UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of SHAHROKH NIKKHAH	CFTC Docket No. 95-13 OPINION AND ORDER

The Division of Enforcement ("Division") appeals an Administrative Law Judge's ("ALJ") decision declining to impose a civil money penalty on respondent Shahrokh Nikkhah ("Nikkhah"). The ALJ based his decision on the Division's failure to produce reliable evidence of Nikkhah's positive net worth. *In re Nikkhah,* [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,647 (September 18, 2001) ("I.D."). The Division emphasizes that the record on net worth is limited due to its inability to obtain full discovery from Nikkhah. It contends that when appropriate adverse inferences are drawn, there is sufficient evidence to show that a $200,000 civil monetary penalty is appropriate in the context of Nikkhah's net worth. Nikkhah argues that the record actually shows that his net worth is negative.

For the reasons explained below, we vacate the ALJ's decision and remand for further proceedings consistent with this Opinion and Order.

BACKGROUND

I.

A brief review of our role in this proceeding provides a useful context for understanding the parties' current dispute. In May 2000, we affirmed the ALJ's conclusion that Nikkhah fraudulently allocated his discretionary account customers' trades and thus violated Section 4b of the Commodity Exchange Act ("Act") and Rule 33.10.[1] We concluded that a cease and desist order and ten-year trading prohibition were appropriate sanctions. We also held that a $200,000 civil monetary penalty was appropriate to the gravity of Nikkhah's wrongdoing. *In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129 (CFTC May 12, 2000) ("*Nikkhah I*").

Since the version of the Act applicable to this proceeding requires that we consider whether a civil monetary penalty is appropriate in the context of Nikkhah's net worth,[2] we gave Nikkhah an opportunity to comment on this issue. Nikkhah replied that no civil monetary penalty was appropriate because his net worth was negative. In support, he submitted an affidavit and a financial statement listing his purported assets and liabilities as of June 2000 (the "June 2000 Financial Statement").

Our second decision explained why a remand for additional proceedings was necessary. *In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,275 at 50,674-78 (CFTC Sept. 26, 2000) ("*Nikkhah II*"). For the first time, we made it clear that the Division has both the burden of production and the burden of proof on issues relating to a respondent's net worth or ability to continue in business.[3] Second, we emphasized that the Division has a right to

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[1] We also affirmed his conclusions involving deceptive conduct, unauthorized trading, noncompetitive transfer of positions, and recordkeeping violations.

[2] Most of Nikkhah's conduct took place before October 28, 1992, the effective date of the Futures Trading Practices Act of 1992, P.L. 102-546, 106 Stat. 3590 ("FTPA"). The FTPA changed both the factors that we must consider in deciding the appropriateness of a civil money penalty and the formula for determining the maximum amount that may be imposed.

[3] Former Section 6(d) sometimes requires consideration of a respondent's ability to continue in the commodities business in imposing a civil money penalty. In its recent decision holding that the Division has both the burden of production and the burden of proof on issues relating to this mandatory factor, the United States Court of Appeals for the Seventh Circuit referred to it as the "'collectibility' condition." *Slusser v. CFTC*, 210 F.3d 783, 786 (7th Cir. 2000). As discussed below, this factor does not play a role in this case.

discover information relevant to net worth-related issues[4] and that negative inferences could be drawn if a respondent fails to cooperate in the process. Third, we specified a procedure for a respondent to protect the privacy of net worth information.[5]

II.

The proceeding on remand was a struggle to define the scope of the Division's right to obtain discovery on net worth issues. Nikkhah tried to limit discovery to information about the assets and liabilities that he disclosed in his June 2000 Financial Statement. For example, Nikkhah opposed the Division's attempt to subpoena documents relating to his family's finances, arguing that it was a "fishing expedition" violating their right to privacy and emphasizing that there was no allegation that Nikkhah transferred assets to his wife.[6] November 30, 2000 Opposition to Subpoena at 1. When Nikkhah appeared for a deposition, his counsel objected to, and Nikkhah refused to answer "any questions relating to [his] family or any aspects of anything that relates to [his] family."[7] January 4, 2001 Transcript at 104.

