (issued Feb. 18, 1982). Instead, it issued a staff interpretive statement on the activities of employees of the exchanges. Id. at 7302. The staff interpretation stated that exchange employees who engaged in market surveillance activities and had access to confidential information generally should be barred from all commodity transactions. Id. The self-regulatory organizations, however, took no action in response to this interpretation. Proposed Rule, supra at 24,536. The CFTC had also previously requested public comment on contract market rules and practices governing conflicts of interest of mem-
The proposed rule would have prohibited members of an exchange governing board or committee from engaging in futures trading where they had knowledge of a nonpublic final decision that would alter rules affecting trading in a futures or options contract, or a reasonable expectation that such a final decision was imminent. Governing members would also have been prohibited from disclosing information concerning an impending rule change. By this provision, the CFTC sought to prevent abuse of information concerning changes in the futures trading environment that might occur through the exercise of an exchange's emergency authority. Examples of such significant emergency actions include: revising margin levels; limiting trading to liquidation only; shortening delivery periods; or forcing liquidation of a major market participant. There was, however, considerable opposition to this proposal because it could impair the ability of knowledgeable members who were also active traders to serve on self-regulatory organizations' board of governors or principal committees. In view of this opposition, the CFTC withdrew the proposal.

Subsequently, the CFTC once again proposed regulations governing trading by members of the board of governors or principal committees of an exchange. The CFTC noted that comments on its prior proposal had generally supported the view that governing members should maintain the confidentiality of information received in the performance of their official duties. The CFTC stated that it found merit in critical comments stating that formulation of a single uniform standard prohibiting trading by governing members having knowledge of a final imminent decision of a board or committee might be impracticable and curtail or inhibit legitimate trading activities. Instead, the CFTC concluded that a prohibition against the misuse of confidential information that does not automatically require governing members to stop trading in affected contracts would be a more appropriate regulatory approach. The CFTC stated that it would allow self-regulatory organizations, subject to its oversight, to specify the content of rules proscribing misuse of material nonpublic information by governing members on a case-by-case basis.
Thereafter, the CFTC adopted the proposal. In so doing, it modified another proposal pursuant to which self-regulatory organizations would have been required to immediately publish decisions that affected particular contracts, so that leaks could not occur. The CFTC dropped this proposal, but urged self-regulatory organizations to publish as quickly as possible.\textsuperscript{253}

Regulation 1.59, as adopted by the CFTC, defined material information as:

\[\text{[I]nformation which, if such information were publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a contract market. As used in this section, "material information" includes, but is not limited to, information relating to present or anticipated cash, futures, or option positions, trading strategies, the financial condition of members of self-regulatory organizations, their customers or option customers, or the regulatory actions and proposed regulatory actions of a self-regulatory organization.}\textsuperscript{254}

The regulation defined "non-public information" as information that has not been disseminated "in a manner which makes it generally available to the trading public through recognized channels of distribution."\textsuperscript{255} The regulation also applied to "linked" and "related" commodity interests, defined to include instances where markets were linked with each other or where intermarket spread margins or other special margin arrangements between exchanges existed.\textsuperscript{256} It did not, however, appear to apply to securities exchanges, since they do not have linkages or reciprocal margin arrangements. The rule also contained exemptions allowing for trading: by an employee in pooled investment vehicles; where a self-regulatory organization determined that the trading would not be contrary to the purposes of the regulation, "the Commodity Exchange Act, the public interest or just and equitable principles of trade."\textsuperscript{257}

The essential prohibition in regulation 1.59 is:

No employee of a self-regulatory organization may disclose to any other person any material, non-public information which such employee obtains as a result of his or her employment at the self-regulatory organization where such employee has or should have a


\textsuperscript{254} 17 C.F.R. § 1.59(a)(3) (1988).

\textsuperscript{255} Id. § 1.59(a)(4).

\textsuperscript{256} Id. § 1.59(a)(5), (7). Cross-margining is also being considered for commodity futures and securities transactions. See SEC REPORT, supra note 3, at 10-57.

\textsuperscript{257} 17 C.F.R. § 1.59(b)(2)(ii) (1988).
reasonable expectation that the information disclosed may assist another person in trading any commodity interest; Provided, however, that this provision shall not prohibit disclosures made in the course of an employee's duties, or disclosures made to another self-regulatory organization, linked exchange, court of competent jurisdiction or a representative of any agency or department of the federal or state government acting in his or her official capacity.  

This regulation, although narrow in its application to employees of self-regulatory organizations, does deal with some essential issues that must be faced in crafting any effective regulation on front-running. First, it defines material information in the context of trading in commodity futures transactions. It also defines nonpublic information. In so doing, the CFTC notably adopts securities law terminology. Second, it recognizes that material nonpublic information can be used in trading in contracts in related markets, although it does not specifically extend its reach to the securities industry. Further, it recognizes that nonpublic material information may be abused, at least in some contexts. The regulation, therefore, sets the stage for regulation of other traders engaging in abusive practices.

