



### III.

The Commission finds the following:

#### A. SUMMARY

Since in or about April 2002 and continuing to at least July 2002, Michael Pate and American FX, LLC (AFX) solicited, and caused others to solicit, individuals to trade off-exchange foreign currency futures contracts through accounts to be managed by Pate and AFX. To further their enterprise, Pate and AFX established the E-FX Fund, through which they purportedly intended to trade foreign currency futures contracts on behalf of customers.

Pate and AFX created and maintained a web site to solicit members of the retail public to participate in the E-FX Fund. Pate and AFX posted on the website the purported track record of E-FX Fund for a twelve month period. The track record showed eleven months of profitable trading and an annual return of over 62 percent. That track record was false; the E-FX Fund had no track record. The E-FX Fund did not exist for most of the time period covered by the track record, and in fact, never actually engaged in any trading. The website contained other similar misrepresentations boasting of the successful trading of E-FX Fund and of AFX. Pate and AFX also falsely represented that customer funds would be maintained in a segregated account. Despite those reassurances, Pate and AFX commingled some customer funds with AFX operating funds. By such fraudulent solicitations, Pate and AFX violated anti-fraud provisions of the Act and Commission Regulations

AFX's customers were retail customers. AFX, which represented that it may act as the counterparty to off-exchange transactions with customers, was not a person who qualified under the Act to act as a counterparty to off-exchange foreign currency futures transactions with members of the retail public. Accordingly, Pate and AFX were illegally offering futures contracts, in violation of the Act.

#### B. RESPONDENTS

**Michael Pate**, who resides in Pontotoc, Mississippi, has never been registered with the Commission in any capacity. Pate is the founder and a Member of AFX, LLC.

**American FX, LLC**, a Delaware corporation with a last known business address was in Tupelo, Mississippi, has never been registered with the Commission in any capacity.

---

enforce the terms of this Order. They do not consent to the use of the Offers or this Order by any other person or entity in this or any other proceeding. The findings to which they have consented in the Offers, as contained in this Order, are not binding on any other person or entity named as a respondent or defendant in this or in any other proceeding.

## C. FACTS

In the spring of 2002, Pate decided to form a foreign currency trading firm, which he called American FX, LLC.<sup>2</sup> Pate also established Euro-Premier, LLC, under the laws of Anguilla, as an offshore shell company to purportedly operate a foreign exchange fund called the E-FX Fund.

Pate designed a web site to advertise AFX and the E-FX Fund. Through that website and telemarketing efforts, Pate and AFX successfully solicited customers to trade foreign currency. The web site was replete with inaccuracies ranging from unsupported puffery to material misrepresentations. The most significant falsehood, sprinkled liberally throughout the AFX web site, concerned the trading history of the E-FX Fund, which covered the twelve-month period of August 2001 through July 2002 and showed eleven profitable months with monthly profits ranging from 1.47% to 11.76% and only one losing month. In total, the track record claimed an annual return of over 62%.

In fact, the E-FX Fund had no track record, successful or otherwise. The E-FX Fund did not exist for most of the time period covered and never engaged in any trading. Pate created the fictitious record for the E-FX Fund based on a purported trading record of a trading advisor he had contemplated using to advise on the trading of the E-FX Fund. Pate never verified or indeed even reviewed that trading advisor's track record to ensure that it was accurate and Pate affirmatively misrepresented that track record as being the actual trading record of the E-FX Fund.

Given that neither AFX nor E-FX had any trading history, the following statements, found on the AFX web site, were also false:

- With over 20 years of experience in the financial market our Asset Management Team (A.M.T.) skillfully navigate the E-FX in and out of the Global Forex to maximize profit, while keeping risk to a minimum.
- They [the E-FX Asset Management Team] combine years of knowledge, experience and technical wisdom to create the highly profitable and Exclusive Foreign Exchange Fund (E-FX)
- Due to the success and profitability of AFX we allow access to this exclusive opportunity with as little as US\$ 50,000 up to US\$ 10,000,000.

Pate and AFX also represented on the on the AFX web site that all customer funds would be held in a segregated account; however, Pate deposited some customer funds into the AFX operating account, thus commingling customer funds with other funds.

