

**UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION**

In the Matter of:

LFG, L.L.C.
107 W. Van Buren St., Suite 214
Chicago, Illinois 60605,

Respondent.

CFTC Docket No.: 01-19

ORDER INSTITUTING PROCEEDINGS
PURSUANT TO SECTIONS 6(c) AND 6(d)
OF THE COMMODITY EXCHANGE ACT,
AS AMENDED, MAKING FINDINGS AND
IMPOSING REMEDIAL SANCTIONS

I.

The Commodity Futures Trading Commission (“Commission”) has reason to believe that LFG, L.L.C. (“LFG”) has violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2001). Therefore, the Commission deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether LFG has engaged in the violations as set forth herein and to determine whether any order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of this administrative proceeding, LFG has submitted an Offer of Settlement (“Offer”) that the Commission has determined to accept. Without admitting or denying the findings herein, LFG acknowledges service of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, As Amended, Making Findings and Imposing Remedial Sanctions (“Order”). LFG consents to the use of the findings herein in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.¹

¹ LFG does not consent to the use of the Offer or the findings in this Order as the sole basis for any other proceeding brought by the Commission, other than a proceeding brought to enforce the terms of this Order. LFG also does not consent to the use of the Offer or the findings in the Order by any other person or entity in this or any other proceeding. The findings made in the Order are not binding on any other person or entity named as a defendant or respondent in this or any other proceeding.

III.

The Commission finds that:

A. SUMMARY

LFG, a registered futures commission merchant (“FCM”), failed to supervise the handling of the foreign omnibus accounts of two Japanese firms under common ownership, Excellent Inc. (“Excellent”) and Core Creation Inc. (“Core”), and thereby contributed to the failure to provide adequate customer protection to foreign retail customers who traded in the U.S. futures markets. Excellent and Core staff solicited Japanese customers to place orders for individual futures trades on a U.S. futures exchange and collected margins for those individual trades. However, Excellent and Core did not transmit the orders as individual orders; instead, they combined different customer and house orders into spreads before relaying them to the U.S. for execution. Excellent and Core faxed their orders to a United States non-clearing FCM owned by Excellent each day before the market opened. Staff of the non-clearing FCM simultaneously transmitted all of Excellent’s and Core’s orders to the LFG grain desk on the floor of the Chicago Board of Trade (“CBOT”). The simultaneously transmitted orders included some orders to buy and sell the same spreads. Each day’s orders, when totaled, resulted in each omnibus account being both long and short approximately the same number of futures contracts in each contract month. Despite the suspicious nature of this trading, LFG never inquired as to the customers’ intent or made any inquiry into the trading at issue.

B. RESPONDENT

LFG, L.L.C., formerly known as Lincco Futures Group, Inc. (“Lincco”) is an Illinois limited liability company that maintains its principal place of business at 107 W. Van Buren St., Suite 214, Chicago, Illinois 60605. LFG has been registered with the Commission as an FCM since at least December 7, 1989, pursuant to Sections 4d and 4f of the Commodity Exchange Act, as amended (“Act”), 7 U.S.C. §§ 6d and 6f (1994), as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. No. 106-554, 114 Stat. 2763 (2000). On or about April 28, 2000, LFG sold substantially all its assets. On or about June 1, 2000, LFG discontinued its operation of customer business in exchange-traded futures, securities, options and other instruments. On or about April 9, 2001, LFG filed a petition for bankruptcy protection under Chapter 11 of the Bankruptcy Code.

C. FACTS

Excellent and Core were Japanese corporations with common ownership that were formed in 1987 and 1994, respectively. The two firms acted as brokerage firms offering trading opportunities in the U.S. commodities markets to retail customers in Japan. Excellent and Core solicited Japanese customers to place orders to buy or sell outright positions in futures contracts traded on the U.S. markets. Both firms collected margins from its customers for outright trades, representing to their customers that the firms had to send the full margin to the U.S. However, Excellent and Core combined their customers' orders into spreads before relaying them to the U.S. for execution. In addition, Excellent and Core sought to maintain a balance between the long and short positions in each futures contract. Because Excellent and Core placed only spread

orders, they had to send only minimal amounts of money to LFG to margin the trades. Excellent and Core kept the balance in Japan and used the funds to pay the firms' operating expenses and to support the extravagant lifestyle of the common owner. By February 29, 2000, Japanese criminal authorities had convicted and sentenced the principals of Core, one of whom also was a principal of Excellent, of cheating unsophisticated customers by churning their accounts, setting up false trades against the trades ordered by customers and misappropriating customer margin funds.

