UNITED STATES OF AMERICA
BEFORE THE
COMMODITY FUTURES TRADING COMMISSION

In the Matter of:	)	CFTC Docket No. 06-01
Veras Investment Partners, LLC James R. McBride, and Kevin D. Larson,	)	ORDER INSTITUTING PROCEEDINGS PURSUANT TO SECTIONS 6(c) AND 6(d) OF THE COMMODITY EXCHANGE ACT, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS
Respondents.	)	

I.

The U.S. Commodity Futures Trading Commission ("Commission") has reason to believe that Veras Investment Partners, LLC ("Veras"), James R. McBride ("McBride"), and Kevin D. Larson ("Larson") (collectively "Respondents") violated Section 4o(1)(B) of the Commodity Exchange Act, as amended ("Act"), 7 U.S.C. §6o(1)(B) (2002). Therefore, the Commission deems it appropriate and in the public interest that public administrative proceedings be, and they hereby are, instituted to determine whether Respondents engaged in the violations set forth herein, and to determine whether an order should be issued imposing remedial sanctions.

II.

In anticipation of the institution of an administrative proceeding, Respondents each submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Without admitting or denying the findings of fact in this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions ("Order"), and prior to any adjudication on the merits, Respondents acknowledge service of this Order. Respondents consent to the use of the findings in this Order in this proceeding and in any other proceeding brought by the Commission, or to which the Commission is a party.[1]

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[1] Respondents do not consent to the use of the Offer, this Order, or the findings consented to in the Offer or this Order, as the sole basis for any proceeding brought by the Commission, other than a proceeding in bankruptcy or to enforce the terms of the Order. Nor do Respondents consent to the use of the Offer or this Order or the findings consented to in the Offer or this Order by any other party in any other proceeding. Respondents further do not consent to the use by the Commission, individually or collectively, of any order or findings in any such order by the United States Securities and Exchange Commission and/or the New York Attorney General's Office which name Respondents and relate to the findings of this Order, or the Texas State Securities Board Order, dated February 24, 2004, In the Matter of the Investment Adviser Registration of Veras Investment Partners, LLC and the Investment Adviser Representative Registrations of James R. McBride and Kevin D. Larson, Order No. IC04-Rev-03, as the sole basis, or the combined basis in conjunction with the instant order, for any other proceeding brought by the Commission.

III.

The Commission finds the following:

A. SUMMARY

Veras, registered with the Commission as a commodity trading advisor ("CTA") and a commodity pool operator ("CPO"), and its principals, Larson and McBride, both registered as associated persons ("APs"), operated two primary commodity pools as hedge funds,[2] that invested in securities and traded commodity futures contracts. Veras used market timing in certain mutual fund families as its primary trading strategy, while trading commodity futures contracts to hedge its overall securities portfolio. Larson and McBride controlled the operations of Veras.

Respondents used deceptive techniques to continue market timing in mutual funds that previously had detected and restricted, or that otherwise would not have permitted, Veras's trading. During the relevant time, Respondents also traded mutual fund shares after 4:00 p.m. EST and received the same day's price. These practices violated federal securities laws.[3]

Between August 2002, when Veras registered with the Commission, and September 2003, Respondents used futures trading to hedge Veras's portfolio. Respondents did not disclose to all commodity pool participants the deceptive and illegal practices Veras used to execute its strategies. The failure to disclose such activities operated as a fraud or deceit upon the commodity pool participants.

B. RESPONDENTS

Veras Investment Partners, LLC, a Texas limited liability company, has its primary place of business in Sugar Land, Texas. Veras is the general partner of multiple limited partnerships which, in turn, have several "feeder fund" limited partnerships of which the Veras commodity pool participants are limited partners. Veras has been registered with the Commission as a CTA and CPO since August 2002.

James R. McBride, an individual, resides in Sugar Land, Texas, and is an owner and managing member of Veras. McBride has been registered with the Commission as an AP of Veras since August 2002.

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[2] Veras operated or advised many commodity pools. At issue here are the Veras Capital Master Fund and VEY Partners Master Fund.