---

<sup>2</sup> Pate exercised day-to-day authority over all of AFX's operations and performed all important managerial, administrative, and supervisory functions.

Pate and AFX successfully solicited customers to open accounts with AFX. Customers made their checks (and one wire transfer) payable to AFX and Pate deposited those funds into AFX accounts. Neither Pate nor anyone else ever traded foreign currency futures contracts or engaged in any trading for and on behalf of AFX customers. Pate eventually discontinued his business and returned all the customer funds he had solicited.

Although Pate and AFX claimed to be offering spot or cash foreign currency contracts, Pate and AFX were offering foreign currency futures contracts. The contracts offered by Respondents involved the purchase and sale of foreign currency for future delivery. Customers were to enter into contracts at a price determined at the time the customers entered into the contract. The contracts had no expiration date and customers could have held a position open indefinitely. Customers did not need to make or receive physical delivery, and, indeed, did not expect to make or receive physical delivery of the foreign currency, in order to close a position. Through these contracts, customers were to have been able to capture price movements and speculate on fluctuations in the value of the currencies without transferring the underlying currency. Ultimately, the contracts could have been settled through offsetting transactions.

Most, if not all, of Pate and AFX's customers were retail customers. In offering the foreign currency futures contracts to customers, AFX represented in its disclosure statement that it might act as the counterparty to any transactions entered into by the customers. AFX was not a counterparty eligible under the Act to offer and sell foreign currency futures contracts to retail customers.

#### **D. LEGAL DISCUSSION**

##### **1. Respondents Committed Solicitation Fraud In Violation of Section 4b(a)(2) of the Act and Regulation 1.1 of the Commission's Regulations**

Pate and AFX violated Section 4b(a)(2)(i) and (iii) of the Act by fraudulently soliciting customers to trade foreign currency futures contracts. Section 4b(a)(2)(i) and (iii) of the Act prohibits cheating and defrauding or attempting to cheat or defraud and willfully deceiving or attempting to deceive another person in connection with any order to make or the making of a contract of sale of a commodity for future delivery made or to be made for or on behalf of any other person. Regulation 1.1 of the Commission's Regulations prohibits the same conduct specifically in connection with foreign currency futures transactions.<sup>3</sup>

---

<sup>3</sup> This anti-fraud rule applies to retail foreign currency agreements, contracts and transactions described in section 2(c)(1) of the Act and states, in significant part, that:

- It shall be unlawful for any person, directly or indirectly, in or in connection with any account, agreement, contract or transaction that is subject to paragraph (a) of this section:
- (1) To cheat or defraud or attempt to cheat or defraud any person;
  - (2) Willfully to make or cause to be made to any person any false report or statement or cause to be entered for any person any false record; or
  - (3) Willfully to deceive or attempt to deceive any person by any means whatsoever.

17 C.F.R. § 1.1

Section 4b(a)(2) prohibits all manner of omissions and misrepresentations of material fact regarding futures transactions, including misrepresentations concerning the likelihood of profit and the risk of loss, the trading record of the firm or broker, and other matters that a reasonable investor would consider material to his investment decision. *See, e.g., JCC, Inc., et al. v. CFTC*, 63 F.3d 1557, 1571 (11th Cir. 1995) (misrepresentations concerning the likelihood of profits and risk of loss); *CFTC v. Commonwealth Financial Group, Inc.*, 874 F. Supp. 1345, 1353-54 (S.D. Fla. 1994), *citing, inter alia, Reed v. Sage Group*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) P 23,942 at 34,299 (CFTC Oct. 14, 1987) (misrepresentations regarding a firm or broker's trading record and experience are fraudulent because past success and experience are material facts to reasonable investors); *Saxe v. E.F. Hutton & Co., Inc.*, 789 F.2d 110-11 (2<sup>nd</sup> Cir. 1986) (to the same effect); *CFTC v. U.S. Metals Depository Co.*, 468 F. Supp. 1149, 1161 (S.D.N.Y. 1979) ("glowing" representations concerning market expectations and likelihood of profit misrepresentations regarding profitability of investment).

Liability for solicitation fraud is established when a person or entity is found to have made misleading statements of, or omitted to disclose, material facts with *scienter*. *Hammond v. Smith Barney, Harris Upham & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,617 at 36,657-36,659 (CFTC March 1, 1990) (*scienter* is a necessary element to establish futures fraud under Section 4b(a)). *Scienter* requires proof that the respondents committed the wrongful acts "intentionally or with reckless disregard for their duties under the Act." *Id.* at 36,659.