In July 1990, Excellent established a non-clearing FCM in the U.S. to process its orders through an omnibus account. The non-clearing FCM introduced the Excellent and Core accounts to Linnco in 1994. Both of these accounts were carried by Linnco and, subsequently LFG, on a fully disclosed basis. These accounts remained open with LFG until January 1998. Between March 1994 and January 1998, Excellent and Core placed their orders by faxing an order sheet to the non-clearing FCM overnight. Most of the Excellent and Core orders instructed the non-clearing FCM to place orders to buy or sell spreads in the Chicago Board of Trade ("CBOT") grain contracts.

Both Excellent and Core regularly entered various spread orders, including simultaneously entered orders to buy or sell the same spread, that resulted in both omnibus accounts holding almost equal and offsetting positions in each futures month. The non-clearing FCM transmitted all of Excellent's and Core's orders for the day to the LFG floor desk at the CBOT before the market opened. LFG accepted the orders to buy and sell the same spreads for the Excellent and Core omnibus accounts.

LFG had no written procedures relating to the supervision of foreign omnibus accounts, and no one at LFG had the responsibility to monitor the foreign omnibus accounts. Instead, the firm purportedly relied on its floor personnel to identify unusual trading.

When the LFG floor personnel questioned the simultaneous entry of offsetting spread orders, which had the appearance of wash sales, LFG management assured them that the trades were appropriate and reflected "Japanese pricing." LFG did not seek a clarification from the non-clearing FCM, Excellent or Core regarding the simultaneous entry of offsetting spread orders or the near symmetry in the long and short positions held in each contract month in the Excellent or Core omnibus accounts.

LFG back-office personnel also failed to act on available information showing the unusual nature of the trading in the foreign omnibus accounts of Excellent and Core. LFG prepared daily equity runs showing the equal offsetting positions in the Excellent and Core omnibus accounts. The daily run for the Excellent and Core omnibus accounts showed that both accounts consistently held almost equal and offsetting open positions in each futures month at the end of each trading day. LFG's margin department staff knew the accounts primarily traded spreads and that the firm's margin requirement barely fluctuated on a day-to-day basis. Although the pattern of trading appeared unusual, the LFG operations personnel did not seek a clarification from Excellent, Core or the non-clearing FCM regarding the trading in the omnibus account.

D. VIOLATION OF COMMISSION REGULATION 166.3

Commission Regulation 166.3 imposes on registrants an affirmative duty to “diligently supervise the handling by its ... employees and agents ... of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its ... employees and agents ... relating to its business as a Commission registrant.” “Failure to supervise is an independent and primary violation of the Commission’s rules.” *In re Paragon Futures Assn.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,266 (CFTC April 1, 1992). There is no requirement to charge an underlying violation of the Act. *In re First National Trading Corporation (“FNTC”)*, [1992-1994 Transfer Binder] Comm.Fut. L. Rep. (CCH) ¶ 26,142 at 41,786 (CFTC July 20, 1994) (“In appropriate circumstances, proof of an independent substantive violation is not a necessary element to establish a breach of the duty imposed by Rule 166.3”), *aff’d without op.*, *Pick v. CFTC*, No. 95-3761 (6th Cir. Oct. 26, 1996). This is an appropriate case to charge a failure to supervise without proof of an independent underlying violation because LFG had no written procedures relating to the monitoring of foreign omnibus accounts, no one was responsible for monitoring the trading in foreign omnibus accounts and, indeed, it appears to have been the policy of the firm not to monitor the trading in foreign omnibus accounts.