From the outset, the Division sought to discover any information that might help it prove either that Nikkhah had not disclosed all his assets or that he had claimed more liabilities than

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[4] We held that the ALJ must give the Division reasonable time to seek discovery, to subpoena witnesses, and to retain experts to review, analyze, and testify about the information obtained.

[5] We indicated that a respondent could stipulate to the Act's mandatory net worth findings and that the civil money penalty found appropriate to the gravity of the violations was also appropriate to net worth. *Id.* at 50,677-78.

[6] Counsel raised similar arguments in a December 21, 2000 motion to quash a Division subpoena.

[7] Nikkhah produced some documents in response to a Division subpoena including: (1) a financial statement concerning his 1995 property sale in New York; (2) 1997-1999 U.S. and 1998-1999 United Kingdom ("U.K.") income tax forms; (3) his New York Citibank account statements; and (4) documents regarding debts allegedly owed to his father, Lloyds TSB Bank, and Loreton Associated Corporation ("Loreton").

truly existed.[8] As explained in its prehearing memorandum, the Division sought information regarding the assets available to Nikkhah and expenditures made by him during the previous five years. Additionally, the Division sought to demonstrate that the largest liabilities that Nikkhah claimed were fictitious. Under the Division's theory, Nikkhah's assets over the five-year period minus his expenditures for legitimate debts and reasonable living expenses would reveal his net worth.

Nikkhah's location outside the United States presented a major obstacle. Because he lived in the U.K. during the period that the Division was investigating, much of the information that it needed was overseas.[9] Since the ALJ's scheduling orders did not contemplate the possibly lengthy period that would be necessary to undertake formal discovery abroad, the Division sought Nikkhah's counsel's assistance in obtaining information from persons located outside the United States. While the Division obtained some information this way, counsel's cooperation was, at best, spotty and grudging.[10]

Shortly after our September 2000 remand, the ALJ set a hearing date and required the parties to file prehearing memoranda by November 20, 2000.[11] Prior to the hearing, Nikkhah

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[8] In opposing Nikkhah's motion to quash a portion of one of its subpoenas, the Division noted that Nikkhah's wife was unemployed and that his children were minors. In these circumstances, it contended, it had a right to investigate whether Nikkhah was the beneficial owner of assets held in their names. December 26, 2000 Opposition at 2.

[9] The Division subpoenaed documents from some domestic banks and credit card services and a domestic affiliate of eNote Europe.com Ltd. ("eNote Europe"), a U.K. firm that employed Nikkhah. It also subpoenaed a friend of Nikkhah's who lived in New York.

[10] The record reflects a variety of disputes about alleged unfulfilled promises to cooperate. At one point, Division counsel argued that Nikkhah's counsel had "obstructed and delayed" the Division's efforts to obtain information. March 7, 2001 Petition for Order Reinstituting Discovery at 8. Nikkhah's counsel responded by moving that the Division be held in contempt for continuing to seek discovery after the ALJ issued an order terminating it.

[11] The hearing was originally set for January 8, 2001, but was rescheduled for March 12, then May 15, and finally, for May 22, 2001.

appeared for a deposition and provided some documents.[12] In response to the Division's request to compel Nikkhah to respond to certain inquiries, the ALJ ordered him to produce only a limited number of documents, otherwise quashed all outstanding subpoenas, and terminated discovery. February 27, 2001 Order at 1. The ALJ did not provide a rationale, noting only that, on February 22 he had conducted a telephone conference on discovery issues.[13] The ALJ also summarily denied the Division's motion for reconsideration of this order stating that, at the conclusion of the hearing, "either party may request that certain inferences be made." March 16, 2001 Notice and Order. On April 13, 2001, the ALJ issued an order reiterating that further discovery was not