Pate and AFX, through the AFX website, defrauded customers by knowingly or recklessly making material misrepresentations. In particular, on the AFX website, AFX and Pate included the fictitious profitable trading record Pate created for the AFX investment vehicle, the E-FX Fund, even though E-FX had not been in existence for most of the time period covered by the purported track record and never actually traded. Pate and AFX also made other misrepresentations concerning the profitable trading and success of both AFX and E-FX Fund. They further misrepresented that customer funds would be segregated. Accordingly, AFX and Pate violated Section 4b(a) of the Act, 7 U.S.C. § 6b(a) and Regulation 1.1, 17 C.F.R. § 1.1.

## **2. Respondents Offered Illegal Foreign Currency Futures Contracts In Violation Of Section 4(a) Of The Act**

Section 4(a) of the Act makes it unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States for the purpose of soliciting, or accepting any order for, or otherwise dealing in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery unless (1) such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or derivatives transaction facility for such commodity, (2) such contract is executed or consummated by or through contract market; and (3) such contract is evidenced by a record in writing which shows the date, the parties to such contract and their addresses, the property covered and its prices and the terms of delivery.

Section 2(c)(2)(B)(ii) of the Commodity Futures Modernization Act of 2000, Appendix E to Public L. No. 106-554 (December 21, 2000) ("CFMA"), clarified the Commission's jurisdiction over foreign currency futures transactions between members of the general public who are not eligible contract participants and counterparties that are not regulated financial institutions. In this case, AFX's customers were retail customers rather than eligible contract participants, as that term is defined in Section 1a(12) of the CFMA,<sup>4</sup> and AFX, which held itself out as a possible counterparty to transactions with the AFX customers, did not constitute one of the enumerated regulated entities that may act as a counterparty under the Act.<sup>5</sup> Accordingly, the Commission has jurisdiction over the transactions AFX and Pate were offering to AFX customers, if such transactions involved futures contracts.

When determining whether the foreign currency contracts marketed by the respondents are futures contracts, "[t]he transaction must be viewed as a whole with a critical eye toward its underlying purpose." *CFTC v. Co Petro Mkg. Group, Inc.*, 680 F.2d 573, 581 (9th Cir. 1982), *relied upon in Motzek v. Monex Int'l. Ltd.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,095 at 41,626 (CFTC June 1, 1994) (endorsing a holistic approach). Futures contracts are contracts for the purchase or sale of a commodity for delivery in the future at a price established when the contract is initiated, with both parties to the transaction obligated to fulfill the contract at the specified price. The contracts are entered into principally to assume or shift price risk without transferring the underlying commodity. Although the contracts provide for settlement by delivery, delivery can be avoided by offset, cash settlement or cancellation. *See CFTC v. Noble Metals Int'l.*, 67 F.3d 766, 772 (9th Cir. 1995) (futures contracts allow the purchaser to enter into offsetting transactions as means to avoid taking delivery); *CFTC v. Hanover Trading Corp.*, 34 F. Supp.2d 203, 205 (S.D.N.Y. 1999) (the lack of an expectation that delivery of the physical commodity will be made is an important factor indicating the presence of a futures contract); *In re Stovall* [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,941 at 23,777 (CFTC Dec. 6, 1979); *CFTC v. Co Petro*, 680 F.2d 573, 581 (9<sup>th</sup> Cir. 1982)

---

<sup>4</sup> Section 1a(12) defines an eligible contract participant in relevant part as

- (i) a financial institution;
- (ii) an insurance company regulated by a State . . .
- (iii) an investment company subject to regulation . . .
- (iv) a commodity pool that has (I) total assets exceeding \$5,000,000 . . .
- (v) a corporation . . .
- (vi) an employee benefit plan . . .
- (vii) a governmental entity . . .
- (viii) a broker or dealer subject to regulation under the Securities Exchange Act . . .
- (ix) a futures commission merchant subject to regulation under this Act. . .
- (x) a floor broker . . .
- (xi) individual who has total assets in excess of: (I) \$10 million; or (II) \$5 million and who enters the transaction to manage the risk associated with the asset he owns. . .