III. INSTITUTIONAL ARBITRAGE AND INTERMARKET FRONT-RUNNING: NEW CONCERNS AFTER THE CFTC INSIDER TRADING STUDY

In the 1970s, the securities and commodity futures industries slowly began to become intertwined with each other. Development of a broad range of financial futures-type instruments began during this period. These investment vehicles included futures contracts on Government National Mortgage Association (GNMA) transactions and trading in stock index futures contracts. Index futures featured a unique distinction in relation to traditional commodities. Index contracts could be settled in cash rather than actual delivery of the underlying property.

The development of stock index futures contracts coincided with the continuing growth of institutional trading in the securities markets that had be-

258. Id. § 1.59(b)(1).
259. Proposed Rule, supra note 246 at 24,539.
261. Id. at 41-42; S. REP. No. 1131, 93d Cong., 2d Sess. 19, reprinted in 1974 U.S. CODE CONG. & ADMIN. NEWS 5843.
gun in the 1960s. Such trading culminated, by 1983, in an institutional trading volume accounting for ninety percent of all securities trans-
actions.263 Institutional traders with large portfolios were also interested in diversifying their portfolios into a broad range of debt instruments and se-
curities that would not be materially impaired if a single investment in a corpo-
ration failed.264 This diversification, however, exposed the institu-
tional trader to another risk: fluctuations in portfolio value due to funda-
mental economic changes such as interest rates, and variances in the overall value of equity securities, as represented by the Dow Jones Industrial Average or other stock indexes. The stock index futures contract and other financial futures provided a means by which institutional portfolio managers could protect themselves against these economic risks. Specifically, in a manner similar to traders in more traditional commodities and securities options discussed earlier, they could hedge their portfolios through such instruments, which they chose to do on a broad scale.265

Institutional traders also became quite sophisticated in their portfolio management, to the extent that they developed computer programs to con-
duct their futures trading. Because of the large resources at their disposal, they also engaged in so-called “market basket” trading, in which the institution would buy “baskets” of securities that were comprised of, or would react in the same manner, as the stocks underlying particular stock indexes, such as the Standard and Poor's Index or the Dow Jones Industrial Average.266 This allowed the institutions to trade their portfolios on the basis of fundamental economic factors, rather than the performance of a single issue, a somewhat new concept in securities trading. In addition, “program” trading allowed the institutions to engage in arbitrage transactions between the futures markets and the underlying securities markets.267 Intermarket arbi-

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263. GAO REPORT, supra note 2, at 24-25. Block trading by institutions has also increased dramatically. In 1970, block transactions accounted for some 15% of the total of share volume of the NYSE, while in 1986 they constituted almost 50% of volume. BRADY REPORT, supra note 1, at II-16; A. Seifert, Overview of Institutional Trading Mechanisms in the Futures and Securities Markets, (May 1988) (address before the Law & Compliance Division of the Futures Industry Association in Baltimore, Maryland on May 11-13, 1988, reprinted in Futures Indus. Assoc. Inc. conference materials); see also Seifert & Turnbull, Institutional Trading Mechanisms in Futures and Securities, F.I.A. Rev., July/Aug. 1988, at 12 (overview of institutional trading mechanisms in stock and futures markets).

264. SEC REPORT, supra note 3, at 3-6.

265. Id. at 1-2; see also supra notes 53, 120-24, 147-49, and accompanying text (discussing hedging in securities options and commodities markets).

266. SEC REPORT, supra note 3, at 3-2 to 3-3. Market basket trading now accounts for some 25% of institutional transactions. Id.

267. See generally Hazen, Volatility and Market Inefficiency: A Commentary on the Effects of Options, Futures, and Risk Arbitrage on the Stock Market, 44 WASH. & LEE L. REV. 789 (1987) (studying the effects of index-trading on the securities markets); SECURITIES AND EX-
trage trading involved sales of futures contracts by institutions when the underlying securities were priced higher than the futures contract or, vice versa, the purchase of stock when the futures contract was selling higher. This practice had the helpful effect of keeping the market prices aligned, but it also led to disruptions during the "triple-witching" hour when options and futures contracts expired at the same time. This problem, however, was resolved by the regulators through staggered expiration times.268

Prior to the October 1987 market crash, there were other warning signals. The NYSE asserted that program trading could lead to a "meltdown" of the exchange if program traders all began selling simultaneously.269 A "cascade" scenario also surfaced, which posited that index arbitrage trading could lead to successively lower levels of prices in securities until the market had completely collapsed.270 These concerns, however, did not reach prominence until the October 1987 market crash.