[3] This same day, the Securities and Exchange Commission (SEC) issued an order instituting and settling an administrative proceeding against Veras, Larson and McBride as well as against the two pools, Veras Capital Master Fund and VEY Partners Master Fund. The SEC order finds that Respondents' market timing practices and their late trading violated, aided and abetted, and/or caused violations of federal securities laws. In the SEC order, Respondents neither admitted nor denied those findings.

Kevin D. Larson, an individual, resides in Sugar Land, Texas and is an owner and managing member of Veras. Larson has been registered with the Commission as an AP of Veras since August 2002.

IV.

FACTS

The Operations of Veras

Veras was organized and operated through various limited partnerships that included two primary commodity pools: the Veras Capital Master Fund and the VEY Partners Master Fund (collectively, the "Veras pools"). Larson and McBride controlled the operations of Veras and created Veras primarily to market time the securities of SEC-registered investment companies ("mutual funds"). At its peak, Veras had more than $1 billion in assets under management. Beginning in approximately August 2002, Respondents used futures markets as a means of hedging the Veras portfolio to manage risk, which continued until September 2003, at which time Veras ceased trading.[4] For its services, Veras was credited with management and performance fees that were paid or allocated to Larson and McBride based on their ownership interests in Veras.

In the Veras disclosure documents, Respondents disclosed that the Veras pools intended "to exploit mispricings in mutual fund portfolios across a variety of asset classes," and that mispricings are identified through extensive modeling including holdings-based analysis, measurement of stale pricings and momentum/volatility measurement." However, Respondents failed to disclose to all investors that they would do so by engaging in deceptive trading practices.

Market Timing

Market timing includes the frequent buying and selling of shares in the same mutual fund in order to exploit stale prices in mutual fund share pricing. Market timing, while not illegal *per se*, can harm other mutual fund shareholders because it can dilute the value of their shares, or disrupt the management of the mutual fund's investment portfolio and can cause the targeted mutual fund to incur costs to accommodate frequent buying and selling of shares by the market timer.

From its inception, Respondents intended to engage in the market timing of mutual funds to take advantage of stale prices. In pursuit of its investment strategy, Veras executed a high volume of trades in mutual funds. Many of the mutual funds in which Veras traded prohibited market timing or limited significantly the frequency of trading in order to prevent market timing.

Complaints by numerous mutual funds about Veras's market timing practices began to mount, resulting in the exclusion of Veras from trading. To circumvent efforts

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[4] Respondents disclosed that Veras might invest in commodity futures in order to "hedge broad market risk from the portfolio. . . ." and "minimize the risk to the portfolio from event-related shocks to the equity market." Veras Capital Partners (QP), LP Private Placement Memorandum, pp. 1, 3 [Executive Summary] October 1, 2002 (effective date).

to exclude Veras from trading, Respondents engaged in deceptive acts that enabled their continued market timing in mutual funds. For instance, Respondents created new legal entities as subsidiaries of Veras that did not have "Veras" in their name. During the relevant period, Respondents created eight such entities. Further, Respondents opened trading accounts for the new entities at multiple brokers. By trading through the new accounts, and by dividing the trades into smaller dollar amounts, Respondents attempted to avoid detection by the mutual funds. Respondents did not disclose to all pool participants that they would engage in deceptive actions to avoid market timing restrictions.

Late Trading

Respondents also engaged in "late trading," conduct that violates the federal securities laws. Late trading refers to the execution of trades in a mutual fund's shares after the time as of which the mutual fund has calculated its current net asset value. Late trading allows trades to receive the same day's net asset value per share, rather than the next day's net asset value per share. Most mutual funds calculate their daily net asset value as of the close of the major United States securities exchanges and markets (normally 4:00 p.m. EST). Late trading thus allows the trader to use information from market events that occur after 4:00 p.m. EST, but that are not reflected in that day's price.