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[12] At the deposition, Nikkhah testified that he worked for Daiwa Securities from 1993 to 1995. Deposition Transcript ("Dep. Tr.") at 52. In 1995, Nikkhah moved to London and sold his U.S. home for $650,000. Dep. Tr. at 55. After working briefly for another company, Nikkhah formed Charles Street Capital Limited ("Charles Street") a fund management company. Dep. Tr. at 37, 54. At the time of the deposition, Charles Street's only asset was a master lease on a downtown London business building that it subleased to tenants for a yearly net profit of £35,000. Dep. Tr. 48-52. Nikkhah's compensation from Charles Street was £120,000 a year plus a $9,000 annual premium on a $2.5 million life insurance policy held by the Nikkhah Family Trust. Dep. Tr. at 29, 74-75. Nikkhah owned a 1993 Mercedes station wagon that he purchased used for £17,000; his furniture was worth between £10,000 and £15,000. Dep. Tr. at 61, 63. He purchased his wife's ring in 1988 for $6,000, earrings in 1989 for $3,000, and his watch in 1981 for £1,200. Dep. Tr. at 68. He also owned some antiques valued at more than $1,000 each. Dep. Tr. at 69. The balance in his Citibank account in New York was $4,000. Dep. Tr. at 78.

According to Nikkhah, he was constantly in debt. Nikkhah's wife was not employed and had no source of income. Dep. Tr. at 58. Nikkhah received no compensation in 1999 and most of his 1998 salary was used to repay a 1997 £90,000 to £95,000 loan from Charles Street. Dep. Tr. at 30, 32. He deposited the remainder of his salary into his wife's account at Natwest and used his overdraft privileges at Lloyds Bank for living expenses. Dep. Tr. at 32-35. He claimed that he had no bank account in the U.K., and therefore, in 2000, he deposited all of his £5000 monthly salary checks from his employer, eNote Europe, into his wife's account. Dep. Tr. at 23-25. Nikkhah testified that his wife usually paid the monthly bills, including £3,600 rent on their three-bedroom London apartment, £200 for telephone service, £25 for television service, £100 for electricity, £100 for membership in a private tennis club, fees for his children's tennis and music lessons, as well as the grocery, laundry, and dry cleaning bills. Dep. Tr. at 57-58, 83-88, 90, 92. She also paid the annual £10,000 school fees for each of his three daughters and Nikkhah's £600 automobile insurance premium. Dep. Tr. at 86-88. Nikkhah claimed that, in 2000, he used frequent flyer miles to take his family on a "very reasonable" six-day vacation to Dubai—costing only $400 per day for the entire family. Dep. Tr. at 98.

The deposition terminated prematurely when Nikkhah refused to answer any more questions. Dep. Tr. 105-108.

[13] The record does not include any contemporaneous record of the discussion at this conference.

appropriate.[14] He emphasized that discovery was originally scheduled to be concluded in December 2000, and that "[c]are must be taken to ensure that the process does not become the punishment." He reiterated that either party could seek adverse inferences at the close of the hearing. April 13, 2001 Order at 1.

III.

The ALJ conducted the hearing on May 22 and 23, 2001 in Chicago, Illinois. The Division called four witnesses, but primarily relied on documentary evidence relating to funds available to Nikkhah between 1996 and 2000.[15]

Consistent with the theory in its prehearing memorandum, the Division attempted to establish the total funds available to Nikkhah between 1995 and 2000. It presented Nikkhah's U.S. and U.K. tax documents showing that he earned about $1.1 million in gross income between 1996 and 1999 and received expense payments of about $158,000 in 1998 and 1999. Under questioning, Nikkhah agreed that, between March and October 2000, he received about $80,000 in salary from eNote International and $96,000 in salary from eNote Europe. (Tr. at 22-23.) The Division also showed that Nikkhah's Citibank account received about $405,000 in wire transfers between 1997 and 2000 from entities other than his employers.

[14] At this point, the Division was seeking an order requiring Nikkhah to: (1) complete his deposition; (2) produce further documentation of his debts; and (3) produce documentation regarding accounts maintained by Nikkhah's wife and children. It also requested an opportunity to seek discovery regarding Nikkhah's relationship with several foreign-based firms.