After the crash, a presidential task force found that the heavy volume of trading during October was fueled in large measure by institutional traders engaged in program trading.271 For example, between 11:40 a.m. and 2:00 p.m. on October 19, portfolio insurers sold approximately 10,000 contracts in the futures market, the equivalent of $1.3 billion in stocks.272 This represented forty-one percent of all futures volume. These portfolio insurers also sold stock worth $900 million on the NYSE during this period. In fact, stock and futures market portfolio insurers contributed over $3.7 billion in selling pressure by early afternoon on October 19, when the market plunged a record 500 points. Indeed, one institution sold thirteen baskets of stock on October 19 worth just under $100 million.273 It was forced to discontinue its program when the market began to collapse. But other portfolio insurers sold over 6,000 futures contracts—the equivalent of $660 million worth of stock. These portfolio insurers comprised only a small group of traders. The top four sellers accounted for $2.85 billion or fourteen percent of total


268. SEC REPORT, supra note 3, at 1-8; NYSE REPORT, supra note 2, at 212-22.

269. Mayer, Some Watchdog! How the SEC Helped Set the Stage for Black Monday, Bar-


270. GAO REPORT, supra note 2, at 31. The CFTC, however, has rejected any such cas-
cade scenario. See CFTC FINAL REPORT, supra note 3, at 22-23.

271. BRADY REPORT, supra note 1, at 34.

272. Id.

273. Id.
sales on the futures side and three portfolio insurers traded just under $2 billion worth of stock on the securities side.\textsuperscript{274}

In its report on the stock market crash of 1987, the SEC examined instances of firms trading in the futures market ahead of customer activity in the securities market. The SEC focused on firm activity at the opening on October 19 and October 20 to determine whether firms were selling futures based on knowledge of large institutional stock orders they were attempting to execute on the opening. The SEC Report found a few troubling trading activities, leading it to recommend that this type of activity, which may disadvantage customer orders, be more thoroughly reviewed.\textsuperscript{275}

The SEC also reviewed trading to determine if brokers or others were trading in the futures markets ahead of market basket transactions on the NYSE. The SEC noted in this regard that it had previously examined front-running in connection with the triple witching hour.\textsuperscript{276} At that time, it considered whether a single firm might be aware of a large number of customer arbitrage programs that needed to be closed out before the opening.\textsuperscript{277} The SEC was concerned that this situation could have occurred at the opening of the NYSE on October 19 and 20, when firms learned of massive imbalances in customer sell orders on October 19 and customer buy orders on October 20.\textsuperscript{278} The SEC surveyed the firms' proprietary activity at the opening on October 19 and 20 to determine whether firms may have sold futures on October 19 or bought futures on October 20 based on the knowledge of large institutional stock orders they were attempting to execute at the opening. It was this investigation that raised the most troubling questions for the SEC. Specifically, it found that thirteen firms included in its survey had sold 771 futures contracts between 9:30 and 10:00 o'clock on October 19, before most of the component stocks' proprietary selling activity.\textsuperscript{279} Similarly, on Octo-

\textsuperscript{274} Id. at 36.

\textsuperscript{275} SEC REPORT, supra note 3, at 3-31 to 3-32. The SEC noted that, while further inquiries appeared justified in those few troubling instances, most of the trades reported for CME member firms did not support the conclusion that portfolio insurance vendors or brokers traded ahead of customer orders. Id. at 3-31.

A principal concern arising out of the stock market crash involved so-called intermarket front-running, not just trading ahead of customer orders. As one newspaper report noted: "Intermarket front-running describes the practice of using inside information about impending market-moving stock transactions to trade ahead in stock-related futures. Some on Wall Street allege, without offering details, that knowledge of customers' big orders is sometimes used to do just that." SEC Splits in 3-2 Vote Over the Nature of a Brokerage Firm's Duties to Clients, Wall St. J., July 11, 1988, at 27, col. 4; see also CME Defines Front-Running, J. Comm., May 23, 1988, at 6A, col. 3.

\textsuperscript{276} SEC REPORT, supra note 3, at 3-31 to 3-32.

\textsuperscript{277} Id.

\textsuperscript{278} Id.

\textsuperscript{279} Id. at 3-32.
ber 20, these thirteen firms purchased 484 futures contracts between 9:30 and 10:00 o'clock, with three firms accounting for seventy-four percent of that buying activity.\textsuperscript{280}

The SEC noted that this activity was not classic front-running because there were many indicators, in addition to a firm's particular customer orders, suggesting that the market would open unusually low on October 19 or higher on October 20.\textsuperscript{281} Nevertheless, it found that these trading activities contributed to the increase in the futures discount to the stock market on October 19 and to a premium between the markets on October 20.\textsuperscript{282} It also contributed to delayed openings and customers receiving executions at lower prices on October 19 and higher prices on October 20 than might otherwise have occurred. The SEC Report concluded that proprietary trading by firms at the opening in the derivative markets could disadvantage customer orders and that this should be thoroughly reviewed.\textsuperscript{283} It also noted that "questions had been raised, which [the SEC] was continuing to review, concerning firms buying futures on October 20 in anticipation of announcements of corporate customer buy-back activity."\textsuperscript{284} Subsequently, as the result of the SEC's report, and after conducting its own review, the NYSE announced that it was considering the adoption of an interpretation "whereby trading in index futures immediately prior to and with knowledge of the execution of one or more baskets of stock that favorably impact the value of the underlying index could constitute front-running and, thus, be a violation of just and equitable principles of trade."\textsuperscript{285}

