

**UNITED STATES OF AMERICA**  
**Before the**  
**COMMODITY FUTURES TRADING COMMISSION**

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_____ )	<b>CFTC Docket No. <u>05-10</u></b>
<b>In the Matter of:</b> )	
)	
<b>HUGH J. MADDOX,</b> )	<b>ORDER INSTITUTING</b>
)	<b>PROCEEDINGS PURSUANT TO</b>
)	<b>SECTIONS 6(c) AND 6(d) OF THE</b>
<b>Respondent.</b> )	<b>COMMODITY EXCHANGE ACT,</b>
)	<b>MAKING FINDINGS AND</b>
)	<b>IMPOSING REMEDIAL SANCTIONS</b>
_____ )	

**I.**

The Commodity Futures Trading Commission ("Commission") has reason to believe that Hugh J. Maddox ("Maddox" or "Respondent") has violated Sections 4b(a)(2)(i) and (iii) of the Commodity Exchange Act, as amended (the "Act"), 7 U.S.C. §§ 6b(a)(2)(i) and (iii) (2002). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted to determine whether Maddox engaged in the violations set forth herein, and to determine whether any order should be issued imposing remedial sanctions.

**II.**

In anticipation of the institution of an administrative proceeding and prior to any adjudication of any issues of fact or law by the Commission, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Without admitting or denying the findings of fact herein, Respondent acknowledges service and consents to the entry of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions ("Order"). Respondent consents to the use by the Commission of the findings herein in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party.<sup>1</sup>

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<sup>1</sup> Respondent does not consent to the use of his Offer or the findings in this Order as the sole basis for any other proceeding brought by the Commission, other than a proceeding brought in bankruptcy, or to enforce the terms of this Order. Respondent does not consent to the use of the Offer or the findings in this Order by any other person or entity in this or any other proceeding. The findings made in this Order are not binding on any other person or entity, including, but not limited to, any person or entity named as a defendant or respondent in any other proceeding.

### III.

The Commission finds the following:

#### A. SUMMARY

From at least May 2003 through January 2004, Respondent and others engaged in a scheme in which they fraudulently allocated to themselves profitable trades belonging to ONEOK Energy Marketing & Trading Company, LP ("OEMT"). Maddox, a former natural gas trader for OEMT, would enter orders to a clerk on the floor of the New York Mercantile Exchange ("NYMEX") to buy and sell natural gas futures. Maddox then coordinated with the clerk to allocate any profitable trades that rightfully belonged to OEMT to Maddox and his associates, and to allocate most losing trades to OEMT. In this manner, Respondent and others misappropriated about \$64,000.

#### B. RESPONDENT

Hugh J. Maddox joined OEMT in December 1998 as an analyst. By 2003, Maddox had progressed to being a basis trader in natural gas. As such, Maddox principally traded financial natural gas products through voice brokers. He also had some limited authority to trade natural gas futures on the NYMEX in connection with basis trades. Maddox left OEMT in February 2004.

#### C. FACTS

As part of its business, OEMT engaged in the marketing and trading of natural gas, both physical and financial. It also traded natural gas futures, primarily to hedge its cash or over-the-counter positions in natural gas. Maddox's own trading was almost exclusively in the over-the-counter market; however, he had access to and did trade in OEMT's futures trading accounts.

Beginning in May 2003, Maddox and others, including a NYMEX floor broker and his clerk, engaged in a scheme to misappropriate funds by allocating profitable natural gas futures trades to accounts they controlled, while placing losing trades in OEMT's account. Maddox and the others then shared in the profits generated by the winning trades they fraudulently allocated.

For example, on May 15, 2003, Maddox instructed the clerk to buy and sell 15 natural gas contracts. These trades resulted in a \$3,000 profit. Although Maddox' sole authority was to trade for OEMT, he allowed the trades to be allocated to the floor broker's account rather than OEMT's account. Over the next three months, Maddox made at least four other profitable trades, purportedly on behalf of OEMT, that were allocated to the floor broker's account. The total profit of all five trades that cleared through the floor broker's account was approximately \$24,000, of which Maddox received at least \$8,000.

Beginning in late September 2003 and continuing through January 2004, Maddox continued his misappropriation and fraudulent allocation scheme with the same floor clerk. This time, however, the profitable OEMT trades were allocated to an account that belonged to friends of Maddox. During this period, the account received funds from twenty-one profitable trades, amounting to net profits of approximately \$27,000, of which Maddox received approximately \$9,000 to \$10,000.