[15] According to the documentary evidence and testimony, Nikkhah represented various firms, including Charles Street, Rodine Invest Corporation, Sienna Investment Limited, and eNote International.com Limited ("eNote International"), among others. John Varsames, who dealt with Nikkhah on behalf of eNote.com ("eNote"), testified that a firm that Nikkhah represented received $500,000 as part of a business deal with eNote.

The Division then presented evidence regarding Nikkhah's expenses between 1996 and 2000. It showed that Nikkhah paid almost $400,000 in taxes during this period.[16] Using Nikkhah's deposition testimony, the Division set forth what it called his "routine living expenses." (Tr. at 32.) Nikkhah testified that his monthly rent had increased to about £5,200 per month. (Tr. at 33.) After the ALJ questioned the value of further testimony regarding Nikkhah's expenses, Division counsel simply represented that its calculation showed that Nikkhah's routine living expenses between 1996 and 2000 were about $385,000[17] and that, during the period 1996 to 2000, Nikkhah received about $1 million more than he spent on taxes and routine living expenses. (Tr. at 38-40). The ALJ also questioned the value of testimony about Nikkhah's lifestyle. (Tr. at 62.) The Division responded by making an offer of proof that Nikkhah spent $95,000 a year on his children's tuition and household rent. (Tr. at 62.) According to the Division, the records of Nikkhah's American Express account showed that, during a three-year period, Nikkhah spent $75,000 on travel, $40,000 on restaurants, and $47,000 on hotels, and that his overall charges totaled $425,000 in the previous four-year period. (Tr. at 63-65.)

In response to a series of questions about the accuracy of the June 2000 Financial Statement, Nikkhah acknowledged that there were some mistakes, but claimed that it was substantially accurate. (Tr. at 42-61.) The Division asked Nikkhah several questions about the liabilities disclosed in the June 2000 Financial Statement. For the most part, these questions

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[16] The Division requested Nikkhah's tax returns for 1997-99. It did not request his 1996 return and his 2000 return was not due or available at the time of the request.

[17] The Division indicated that its calculation was based on Nikkhah's deposition testimony and an analysis of his American Express statements. Nikkhah's deposition indicates that the Division questioned him about his current expenses, but did not specifically question him about expenses between 1996 and 2000. Noting that Nikkhah had moved during this period, the Division asked him about both his current and prior rent.

focused on the limited documentation that Nikkhah produced to prove these liabilities. (Tr. at 67-76.)

In his own behalf, Nikkhah testified that: (1) he owed about $2 million to Loreton;[18] (2) he owed about $63,000 to Lloyd's Bank; (3) his father was suing him to recover in excess of $200,000; and (4) the Division's estimate of his expenses between 1996 and 2000 was inaccurate.[19]

During cross-examination, Nikkhah acknowledged that he had recently transferred money from Charles Street to pay for personal expenses such as rent. (Tr. at 187-88.) When the Division attempted to pin down Nikkhah on when his financial difficulties began, the ALJ interrupted the questioning. (Tr. at 192.) The Division then tried to impeach Nikkhah's testimony with a London Times newspaper article for which his fourteen-year-old daughter was interviewed, but the ALJ sustained an objection.[20] (Tr. at 194.) Finally, the ALJ admitted most of Nikkhah's exhibits over the Division's objections.

IV.

The parties' posthearing briefs reiterated points raised earlier in the proceeding. The Division alleged that there was a $1 million gap between the funds available to Nikkhah between 1996 and 2000 and the amount he paid in taxes and for what the Division regarded as reasonable

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[18] In essence, Nikkhah claimed that Loreton had supplied about $4.5 million to fund a joint venture in Charles Street with the understanding that it would receive the first $2.25 million in profits, characterizing this as a "loan" of his capital contribution. (Tr. at 141.) Nikkhah testified about an exhibit purporting to show that, as of March 31, 2000, Charles Street's liabilities exceeded its assets. (Tr. at 144.) Nikkhah also testified that he had an "arrangement" with Loreton to repay over $2 million. (Tr. at 150.)