The CFTC Final Report on the stock market crash of 1987 also considered front-running.\textsuperscript{286} The CFTC stated that it was only in recent years that the concept has had any application in the futures markets. According to the CFTC, front-running historically referred to the use of information con-

\textsuperscript{280.} Id.
\textsuperscript{281.} Id.
\textsuperscript{282.} Id. During the October market crisis, futures stock index contracts often traded at a discount or a premium compared to the stocks underlying the index because execution delays and uncertainty as to whether stocks were open for trading on the NYSE precluded effective arbitrage. \textit{See CFTC Final Report}, supra note 3, at 22-23.
\textsuperscript{283.} SEC REPORT, supra note 3, at 3-32.
\textsuperscript{284.} Id. at 3-32, 3-33 & n.85. The corporate buy-back activity arose when several corporations began purchasing back their own stock to take advantage of favorable prices caused by the drastic market decline in October. It was thought that this effectively rallied the market. \textit{Id.} at 6-10.
\textsuperscript{285.} Donald J. Solodar, New York Stock Exchange Information Memo (Apr. 13, 1988) (Mr. Solodar is Senior Vice President of the NYSE). Interestingly, the CME has stated that it supports the NYSE's position that intermarket front-running from stock to futures exchanges violates its rules. \textit{CME Supports NYSE Position on Front-Running Ban}, Reuter Bus. Rep., Apr. 5, 1988.
\textsuperscript{286.} CFTC FINAL REPORT, supra note 3, at 199-200.
cerning securities or securities options on large block orders relating to trading in the options and stock markets, rather than the futures markets. The CFTC stated in its opinion that the antifraud provisions of the Securities Exchange Act of 1934 and the Commodity Exchange Act may apply to particular instances of front-running, which it did not identify, but pointed out that neither statutory scheme specifically addresses the practice.\textsuperscript{287} It noted that the rules of the securities and futures exchanges also did not specifically address intermarket front-running, although, as discussed below, the commodities exchanges have taken the position that such conduct violates their general prohibitions against conduct inconsistent with just and equitable principles of trade.\textsuperscript{288}

The CFTC Final Report stated that no allegations of front-running involving trading in stock index futures or options on futures during 1987 had been brought to the attention of its staff. Further, the report stated that what constitutes front-running under a particular set of circumstances is not always clear. It noted that the SEC had conceded that the "line which separates appropriate hedging and other legitimate activity and front-running is not always clear," and the CFTC asserted that it could find no cases brought by the SEC charging front-running under rule 10b-5.\textsuperscript{289} The CFTC Final Report also noted a paucity of disciplinary actions on the securities side involving front-running and that those few that had been brought involved front-running of customer orders in favor of proprietary accounts. The CFTC stated that it was continuing to consider the issue and that it sought to establish methods for identifying potential intermarket front-running trading patterns.\textsuperscript{290} It acknowledged the need for a mechanism for timely communication of market surveillance data revealing possible front-running among all exchanges with common self-regulatory interests. It further concluded that the Intermarket Surveillance Group was an appropriate forum for facilitating necessary communication of such market surveillance data.\textsuperscript{291} It noted that the Intermarket Surveillance Group was considering the manner in which futures exchanges could be included more formally in its deliberations. The CFTC expressed the view that formal recognition of the futures exchanges by the Group would contribute significantly to addressing common surveillance concerns. The CFTC staff is also currently considering the advisability of a "regulation establishing a minimum futures industry standard for the prohibition of front-running activity involving

\textsuperscript{287} Id. at 198.
\textsuperscript{288} Id. at 198-99.
\textsuperscript{289} Id. at 198.
\textsuperscript{290} Id. at 199-200.
\textsuperscript{291} Id. at 200; see also supra notes 64-66 and accompanying text.
transactions on futures exchanges."

Even before the market crash in October 1987, various commodity futures exchanges had responded to inquiries made by the CFTC on front-running and whether their rules would proscribe such activity. In a letter dated April 6, 1987, the Chicago Board of Trade noted that the rules of the securities and options exchanges did not specifically address front-running, and neither did its own rules. The Chicago Board of Trade stated, however, that a number of its rules could be applicable “depending upon the facts of the particular situation, in which, if circumstances warranted, the exchange would apply to member firms engaging in strategies abusive of the markets.” This included rules prohibiting conduct inconsistent with “just and equitable principles of trade,” or activities that result in the demoralization of the market or acts detrimental to the welfare of the exchange.

The New York Futures Exchange (NYFE) advised the CFTC that it was monitoring the activity of member firms to determine whether front-running had occurred. In one case, concern was apparently expressed as to intermarket front-running, and the NYFE informed the CFTC that it would investigate that particular activity to determine whether it constituted prearranged trading, manipulation, or conduct inconsistent with just and equitable principles of trade. It also noted that it was conducting its investigation jointly with the NYSE.