<sup>5</sup> The CFMA denies the Commission jurisdiction over retail sales of foreign currency contracts if the counterparty, or the person offering to be the counterparty, of the retail customer is:

- (I) a financial institution;
- (II) a broker or securities dealer . . .
- (III) an associated person of a broker or dealer . . .
- (IV) an insurance company . . .
- (V) a financial holding company . . .
- (VI) an investment bank holding company . . . .

(contracts were "speculative ventures" that were "marketed to those for whom delivery was not an expectation," and therefore futures contracts).

The foreign currency contracts offered by Pate and AFX exhibited the characteristics of futures contracts. The contracts offered involved the purchase and sale of foreign currency for future delivery and customers were to enter into contracts at a price determined at the time the customers entered into the contract. Through these contracts, customers were to have been able to capture price movements and speculate on fluctuations in the value of the currencies without transferring the underlying currency. The contracts provided for settlement by offset. The foreign currency contracts that Pate and AFX offered were therefore commodity futures contracts. *CFTC v. Noble Wealth Data Info. Servcs*, 90 F. Supp. 2d 676, 688 (D. Md. 2000) (foreign currency contracts that were for future delivery, could be satisfied by offset or other means to avoid delivery, with prices that were set at the time the contract was entered into, and that were engaged in primarily to speculate, were futures contracts); *accord CFTC v. Hanover Trading Corp.*, 34 F. Supp. 2d at 205.

Accordingly, Pate and AFX offered illegal foreign currency futures contracts to the retail public that were not conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or as a derivative transaction execution facility for such commodity, in violation of Section 4(a) of the Act, 7 U.S.C. § 6(a)

### **3. AFX is Vicariously Liable for the Acts and Omissions of its Agent, Pate**

Inasmuch as Pate was a "member" of American FX, LLC and performed most if not all of AFX's critical business functions, all of Pate's acts and omissions in that regard may be imputed to AFX pursuant to Section 2(a)(1)(B) of the Act, which provides in pertinent part:

the act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual agent, or other person.

7 U.S.C. § 4. Therefore, in addition to its own direct liability, AFX is liable for the acts, omissions and failures of Pate. *Stotler and Co. v. CFTC*, 855 F.2d 1288, 1292 (7<sup>th</sup> Cir. 1988) (holding that Section 2(a)(1)(B) imposes vicarious liability).

## **IV.**

### **JOINT OFFER OF SETTLEMENT**

AFX and Pate have submitted a Joint Offer of Settlement in which they admit the jurisdiction of the Commission with respect to the matters set forth in this Order and acknowledge that failure to comply with the Order shall constitute a violation of the Order and may subject them to injunctive or administrative proceedings under the Act. AFX and Pate each waive the filing and service of a complaint and notice of hearing, a hearing, all post-hearing

procedures, judicial review by any court, any objection to the staff's participation in the Commission's consideration of the Joint Offer, 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, and all claims which they may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 and 28 U.S.C. § 2412, as amended by Pub. L. No. 104-121, §§ 231-32, 110 Stat. 862-63, and Part 148 of the Commission Regulations, 17 C.F.R. §§ 148.1, *et seq.*, relating to, or arising from this action.

AFX and Pate stipulate that the record basis on which this Order is entered consists solely of the findings in this Order, the entry of which they have consented to in their Joint Offer. AFX and Pate each consent to the Commission's issuance of this Order, which makes findings, as set forth herein, and orders that: (1) AFX and Pate each cease and desist from violating Sections 4(a) and 4b(a) of the Act and Section 1.1 of the Regulations; (2) AFX and Pate are subject to a five year ban from trading on registered entities; (3) AFX and Pate are jointly and severally liable to pay a civil monetary penalty in the amount of fifteen thousand dollars (\$15,000); and (4) AFX and Pate shall comply with their undertakings as set forth in their Joint Offer and incorporated in this Order including: (a) not to apply for registration or seek exemption from registration with the Commission in any capacity for five (5) years from the date of this Order, except as provided for in Regulation 4.14(a)(9), and not to engage in any activity requiring registration or exemption from registration for five (5) years from the date of this Order, unless such exemption is pursuant to Regulation 4.14(a)(9); (b) never to engage in, control, or participate in any manner or affiliate in any way with any individual or entity which involves the solicitation, acceptance of orders, transmission of orders, advice related to futures or options trading or trading, or execution of commodity futures contracts, options on commodity futures contracts, or options on foreign currency as a counterparty or for or on behalf of any person or entity; (c) never to take any action or make any public statement denying, directly or indirectly, any allegation in the Complaint or finding or conclusion in this Order or creating, or tending to create, the impression that the Complaint or this Order is without a factual basis.