Respondents established late trading arrangements with various broker dealers and two mutual fund companies. Through these arrangements, Respondents regularly placed orders to buy and sell mutual fund shares after 4:00 p.m. EST, and still received that day's net asset value per share. At times, Respondents late traded based on information obtained after 4:00 p.m. EST, including information gleaned from the futures markets. In fact, one of the Veras pools' proprietary trading models incorporated information obtained from the futures market between 4:00 p.m. EST and 4:15 p.m. EST to generate a signal to buy or sell.

Respondents did not disclose that they were being allowed to late trade mutual fund shares in violation of federal securities laws and obtaining a trading advantage not available to all other mutual fund investors.

LEGAL DISCUSSION

Respondents' failure to disclose to all commodity pool participants that Veras would engage in such violative market timing and late trading practices operated as a fraud or deceit upon pool participants in violation of Section 4o(1)(B) of the CEA, 7 U.S.C. § 6o(1)(B). That provision makes it unlawful for any CPO or CTA, or their APs, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly:

> to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

Section 4o(1)(B) does not require willful or knowing conduct as a prerequisite to establishing liability. *In re Kolter,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,262 at 42,198 (CFTC Nov. 8, 1994), *citing Messer v. E.F. Hutton & Co.*, 847

F. 2d 673, 678-9 (11th Cir. 1988); *see also CFTC v. Savage*, 611 F.2d 270, 285 (9th Cir. 1979) (it is not necessary for the CTA or CPO to intend to defraud to establish liability for fraud under Section 4o(1)(B)). Pursuant to Section 4o(1)(B), a defendant is liable if his actions "operate as a fraud," even if that was not the intent. *In re Slusser,* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,701 at 48,311, 48,315 (CFTC July 9, 1999), *aff'd and remanded on other grounds sub nom. Slusser v. CFTC*, 210 F.3d 783 (7 th Cir. 2000).

As a CPO and CTA, Veras acted as a fiduciary to its commodity pool participants. *See Weinberg v. NFA,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,087 at 32,219 (CFTC June 6, 1986) (CTA and CPO "held fiduciary relationships in soliciting and advising commodity clients and in handling the money of commodity pool participants"); *Klatt v. International Trading Group, Ltd.*, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,636 at 22,598 (CFTC June 21, 1978) ("[t]he fiduciary nature of the relationship between a commodity trading advisor and his customer is beyond question"); *see also Savage*, 611 F.2d at 285 (section 4o(1) "implements the fiduciary capacity that characterizes the [commodity trading] advisor's relationship to his clients").

Fiduciaries, such as Respondents, are held to "a higher standard of care" under the Act. *First National Monetary Corp. v. Weinberger*, 819 F.2d 1334, 1342 (6th Cir. 1987), *citing CFTC v. Savage*, 611 F.2d at 285 (finding that Congress intended to hold fiduciaries to a higher standard of care under the Act). *Cf. SEC v. Blavin,* 760 F.2d 706, 711-712 (6th Cir. 1985), *quoting SEC v. Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 194, 84 S.Ct. 275, 284 (1963) (securities investment adviser, as a fiduciary, owes "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' [its] clients").

As a fiduciary, a CPO or CTA has a duty to disclose material facts concerning its investments. *See, e.g., In re Commodities International Corp.,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,943 at 44,566 (CFTC January 14, 1997) (registered CPO and CTA owed clients "a duty of complete and accurate disclosure"); *In re Armstrong,* [1994-1996 Transfer Binder] Comm. Fut. Rep. (CCH) 26,332 (CFTC March 13, 1995) (CTA had a duty to disclose material facts to clients, such as the existence of a commission-sharing arrangement); *In re Stotler and Co.,* [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,298 at 32,814 (CFTC September 30, 1986), *aff'd sub nom. Stotler and Co. v. CFTC*, 855 F.2d 1288 (7th Cir. 1988) (CTA's failure to disclose commission-sharing arrangements is fraud). As the Commission stated in *Klatt v. International Trading Group*, ¶ 20,636 at 22,598:

> It is a well-settled principle of securities law that it is the duty of a person who holds a fiduciary relationship to another person to make full disclosure of all material facts regarding the transaction between the parties. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). In the Commission's view, this

> proposition is no less applicable to the commodities field. Indeed, given the volatility and intricacy of the commodity market mechanisms, such a rule is an absolute necessity.