The Kansas City Board of Trade advised the CFTC that it had no specific prohibition against front-running but that it believed that front-running was a possible violation of the Board’s rule against detrimental acts against the exchange and a general rule against other prohibited activities and manipulation. It noted that, to conduct a successful investigation concerning front-running, it would require cooperation from the options and stock markets. Significantly, it viewed as objectionable the related transactions between the markets made for the account of a member of the exchange.

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292. Id.
293. Letter from Frederick J. Grede, Vice President, Administration and Planning, Chicago Board of Trade, to Andrea M. Corcoran, Director of CFTC, Division of Trading and Markets 1 (Apr. 6, 1987).
294. Id.
295. Id. at 1-2.
296. Letter from Jill S. Fessler, Enforcement Counsel, New York Futures Exchange, Inc., to Alan A. Seifert, Deputy Director, CFTC, Division of Trading and Markets 1 (May 1, 1987).
297. Id. at 2.
298. Letter from Michael Braude, President, Kansas City Board of Trade to Alan A. Seifert, Deputy Director, CFTC, Division of Trading and Markets (May 7, 1987).
299. Id.
member trades executed at the exchange or related trades on options and stock markets.\textsuperscript{300}

The Chicago Mercantile Exchange (CME) advised the CFTC that its surveillance staff had worked with the NYSE staff since at least December of 1986 to ascertain the identity of major stock purchasers and sellers at and just prior to the expiration of trading in December 1986 index contracts.\textsuperscript{301} The CME then conducted an investigation in connection with arbitrage activity of those traders.\textsuperscript{302} It noted that it encountered difficulty in its investigation because it had not received all the information requested of one of the traders.\textsuperscript{303} Its survey also focused on whether a particular trader had traded ahead of its customers' stock orders using the futures markets. This was discussed with the NYSE surveillance staff as a part of a joint investigation.\textsuperscript{304}

The CME noted that its rules prohibit a member from trading for its own account ahead of customer orders and ban trading of a derivative option when the member has customer orders for futures contracts and vice versa, until the customer orders are executed.\textsuperscript{305} It need not be shown that the customer was harmed in order for a violation of these rules to exist. The CME said that a member's misuse of its knowledge of a customer order for another market by trading ahead of that order at the exchange would constitute bad faith, dishonest conduct and/or conduct detrimental to the exchange in violation of exchange rules.\textsuperscript{306} The exchange stated that it would accordingly prosecute any firm engaging in this activity.\textsuperscript{307} The CME, in conjunction with the NYSE, has since adopted an interpretation prohibiting intermarket front-running, which declares that certain transactions by those trading on their own or customer accounts with material, non-public information may violate exchange rules.\textsuperscript{308} Transactions covered by the interpretation include trading in stock index futures contracts or options with knowledge of an imminent stock program transaction by another, and, conversely, stock program transactions with knowledge of the imminent execu-

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\textsuperscript{300} Id.

\textsuperscript{301} Letter from Gerald D. Beyer, Senior Vice President, Legal and Regulatory Affairs, CME, to Andrea Corcoran, CFTC, Division of Trading and Markets 1 (Apr. 15, 1987).

\textsuperscript{302} Id.

\textsuperscript{303} Id. at 2.

\textsuperscript{304} Id.

\textsuperscript{305} Id. at 3.

\textsuperscript{306} Id.

\textsuperscript{307} Id.

\textsuperscript{308} Chicago Mercantile Exchange/New York Stock Exchange Intermarket Trading Restrictions, Submission No. 88-54 (Sept. 1, 1988) [hereinafter Intermarket Trading Restrictions]; see also CME Defines Front-Running, J. Comm., May 23, 1988, at 6A, col. 3.
tion of another's orders in stock index futures or options.\(^{309}\) The policy states explicitly that it is unnecessary for the CME to demonstrate that another has been disadvantaged in order to find a violation of rules requiring just and equitable trading practices.\(^{310}\) Further, it states that front-running may violate just and equitable principles of trade regardless of whether the source of the material, non-public information gave permission for such trading.\(^{311}\) The CME, however, took pains to clarify that its new policy does not extend to legitimate hedging strategies:

\[\text{[N]othing herein shall prevent such member or person from establishing, in a futures market, a bona fide hedge of risk such member or person may have assumed or agreed to assume in facilitating the execution of any other person's stock program orders. In addition, nothing herein shall prevent a member or person associated with a member organization from implementing a proprietary market strategy involving a stock program and a related stock index futures transaction by executing the stock index futures trade(s) prior to the execution of the stock program.}\(^{312}\)

Nevertheless, the policy attempts to delineate the limits of permissible hedging, noting that "if a member or person [associated with a member] executes or causes to be executed a transaction in one market to take advantage of such member's or person's imminent transaction in a related market, that member or person may be engaging in manipulative activity."