[19] In this regard, Nikkhah testified that he paid rent of approximately $385,000 during the period at issue. He claimed that the Division's calculation was faulty because it did not reflect either his average rental payment during the period at issue or changes in the relevant exchange rate. (Tr. at 176.)

[20] At the conclusion of the hearing, the Division made a written offer of proof in which it claimed that questioning Nikkhah about the newspaper article would have elicited further evidence of his affluent lifestyle and a bank account giving his daughter access to parental funds. The Division also claimed that John Varsames would have testified about representations Nikkhah made during their business relationship concerning his success and lavish lifestyle.

living expenses. In calculating the funds available to Nikkhah, the Division relied on testimony and documents concerning Nikkhah's salaries, commissions, retainers, wire transfers and expense reimbursments for the five-year period immediately preceding the hearing. Div. Posthearing Brief at 2 and n.2. The Division had evidence regarding Nikkhah's expenditures for only three years of the same five-year period. Therefore, in calculating outflows, it extrapolated a total for the full five-year period. *Id.* at 3. Also, in calculating Nikkhah's expenditures, the Division included only those items that it deemed necessary for living. It ignored Nikkhah's other expenses. *Id.* at 2-3. The Division asserted that the gap between its calculated income and expenses constituted discretionary income from which Nikkhah could have paid a civil monetary penalty. It noted certain anomalies that it believed supported an inference that Nikkhah was hiding his assets and argued that Nikkhah's extravagant lifestyle raised an inference that he had a positive net worth. In addition, the Division asserted that some of Nikkhah's alleged debts were either not current obligations or were unsubstantiated. Finally, the Division claimed that adverse inferences were appropriate because Nikkhah failed to comply with his discovery obligations.

Nikkhah argued that the Division's evidence did not establish that his current assets exceeded his current liabilities. He also averred that his tax returns were consistent with his claim that he had no current income and that his agreement with Loreton established that he had over $2 million in debts. As for the Division's request for adverse inferences, Nikkhah pointed out that the Division did not subpoena firms that could have supplied information about his wife's accounts.

V.

In his September 2001 decision, the ALJ remarked that the Division had expended "a considerable amount of time and energy" to impose a civil monetary penalty. I.D. at 52,523. As for the sanctions already imposed, the ALJ commented that Nikkhah had "paid a high price for his transgressions." *Id.*

Turning to the Division's request for negative inferences, the ALJ stated that the Commission "does not uniformly make negative inferences against non-compliant respondents," *Id.* (citing *In re Incomco*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) (CFTC ¶ 25,198 at 38,535 (Dec. 30, 1991) in which the Commission reduced the amount of the civil monetary penalty imposed by the ALJ, and *In re Gordon*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,326 (CFTC March 6, 1995), in which the Commission increased the civil monetary penalty imposed by the ALJ).[21] According to the ALJ, these cases suggested that the Commission imposes severe sanctions on "bottom rung registrants" such as Nikkhah, but is more lenient in sanctioning those "on the highest rung," such as the *Incomco* respondent. *Id.* at 52,524.

The ALJ then criticized the Division's approach to meeting its burden of proof on the issue of net worth. He stated that the Division had focused on intervals when Nikkhah had a high income rather than on his net worth at the time of the hearing. *Id.* He also criticized the Division's reliance on the London Times article, stressing that the Division had not attempted to verify the story by interviewing either the reporter or Nikkhah's daughter. *Id.* at 52,524-25. In addition, the judge noted that the Division relied on witnesses with "little credibility" to establish

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[21] We note that in no way do *Incomco* or *Gordon* support the ALJ's conclusion that the Commmission sometimes fails to draw negative inferences from a respondent's refusal to cooperate in building a record to establish net worth. In *Incomco* the respondent waived his right to a net worth hearing. *See Incomco,* ¶ 25,198 at 38,535 n.14. Accordingly, the Commission determined the appropriate penalty based upon the gravity of the respondent's violations, without regard to his net worth. In *Gordon,* the Commission again adjusted the civil monetary penalty based upon its assessment of the gravity of the respondent's violations. With respect to calculating net worth, the Commission found that certain debts allegedly owed by the respondent should not be considered because he failed to substantiate his indebtedness with authenticated documents or testimony. *See Gordon,* ¶ 26,326 at 42,592.