#### D. LEGAL DISCUSSION

##### **Maddox Fraudulently Allocated Commodity Futures Trades Belonging to OEMT in Violation of Sections 4b(a)(2)(i) and (iii) of the Act**

Maddox violated Sections 4b(a)(2)(i) and (iii) by intentionally misappropriating funds and allocating profitable trades belonging to OEMT to accounts controlled by others while shunting losing trades to OEMT's accounts. The Commission has consistently held that the intentional allocation of trades to disadvantage one or more customers constitutes fraud under Section 4b(a) of the Act. *In re Lincolnwood Commodities, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,986 at 28,246 (CFTC Jan. 31, 1984) (respondents allocated winning day trades to their account and losing day trades to customers' accounts); *In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,206 (CFTC Aug. 11, 1992), *aff'd sub nom. Monieson v. CFTC*, 996 F.2d 852 (7<sup>th</sup> Cir. 1993) (respondents allocated winning trades to respondents' accounts and losing trades to customer's account). Allocation schemes such as that in which Maddox engaged violate Section 4b(a) because allocating winning trades to one account and losing trades to another account deprives the other customer of a fair opportunity to obtain profitable trades. *See In re Nikkhah*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129 at 49,879 (CFTC May 12, 2000).

Maddox also deceived OEMT by failing to disclose to it the material facts that he entered orders and later allocated the resulting trades on the basis of whether they were profitable or not. A broker's failure to inform a customer that he allocated trades at his discretion after receiving the fills on the orders is a material omission in violation of section 4b of the Act. *Parciasepe v. Shearson, Hayden, Stone Inc.* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,464 at 30,068 (CFTC Jan. 2, 1985).

A violation of Section 4b requires that the wrongdoer act with scienter. *See Drexel Burnham Lambert, Inc. v. CFTC*, 850 F.2d 742, 748 (D.C. Cir. 1988). Scienter "refers to a mental state embracing an intent to deceive, manipulate, or defraud." *CFTC v. Rosenberg*, 85 F.Supp.2d 424, 448 (D.N.J. 2000). The Commission "need not show that defendants acted with an evil motive or an intent to injure[;] rather, recklessness is sufficient to satisfy the scienter requirement." *Id.* (internal quotations omitted); *accord, CFTC v. Savage*, 611 F.2d 270, 283 (9<sup>th</sup> Cir. 1979); *In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,080 at 41,579 (CFTC May 12, 1994), *aff'd sub nom. JCC, Inc. v. CFTC*, 63 F.3d 1557 (11<sup>th</sup> Cir. 1995). Specifically, the Commission

can establish scienter by showing that defendant made an extreme departure from the standards of ordinary care. *CFTC v. R.J. Fitzgerald & Co., Inc.*, 310 F.3d 1321, 1328 (11<sup>th</sup> Cir. 2002).

As discussed above, by allocating winning trades for his own benefit and losing trades to the detriment of OEMT, Maddox knowingly acted in a fraudulent manner.

#### IV.

#### OFFER OF SETTLEMENT

Respondent has submitted an Offer in which, without admitting or denying the findings herein, he acknowledges service of the Order and admits jurisdiction of the Commission with respect to the matters set forth in the Order. In the Offer, Respondent waives (1) service and filing of a complaint and notice of hearing; (2) a hearing; (3) all post-hearing procedures; (4) judicial review by any court; (5) any objection to the staff's participation in the Commission's consideration of the Offer; (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; and (7) all claims which he may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2000) and 28 U.S.C. § 2412 (2000), and Part 148 of the Commission Regulations, 17 C.F.R. §§ 148.1, et seq. (2004), relating to, or arising from, this action.