Consequently, it now appears that the futures exchanges are taking the same view as the securities exchanges on front-running practices, other than self-front-running. Such front-running constitutes a violation of the general principles of equitable conduct governing trading on those exchanges. Members engaging in such violations may, therefore, be disciplined by the exchange. These exchange rules, however, do not provide for a private right of action for someone injured by this activity. More importantly, they do not apply to individuals who are not members of the particular exchanges where the activity occurs. Accordingly, there is a gap in the regulatory framework and federal regulation may be necessary.

\(^{309}\) Intermarket Trading Restrictions, supra note 308.
\(^{310}\) Id.
\(^{311}\) Id.
\(^{312}\) Id.
\(^{313}\) Id.
IV. CONTROLLING IMPROPER FRONT-RUNNING:
A PROPOSAL FOR REFORM

A. Clarify Authority of the CFTC to Prohibit Fraudulent and Manipulative Practices

In all likelihood, the CFTC will not retreat from its position that market users should be able to hedge their positions on the futures markets by, for example, selling futures contracts before effectuating large block transactions. This is a fundamental purpose of the Commodity Exchange Act and transactions of this nature depend on use of the hedging function. Since the Commodity Exchange Act was adopted on the premise that such hedging should be permitted, and since it is a principal reason why futures contracts are allowed to exist at all, it does not seem likely that front-running of this nature would or should be proscribed.

On the other hand, persons front-running on the basis of nonpublic information concerning the activities of hedgers or cash traders have a much reduced claim of legitimacy. These persons may bring information of an impending sale into the marketplace. In so doing, they injure the large trader selling the block by depressing prices in advance. In such cases, it might be claimed that they misappropriate information of the trader, as in Carpenter v. United States. In other cases that lack the specific element of misappropriation (e.g., front-running by a tippee of a cash market dealer), the front-running trader obtains an advantage over other traders on the basis of material, nonpublic information. In other words, such a trader tilts an otherwise level playing field because of his pipeline to a source of information, the willing tippor. In contrast to a Dirks v. SEC type of adviser or other persons who ferret out market information through their own efforts and resources, the willing tippor and front-running tippee stand in an oppor-


316. See generally Gaming Instruments, supra note 308 (futures speculators provide liquidity needed by cash market participants to hedge against adverse price fluctuations).


tunistic relationship, sharing advantageous information unavailable through legitimate channels to even the most diligent traders and advisors.

The CFTC may have the power to broadly interpret its statute in enforcement cases or to adopt rules necessary specifically to prohibit undesirable front-running practices. It may be more appropriate, however, to seek express authority from Congress in view of the fact that such a rule may be quite controversial and the courts may be reluctant to recognize such sweeping agency enforcement powers, possibly finding that the agency lacks authority to adopt such a rule under existing statutes.319

Various bills have been introduced that would curb front-running in one form or another. For example, H.R. 251, a bill introduced by Representative Neal Smith, tracks the provision he sought to introduce in 1982. This bill would prohibit insiders from trading on material information “about present or anticipated cash or futures trading . . . to which such individual is not a party,” where the amounts involved exceed a specified minimum.320 In another bill, Representative Smith would prohibit traders executing orders for any other person from holding any beneficial interest in stock index futures contracts.321 A Senate bill would create an intermarket coordinating committee composed of the CFTC, the SEC and the Federal Reserve Board. Among other things, the committee would be directed to improve intermarket cooperation and improve information systems and methods for


detecting front-running.\textsuperscript{322}

Legislation, however, might be more effective if it afforded the CFTC broad and flexible authority to promulgate rules that better define fraudulent or manipulative acts. Under such authority, the CFTC could adopt a regulation defining front-running and other similar activities and prohibit such activities as fraudulent or manipulative practices in violation of the Commodity Exchange Act. This would allow the CFTC to more broadly proscribe practices that do not meet its presently uncertain manipulation definition, but which may have undue and adverse effects upon the market, whatever the motives of the traders involved.\textsuperscript{323}

Such a proscription could be worded as follows: "The Commission may adopt such rules and regulations as are necessary to implement the provisions of section 4(b) and section 9(b) of this Act, including rules and regula-

\textsuperscript{322} S. 2256, 100th Cong., 2nd Sess. (1988). In testimony before Congress by various securities industry officials, it was stated that "brokerage firms should be required to disclose more information on their institutional customers' trading activities as a means of curbing intermarket front-running." *Brokers Should Disclose More Data to Stop Front-Running, Senate Panel Told.* Daily Report for Executives, (BNA) No. 77, at A-4 (Apr. 21, 1988). Those firms stated that "intermarket front-running may be costing institutional and individual investors billions of dollars in hidden costs," id., but they declined to forego their investment banking activities to stop front-running. A member of the Presidential Task Force that filed the *Brady Report, supra* note 1, also stated that finding front-running was comparable to locating the Loch Ness Monster or Big Foot: "All three are widespread topics of conversation and are passionately believed to exist by a segment of the population. However, in no case does there exist an accumulation of hard evidence of proof [of] the case." *SIA Proposed Intermarket Council Composed of Futures, Securities SROs,* 50 Bureau of National Affairs, Banking Report, 724 (Apr. 25, 1988); Dingell Launches Investigation of Short Selling, Front-Running, Securities Week, Mar. 14, 1988, at 3.