A misrepresented or omitted fact is material "if it is substantially likely that a reasonable investor would attach significance to the fact in making an investment decision." *Sudol v. Shearson Loeb Rhoades, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,748 at 31,119 (CFTC September 30, 1985). *Accord, R&W Technical Services v. CFTC*, 205 F.3d at 169. Materiality is an objective determination that "turns on whether a reasonable investor would regard the fact as significantly changing the total data available to him or her." *In re Citadel Trading Co. of Chicago, Ltd.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,082 at 32,187-88 (CFTC May 23, 1986).

A CTA or CPO has a duty to disclose how client or commodity pool assets are going to be used. In deciding to invest in a commodity pool, it is substantially likely that a reasonable investor would consider it important that the pool operator or advisor is engaging in illegal or improper trading practices, and the failure to disclose that fact is material. *See Roeder v. Alpha Industries Inc.*, 814 F.2d 22, 25 (1st Cir. 1987) ("we conclude that reasonable investors might have considered defendants' alleged illegal conduct to be important information they would want to have before they made their investment decision;" "investors may prefer to steer away from an enterprise that . . . opens itself to accusations of misconduct").

Here, Respondents were able to continue their primary strategy of market timing only by engaging in deceptive actions to ensure that Veras could execute that strategy with mutual funds that had overtly restricted, or did not otherwise permit, Veras's trading. It is substantially likely that a reasonable investor would attach significance to this fact in deciding whether to invest, or to redeem an investment, in the Veras pools. Accordingly, Respondents' employment of such practices was a material fact that they were required to disclose to their commodity pool participants.

Likewise, Respondents engaged in late trading, conduct which violates the federal securities laws. In some instances, Respondents based their trading decisions on information learned after 4:00 p.m. EST, including futures market information. Respondents' intended use of investor assets constitutes material information that must be disclosed to investors. *See In re Slusser,* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,701 (CFTC July 19, 1999), *aff'd as to liability, rev'd and remanded in part as to sanctions sub nom. Slusser v. CFTC,* 210 F.3d 783 (7th Cir. 2000) (CPO's undisclosed securities trading constituted fraud in violation of CEA Section 4o(1)); *In re Kolter,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,262 (CFTC November 9, 1994) (CPO's failure to disclose how commodity pool assets were being used violated CEA Section 4o(1)). Particularly where the intended use violates federal securities laws, an investor may reasonably have declined to invest, or redeemed an investment, with Veras if provided with full disclosure.

By failing to disclose the illegal and deceptive trading practices discussed herein to all its commodity pool participants, Veras, as a fiduciary CPO and CTA, and Larson and McBride, as fiduciary APs of Veras, engaged in transactions, practices and a course of business that operated as a fraud and deceit upon the participants in the various commodity pools operated by Veras, in violation of Section 4o(1)(B) of the Act, 7 U.S.C. § 6o(1)(B) (2002).

VI.

OFFERS OF SETTLEMENT

The Respondents submitted Offers of Settlement in which, without admitting or denying the findings herein, and prior to any adjudication on the merits, they acknowledge service of the Order, admit jurisdiction of the Commission with respect to the matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based upon violations or for enforcement of the Order; waive 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 Offer, any claim of double jeopardy based on the institution of this proceeding or the entry of any order imposing a civil monetary penalty or other relief, and all claims which they 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's Regulations, 17 C.F.R. §§ 148.1, *et seq.* (2004), relating to, or arising from, this action.

Respondents stipulate that the record basis upon which this Order is entered consists solely of this Order. Respondents consent to the Commission's issuance of this Order, which makes findings, as set forth herein, including findings that Respondents violated Section 4o(1)(B) of the Act, and orders that Respondents cease and desist from violating the provision of the Act they have been found to have violated, holds them jointly and severally liable for a civil monetary penalty of $500,000.00, revokes their registrations, requires them to comply with the undertakings set forth below, and imposes an eighteen (18) month trading ban against Respondents Larson and McBride.