Respondent stipulates that the record basis on which this Order is entered consists solely of the findings in this Order, the entry of which he has consented to in the Offer. Pursuant to the Offer, Respondent consents to the Commission's issuance of this Order, which makes findings, as set forth herein, and orders that Maddox shall: (1) cease and desist from violating the provisions of the Act that he has been found to have violated; (2) for a period of one year, be prohibited from trading for his own account, or any account in which he has a direct and substantial interest on any registered entity, as that term is defined in Section 1a(29) of the Act, 7 U.S.C. § 1a(29), and all registered entities shall refuse Maddox trading privileges for that period; (3) pay a civil monetary penalty of Twenty-Five Thousand dollars (\$25,000); (4) make restitution in the amount of Thirty-One Thousand dollars (\$31,000) to OEMT; and (5) comply with his undertakings as set forth in the Offer and incorporated in this Order, including but not limited to agreeing: (a) for a period of three years commencing on the date of this Order, not to apply for registration or claim exemption from registration with the Commission in any capacity; not to engage in any activity requiring registration or exemption from registration, except as provided for in Regulation 4.14(a)(9) of the Commission Regulations, ("Regulation") 17 C.F.R. § 4.14(a)(9); not to act as principal, partner, agent, officer, or branch office manager of any person or entity registered, required to be registered, or exempted from registration with the Commission, unless such exemption is pursuant to Section 4.14(a)(9) of the Regulation, 17 C.F.R. § 4.14(a)(9); not to act, directly or indirectly, in any supervisory capacity over anyone registered or required to be registered with the Commission; and (b) not 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**

Based on the foregoing, the Commission finds that from May 2003 through January 2004, Maddox violated Sections 4b(a)(2)(i) and (iii) of the Act, 7 U.S.C. §§ 6b(a)(2)(i) and (iii).

VI.

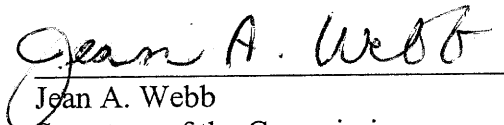
**Accordingly, IT IS HEREBY ORDERED THAT:**

1. Maddox shall cease and desist from violating Sections 4b(a)(2)(i) and (iii) of the Act, 7 U.S.C. § 6b(a)(2)(i) and (iii).
2. Maddox shall be prohibited for one year from trading for his own account, or for any account in which he has a direct or indirect interest, on any registered entity, as that term is defined in Section 1a(29) of the Act, 7 U.S.C. § 1a(29), and all registered entities shall refuse Maddox trading privileges for that period.
3. Maddox shall pay restitution in the amount of Thirty-One Thousand dollars (\$31,000) to the monitor designated herein by the Commission ("the Monitor") within five days of the date of this Order, and the Monitor shall immediately pay such restitution to ONEOK Energy Marketing & Trading Company.
4. Maddox shall pay a civil monetary penalty, after the restitution obligation has been fully satisfied, in the amount of Twenty-Five Thousand dollars (\$25,000) by electronic funds transfer to the account of the Commission at the United States Treasury, 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, Commodity Futures Trading Commission, 1155 21<sup>st</sup> Street, NW, Washington, D.C. 20581, under cover of letter that identifies Maddox and the name and docket number of this proceeding. Maddox shall simultaneously transmit a copy of the cover letter and the form of payment to the Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21<sup>st</sup> Street, NW, Washington, DC 20581.
5. The National Futures Association is hereby designated as Monitor with respect to the restitution payments ordered herein. Notice to the Monitor shall be made to Daniel A. Driscoll, Executive Vice President, or his successor, at the following address: National Futures Association, 200 West Madison Street, Chicago, IL 60606;
6. Maddox shall comply with the following undertakings:

- A. For a period of three years commencing on the date of this Order, never to apply for registration or claim exemption from registration with the Commission in any capacity; never to engage in any activity requiring registration or exemption from registration, except as provided for in Regulation 4.14(a)(9) of the Commission Regulations, 17 C.F.R. § 4.14(a)(9); never to act as principal, partner, agent, officer, or branch office manager of any person or entity registered, required to be registered, or exempted from registration with the Commission, unless such exemption is pursuant to Section 4.14(a)(9) of the Commission Regulations, 17 C.F.R. § 4.14(a)(9); and never to act, directly or indirectly, in any supervisory capacity over anyone registered or required to be registered with the Commission.
- B. Neither Maddox nor any of his agents shall take any action or make any public statement denying, directly or indirectly, any finding or conclusion in the Order, or creating or tending to create, the impression that the Order is without factual basis; provided, however, that nothing in this undertaking affects Maddox': (a) testimonial obligations; or (b) right to take legal positions in other proceedings to which the Commission is not a party. Maddox will take all steps necessary to assure that all of his agents under his authority or control understand and comply with this agreement.

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

By the Commission.

  
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Jean A. Webb  
Secretary of the Commission  
Commodity Futures Trading Commission

Dated: June 9, 2005