\textsuperscript{323} This form of legislation would afford the CFTC flexibility to proscribe additional manipulative and fraudulent activity, some of which is related to front-running. For example, the SEC Options Study, *supra* note 11," noted another practice related to front-running known as "tape racing." *Id.* at 189. This involves "trading of options based on last sale information regarding the underlying stock," prior to the dissemination of the information to the general public. *Id.* Tape racing was possible because of inefficiencies in systems by which information regarding executed trades was reported off the floors of the exchange. Persons observing the trades on the floor of the stock exchange were, therefore, "able to transmit options orders reflecting that information to the floors of the option exchanges and have such orders executed at favorable prices prior to the availability of the last sale information" to the general public. *Id.* The SEC found that the practice was largely eliminated by expediting the entry of transaction information into their reporting system. *Id.*

During the stock market crash of 1987, opportunity presented itself for tape racing. Trading delays on the NYSE in particular stocks, and overloaded order entry and execution systems resulted in confusion and delays in reporting information off the floor of the NYSE. As a consequence, price disparities developed between the two marketplaces, presenting opportunities for persons on the floor of the NYSE to utilize their position and more current information to advantageously trade futures. To date, no such abuses have been uncovered, but the potential nonetheless existed. See CFTC Final Report, *supra* note 3, at 22-23.
tions that proscribe particular practices as being manipulative or fraudulent or having the effect of being manipulative or fraudulent."

A CFTC regulation promulgated pursuant to such statutory authority to proscribe front-running could take the following form:

PROHIBITED MANIPULATIVE FRAUDULENT PRACTICES
(a) Front-running as defined herein shall constitute a manipulative and fraudulent practice in violation of sections 4(b) and 9(b) of the Commodity Exchange Act.
(b) Material information is information which, if publicly known, would be considered important by a reasonable person in deciding whether to trade a particular commodity interest on a contract market. As used in this section, material information includes, but is not limited to, information relating to present or anticipated cash, futures, or option positions or trading strategies.
(c) Nonpublic information is information that has not been disseminated in a manner which makes it generally available to the trading public through recognized channels of distribution.
(d) Front-running is the practice of trading in commodity futures or options contracts with advance knowledge of material nonpublic information about the cash, options, or futures market activities of any dealer, processor, user or consumer of a commodity or customer of the acting party where such activities could reasonably be foreseen to affect market prices and where the information is obtained by the acting party through employment with such persons or through any confidential, fiduciary or any other such special relationship with such persons.

This proscription is worded in such a way as to allow investment advisors or other persons trading on fundamentals to acquire such information freely in the same way as the advisor did in the Dirks v. SEC case. It would, however, prevent an employee or someone having a special relationship from providing access to material nonpublic information and obtaining a trading advantage over other traders to the possible detriment of the cash trader. In other words, while this provision would outlaw truly inside "tippee" and "trading ahead" transactions, it would allow hedging and legitimate price discovery activities to proceed unfettered.

B. Improve Systematic Intermarket Surveillance

Effective prohibitions on improper front-running represent only part of

the solution. To regulate front-running effectively, it must be identified as well as proscribed. This will require expanded intermarket surveillance efforts. Presently, the SEC has in place a sophisticated system of following individual stock prices to determine whether inside trading or front-running in option contracts on individual securities has occurred. The SEC and the self-regulatory organizations such as the NASD and the securities exchanges follow stock prices closely. If abnormal trading or sharp fluctuations occur, as in the case of a large block sale, the SEC and the exchanges can investigate to determine who was trading and for what reasons. This is often a long and involved process, but effective in uncovering instances of insider trading. The SEC, however, does not appear to have any analogous method to determine if front-running is occurring in stock index option contracts, and it is certainly unable to determine whether it is occurring in stock index futures contracts. This is the case with stock option contracts because in the past the SEC has been unable to determine promptly who engaged in basket trading at any particular time. This deficiency is being corrected so that the SEC can examine the basket traders and also look at stock option index activity to determine whether there is any correlation. From there the SEC can proceed as it has in traditional insider trading cases. A more effective reporting system such as that similar to the CFTC's, however, could provide more effective surveillance.

The SEC surveillance system differs somewhat from that of the CFTC. The CFTC requires all large traders to file a Form 40, that describes who the traders are, when they initially reach a reportable level in a commodity. A reporting level simply means that the trader has purchased or sold enough commodity futures contracts for the CFTC to deem its activities significant. In fact, the trading levels are reasonably low and, therefore, the reports afford the CFTC information regarding broad computerized access to who is

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326. As noted above, see supra notes 64-66 and accompanying text, self-regulatory organizations in the securities industry have developed an Intermarket Surveillance Group to which all securities and securities option exchanges are members and which closely follows front-running issues; see also SEC REPORT, supra note 3, at 3-33. The Intermarket Surveillance Group is apparently being expanded to include commodity futures exchanges. See CFTC, SEC and Exchanges Meet to Discuss Sharing Surveillance Information, Sec. Week, Mar. 21, 1988, at 7; see also CFTC Chairman Questions SEC Conclusions About Front-Running, Sec. Week, Mar. 21, 1988, at 8. The Intermarket Surveillance Group is forming a subcommittee to develop a definition of front-running that will apply to all markets. ISG Members Appoint Group to Help Define Intermarket Front-Running, Sec. Week, Apr. 11, 1988, at 4.