Nikkhah's relationship with eNote. *Id.* at 52,525. Summarizing his overall analysis, the ALJ stated:

> Evidence adduced at the May 2001 hearings suggests that Nikkhah may have had substantial "discretionary income" in the years 1996 through 2000. However, the record fails to show that he had a net worth of $200,000 in May 2001, or that any penalty assessed would be collectible.

Id.

VI.

On appeal, the Division reiterates the points it raised before the ALJ. In addition, it argues that the ALJ erred as a matter of law by declining to impose a civil monetary penalty because there was no reliable evidence that it was collectible. In response, Nikkhah continues to insist that the record reliably establishes that his net worth is negative.

DISCUSSION

I.

Nikkhah II established a new discovery and hearing process for determining net worth. As might be expected, each side took a sharply different approach to the task at hand. The Division recognized that Nikkhah had an obvious incentive to understate his assets and overstate his liabilities. Consequently, it took a broad approach to discovery, seeking information that would help it determine the *bona fides* of Nikkhah's voluntary disclosure.

Nikkhah, however, insisted that his *bona fides* be taken for granted, despite our prior conclusion that his testimony was not credible. *Nikkhah I,* ¶ 28,129 at 49,886, 49,890-91; *Nikkhah II,* ¶ 28,275 at 50,678. He also argued that his family's right to financial privacy outweighed the Division's right to obtain information relevant to his net worth.

The ALJ's approach to resolving the parties' dispute over the scope of discovery was clearly focused on bringing the proceeding on remand to a quick conclusion while minimizing the resources and effort devoted to the process. Although decisional efficiency is an important goal, our precedent recognizes that its pursuit must be modulated such that parties receive a "fair opportunity to be heard." *In re Zuccarelli*, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,637 at 52,432 (CFTC Sept. 7, 2001). The ALJ's preference for a quick resolution upset the required balance. For example, given the likelihood that the Division would have to seek discovery in the U.K., the ALJ's initial prehearing schedule was facially unreasonable. Moreover, the ALJ denied the Division a fair opportunity to prepare for the hearing when he terminated the discovery process simply because it had already been lengthy. Finally, at the hearing, the ALJ's impatience and abrupt rulings clearly interfered with the Division's efforts to develop the record.

Apparently the ALJ regarded *Nikkhah II's* reference to "appropriate adverse inferences" as providing a quick, simple alternative to the tedium of developing the record through the discovery and hearing process. Adverse inferences are appropriately drawn, however, only when respondents "fail to comply with their discovery obligations or to either appear or testify at the [net worth] hearing after receiving a request from the Division." *Nikkhah II,* ¶ 28,275 at 50,678.[22] Where, as here, an ALJ sustains a respondent's objections to discovery requests and respondent appears and testifies at the hearing, we cannot say that the respondent has failed to comply with his obligations.

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[22]Adverse inferences are a tool to ameliorate the harm caused one party due to an opposing party's failure to participate in the process for developing the factual record. *See* Commission Rule 12.312(b)(2) (outlining the two-step process for sanctioning parties to reparations proceedings who fail to appear at an oral hearing), and 12.35 (describing the sanctions that may be imposed when a party to a reparations proceeding fails to comply with a presiding officer's discovery order). The ALJ's determination of whether adverse inferences were appropriate should have focused on whether Nikkhah complied with his discovery obligations and, if not, the nature of the inferences necessary to ameliorate the harm arising from the failure to cooperate. In this context, the Division's claim that adverse inferences should be drawn on appeal is unavailing. Because the ALJ quashed its subpoenas in the face of Nikkhah's objections, there is no basis for imposing a sanction for failing to comply with a discovery order.

II.