LFG knew or should have known that the trading patterns, whereby both accounts held almost equal and offsetting open positions in each futures month at the end of each trading day, in the customer omnibus accounts were unusual. LFG disregarded the red flags raised by its floor personnel and in its daily equity run. Instead, LFG compliance personnel assured the floor personnel that it was appropriate to accept the simultaneous entry of buy and sell orders even though the appearance of these orders indicated that the customer or its representative may have intended to avoid taking a bona fide position in the market. An FCM has a duty not to accept or transmit orders for transactions that demonstrate intent to avoid a bona fide market position. *In re Three Eight Corporation*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,749 at 40,445 (CFTC June 16, 1993). In *Three Eight*, the Commission found that the receipt of paired orders for matching executions demanded clarification before execution. *Id.* at 40,446. The Commission recently reaffirmed this principle in *In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,276 at 50,689 (CFTC September 29, 2000) (account executive has a duty to inquire about customer’s intent when he receives simultaneous orders to buy and sell the same spread). While both *Three Eight* and *Piasio* dealt with liability for wash sales, they also set out a standard that is applicable in evaluating FCM supervision of other improper trade practices. In this case, the trades do not appear to be wash sales, but the orders were sufficiently unusual that LFG should have sought clarification from the non-clearing FCM or its customers, Excellent and Core regarding the intent or rationale behind the trades.

IV.

OFFER OF SETTLEMENT

LFG has submitted an Offer of Settlement in which LFG neither admits nor denies the findings in the Order. Subject to the foregoing: LFG acknowledges service of this Order and admits the jurisdiction of the Commission with respect to the matters set forth in this Order;

waives (1) the service and filing of a complaint and notice of hearing, (2) a hearing and all post-hearing procedures, (3) judicial review by any court, (4) any objection to the staff's participation in the Commission's consideration of the Offer, (5) all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (1994) and 28 U.S.C. § 2412 (1994), as amended by Pub. L. No. 104-121, §§ 231-232, 110 Stat. 862-63, and part 148 of the Commission's Regulations, 17 C.F.R. §§ 148.1, et seq. (2001), relating to, or arising from this action, and (6) any claim of double jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief.

LFG stipulates that the record basis on which the Order is entered consists of the Order and the findings in the Order consented to in the Offer. LFG consents to the Commission's issuance of this Order, which makes findings as set forth herein and orders that LFG comply with its undertaking as set forth in the Offer and incorporated in this Order.

V.

FINDING OF VIOLATIONS

Solely on the basis of LFG's consent, as evidenced by the Offer, and prior to any adjudication on the merits, the Commission finds that LFG violated Commission Regulation 166.3, 17 C.F.R. § 166.3 (2001).

VI.

ORDER

Accordingly, **IT IS HEREBY ORDERED THAT:**

1. LFG shall comply with its undertaking, as set forth in the Offer, to complete the process to withdraw its registration as a futures commission merchant and shall never: apply for registration or seek exemption from registration with the Commission in any capacity, and never engage in any activity requiring registration or exemption from registration, except as provided for in Section 4.14(a)(9) of the Commission Regulations, 17 C.F.R. § 4.14(a)(9); act, directly or indirectly, as a principal, officer or director of any person registered, required to be registered or exempted from registration, unless such exemption is pursuant to Section 4.14(a)(9) of the Commission's Regulations; act, directly or indirectly, in a supervisory capacity over any person employed by any person registered, required to be registered or exempted from registration, unless such exemption is pursuant to Section 4.14(a)(9) of the Commission's Regulations.

2. The Commission recognizes that imposition of sanctions, including a civil monetary penalty and a cease and desist order, would be appropriate in this case, but declines to impose such sanctions in light of LFG's sale of its assets; its discontinuance of its operation of customer business in exchange-traded futures, securities, options and other instruments; and its filing of a petition for bankruptcy protection under Chapter 11 of the Bankruptcy Code.

3. Nothing in this Order shall preclude LFG from receiving payments due from the April 28, 2000 sale of its assets.

The provisions of this Order shall be effective on this date.

By the Commission:

Catherine D. Dixon
Assistant Secretary to the Commission
Commodity Futures Trading Commission

Dated: August 20, 2001