327. See generally SEC REPORT, supra note 3, at 3-33.

trading and for what reasons.\footnote{329} A trader's broker must also file another report for each day the trader remains at reportable levels.\footnote{330} This report tells the CFTC the magnitude of futures trading being conducted by that trader. Because this system is computerized, it allows the CFTC to rapidly review those traders in the market. By integrating this system with that of the SEC, an effective market surveillance system could be readily implemented. The CFTC, however, does not presently follow short term trading fluctuations in the same manner as the SEC. Rather, the CFTC generally concentrates its surveillance upon trading activities occurring as a contract approaches expiration. This is because it is in the delivery period of contracts that most manipulations and problems take place. At such times, the CFTC heightens its surveillance to assure that there are sufficient supplies on hand to meet delivery requirements. It seeks to avoid a squeeze or a market default.\footnote{331}

Consequently, front-running activities prior to an approaching delivery period may go undetected, or at least the CFTC's surveillance mechanisms are not directed at promptly identifying them. Therefore, in order to determine whether front-running is occurring, the CFTC must focus more on short turn trading prior to delivery periods and it must share its data with that of the securities exchanges and the SEC. By comparing the data, both agencies can determine whether futures market activities on the futures exchanges preceded block transactions. If so, they can then determine who the traders were and see if there were any connections between the traders and, if so, whether the activities were legitimate hedging activities. If not, they can focus on the traders involved to determine whether they gained access to material nonpublic information and, if so, can then prosecute them.\footnote{332}

V. CONCLUSION

Trading on material non-public information on options and futures mar-

\footnote{329} See id. \S 15.03. The reporting level for the Standard \& Poor's 500 stock index contract is 300 contracts and for the Value Line Average Index it is 100 contracts. \textit{Id.}

\footnote{330} \textit{Id.} \S 17.00-02.

\footnote{331} The CFTC asserts that its daily market surveillance program includes daily monitoring of all active futures and option contracts, the activity of large traders, key cash futures market price relationships and relevant supply and demand factors. J. MARKHAM, THE HISTORY OF COMMODITY FUTURES TRADING AND ITS REGULATION, 134-36 (1987); CFTC, 1983 ANNUAL REPORT 57. Nevertheless, its focus traditionally has been on problems in expiring futures contracts or large scale, long term position trading. \textit{See generally id.} at 58; CFTC, 1985 ANNUAL REPORT 48; CFTC, 1982 ANNUAL REPORT 64-66; CFTC, 1980 ANNUAL REPORT 66-71; CFTC, 1979 ANNUAL REPORT 53-54.

\footnote{332} \textit{See generally Brokers Should Disclose More Data to Stop Front-Running, Senate Panel Told, BUREAU OF NATIONAL AFFAIRS, DAILY REPORT FOR EXECUTIVES, (BNA) No. 77 (Apr. 21 1988).}
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kets raises more sophisticated concerns than more infamous insider trading in securities. Presently, neither the SEC nor the CFTC has effective prohibitions against front-running activities in place. The SEC's permissible application of its insider trading standard to front-running may be too narrow to effectively prohibit this activity. At the present time, the SEC has chosen to rely upon circulars issued by the self-regulatory organizations which state that such front-running activities violate exchange rules. As noted above, however, the exchanges can only apply their rules to their members and, therefore, nonmember traders may escape the prohibition.

Similarly, the CFTC does not appear presently to have sufficient statutory authority to proscribe front-running. It also evinces an apparent unwillingness to do so. Therefore, statutory changes may be necessary both in the SEC and the CFTC areas if this practice is to be prevented.

CFTC's current reluctance to regulate in this area results from its desire to preserve the traditional conceptual distinctions between insider trading in securities and futures industries. It also appears to be dissuaded by the difficulty in detecting front-running activity, even to the point of questioning whether harmful front-running practices are occurring. The solution proposed by this Article addresses both problems. It insures that traditionally acceptable hedging activities will remain inviolate, by carefully excluding such practices from the regulatory definition of front-running, and, in the final analysis, by affording CFTC broad statutory authority to determine what constitutes fraud and manipulation. This flexible authority could be exercised as sparingly and precisely as warranted by circumstances. With regard to the elusiveness of front-running, the proposed improvements in surveillance methodology should allow proscribed practices to be detected more readily.

Finally, to the extent that specific individuals are harmed by improper front-running, bringing the practice under the aegis of section nine of the Commodity Exchange Act would afford aggrieved parties potent remedies under the express private right of action available for violations of that section.