## V.

### FINDING OF VIOLATIONS

Solely on the basis of the consents of AFX and Pate as evidenced by their Joint Offer, and prior to any adjudication on the merits, the Commission finds that AFX and Pate violated Sections 4(a) and 4b(a) of the Act, 7 U.S.C. §§ 6(a), 6b(a) and Section 1.1 of the Regulations, 17 C.F.R. § 1.1.

## VI. ORDER

Based on the consents of AFX and Pate to the entry of this Order and the findings herein that AFX and Pate violated Sections 4(a) and 4b(a) of the Act and Section 1.1 of the Regulations, the Commission deems it appropriate and in the public interest to impose remedial sanctions against AFX and Pate, and accordingly:

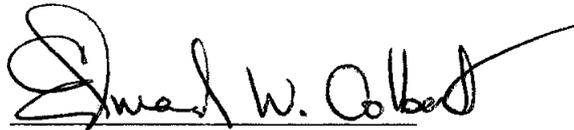
- A. **IT IS HEREBY ORDERED** that AFX and Pate shall cease and desist from violating Sections 4(a) and 4b(a) of the Act; 7 U.S.C. §§ 6(a), 6b(a) and Section 1.1 of the Regulations, 17 C.F.R. § 1.1.
- B. **IT IS HEREBY FURTHER ORDERED** that AFX and Pate are prohibited from trading on or subject to the rules of any registered entity and all registered entities shall refuse AFX and Pate all privileges thereon for a period of five years from the date of this Order.
- C. **IT IS HEREBY FURTHER ORDERED** that AFX and Pate, jointly and severally, shall pay a civil monetary penalty in the amount of fifteen thousand dollars (\$15,000). Pate and AFX shall make payment by electronic funds transfer, or by U.S. postal money order, certified check, bank cashier's check, or bank money order, made payable to the Commodity Futures Trading Commission, and sent to Dennese Posey, or her successor, Division of Enforcement, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581, under cover of a letter that identifies Pate and AFX and the name and docket number of the proceeding; Pate and AFX shall simultaneously transmit a copy of the cover letter and the form of payment to Gregory G. Mocek, Director, Division of Enforcement, Commodity Futures Trading Commission, at the following address: 1155 21<sup>st</sup> Street, N.W., Washington, D.C. 20581.
- D. **IT IS HEREBY FURTHER ORDERED** that AFX and Pate shall comply with the following undertakings:
1. AFX and Pate shall not take any action or make any public statement denying, directly or indirectly, any finding in this Order, or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision effects AFX or Pate's (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party;
  2. AFX and Pate shall not engage in, control, or participate in any manner or affiliate in any way with any individual or entity which involves the solicitation, acceptance of orders, transmission of orders, advice relating to foreign currency futures or options, trading or execution of foreign currency futures contracts, options on foreign currency futures contracts, or options on foreign currency as a counterparty or for or on behalf of any person or entity; and

3. for a period of five years from the date of this Order, AFX and Pate shall not apply for registration, seek exemption from registration, engage in any activity requiring registration or exemption from registration, except as provided for in Section 4.14(a)(9) of the Commission's Regulations, or act in any capacity or affiliate in any way with any individual or entity that is registered, is required to be registered, or is exempt from registration with the Commission, except as provided for in Section 4.14(a)(9) of the Commission's Regulations, or is acting in any capacity requiring registration with the Commission or exempt from registration, except as provided in Section 4.14(a)(9) of the Commission's Regulations.

Unless otherwise specified, the provisions of this Order shall be effective on this date.

Dated: June 6, 2003

**BY THE COMMISSION**



Edward W. Colbert

Deputy Secretary to the Commission  
Commodity Futures Trading Commission