VII.

FINDING OF VIOLATIONS

Based solely upon the consent of Respondents as to entry of the Order, and prior to any adjudication upon the merits, the Commission finds that Respondents violated Section 4o (1)(B) of the Act, 7 U.S.C. § 6o(1)(B)(2002).

VIII.

ORDER

Based upon the consent of Respondents to the entry of this Order and the findings herein that Respondents violated Section 4o(1)(B), 7 U.S.C. § 6o(1)(B)(2002) of the Act, the Commission deems it appropriate and in the public interest to impose remedial sanctions against Respondents, and accordingly:

A. **IT IS HEREBY ORDERED** that Respondents shall cease and desist from violating Section 4o(1)(B) of the Act, 7 U.S.C. §6o(1)(B) (2002).

B. **IT IS HEREBY ORDERED** that Respondents shall be liable, jointly and severally, for and shall pay a civil monetary penalty of Five Hundred Thousand Dollars ($500,000) within ten business days of the date of the entry of this Order, and make such payment by electronic funds transfer to the account of the Commission at the United States Treasury or by certified check or bank cashier's check made payable to the Commodity Futures Trading Commission and addressed to Dennese Posey, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581, under cover of a letter that identifies the Respondents and the name and docket number of this proceeding. Copies of the cover letter and the form of payment shall be simultaneously transmitted to Gregory Mocek, Director, Division of Enforcement, Commodity Futures Trading Commission, 1155 21st Street, N.W., Washington, D.C. 20581. If payment is not made in accordance with the requirements of this paragraph, Respondents shall be subject to further proceedings pursuant to Section 6(c) and Section 6(e)(2) of the Act, 7 U.S.C. §§ 9 and 9a(e)(2) (2001), for violating a Commission Order; and,

C. **IT IS HEREBY FURTHER ORDERED** that Veras's registration with the Commission as a CPO/CTA is revoked;

D. **IT IS HEREBY FURTHER ORDERED** that Larson's and McBride's registrations with the Commission as APs are revoked, and that Larson and McBride are prohibited for a period of eighteen (18) months following the date of this Order from trading for others on or subject to the rules of any registered entity and all registered entities shall refuse Larson and McBride all privileges thereon, provided, however, that Larson and McBride may continue to trade on or subject to the rules of any registered entity for and on behalf of an existing limited partnership ("LP") in which each is an investing partner and the only other investing partners are a third individual and the three partners' respective family limited partnerships and children's trusts, and Larson and McBride may continue to serve with the third individual partner as the only members of the general partner of the LP.

E. **IT IS HEREBY FURTHER ORDERED** that Respondents shall comply with the following undertakings, subject to the terms set forth in paragraph D above:

1. Respondents Larson and McBride agree not to apply for registration, or claim exemption from registration with the Commission in any capacity, for a period of eighteen (18) months from the date of this Order, except as provided for in Regulation 4.14(a)(9), 17 C.F.R. § 4.14(a)(9) (2004), and, subject to VIII-D above, shall refrain from engaging in any activity requiring such registration or exemption from registration, or act as a principal, agent or officer of any person registered or exempted from registration, for a period of eighteen months from the date of this Order, except as provided for in Regulation 4.14 (a)(9), 17 C.F.R. § 4.14(a)(9) (2004); and,

2. Respondents agree that neither they, nor any of their agents or employees acting under their authority or control shall take any action or make any public statement denying, directly or indirectly, any findings in the Order or creating, or tending to create, the impression that the Order is without a factual basis; provided, however, that nothing in this provision affects Respondents' (i) testimonial obligations; or (ii) right to take legal or factual positions in other proceedings to which the Commission is not a party.

The provisions of this Order shall be effective on this date. A copy of this Order shall be served on all contract markets, and on the National Futures Association.

By the Commission:

Jean A. Webb
Secretary to the Commodity
Futures Trading Commission

Date: December 22, 2005