Because the Division was not given a fair opportunity to develop the record, a remand for additional proceedings is appropriate. As noted above, we recognize that the type of discovery that the Division has sought and is likely to seek on remand will affect the privacy interests of Nikkhah's family.[23] Court precedent recognizes that the privacy interests of third parties deserve special consideration in the context of agency subpoenas, but holds that such interests may be overcome in appropriate circumstances. *See John Doe v. United States,* 253 F.3d 256, 270-271 (6th Cir. 2001); *FDIC v. Garner,* 126 F.3d 1138, 1144-1145 (9th Cir. 1997).

Nikkhah admits that he provides all financial support for his family and has transferred funds to an account in his wife's name. His insistence that he exercises no control over the funds after they are transferred is facially questionable in light of his failure to observe other financial formalities.[24] Consequently, on remand, the ALJ shall give the Division wide latitude in discovering information concerning assets held in Nikkhah's wife's and children's names.[25]

Finally, we provide some brief guidance about proof of net worth. Our precedent recognizes that net worth is derived by subtracting current liabilities from current assets. *In re Nelson Ghun & Assoc.* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,584 at

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[23] The Division's discovery will also affect Nikkhah's privacy interests. Having placed his net worth at issue, however, Nikkhah has essentially waived his privacy interest in any and all information relevant to his net worth.

[24] The record shows that Nikkhah exercises control over a variety of firms organized abroad and uses firm assets for personal purposes. In these circumstances, the Division has good reason to investigate whether Nikkhah is manipulating formal or apparent elements of his personal relationships to disguise his control over significant assets.

[25] Consistent with the requirements of Commission Rule 10.68, the ALJ may assess the Division's subpoena requests and impose appropriate limitations based on a showing that the request is "unreasonable, oppressive, excessive in scope, or unduly burdensome." For example, Nikkhah's wife should not be burdened with discovery requests unrelated to assets directly or indirectly derived from Nikkhah. The ALJ shall conduct all conferences relating to discovery on the record and provide a specific written explanation for any order that limits discovery. In appropriate circumstances, the Commission will consider interlocutory challenges to the ALJ's discovery rulings so that further waste of resources may be avoided.

30,526 n. 3 (CFTC May 2, 1985). Various methodologies can be used to reliably identify current assets and current liabilities. In this instance, the Division sought to prove Nikkhah's current assets by identifying financial inflows and outflows during the five-year period preceding the net worth hearing. This approach is acceptable, but the Division must ensure that its methodology for proving outflows during the period at issue is comparable to its methodology for proving inflows.[26] Moreover, expenditures cannot be ignored simply because the Division deems them to have been discretionary. And as the ALJ recognized, because the goal of a net worth hearing is to identify assets that are current, earnings are considered only to the extent that funds are available at the time of the hearing.[27]

It is regrettable that we are unable to resolve this case on the basis of the record before us. While the Division must be given sufficient time to develop the record further, we also recognize that bringing this case to a swift conclusion, if possible, would serve the public interest. In this context, we reiterate our observation in *Nikkhah II*:

> We recognize that the time necessary to complete this process [for developing the record on net worth] will delay the final resolution of affected enforcement matters. Consequently, we urge the affected parties to consider the use of stipulations under Commission Rule 10.43 to narrow the scope of issues at the supplemental hearing. Parties may also find that Rule 10.108's settlement

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[26] If the Division wishes to rely on extrapolated figures, it must demonstrate that its methodology and inputs are reliable.

[27] The ALJ erred by tying his refusal to impose a civil money penalty to the lack of evidence that it would be collectible. As noted above, the Seventh Circuit's *Slusser* decision used the term "collectibility" as a short-hand reference to former Section 6(d)'s requirement that we consider whether a proposed civil money penalty is appropriate in the context of a respondent's ability to continue in the commodities business. As we observed in *Nikkhah II*, ¶ 28,275 at 50,675 n.5, however, that requirement is not at issue in this case because Nikkhah's continuation in the commodities business is incompatible with the non-monetary sanctions we have imposed. The Commission has used the term "collectibility" in a broader sense that is unrelated to any of the mandatory factors described in either former Section 6(d) or current Section 6(e). *See Nelson, Ghun & Assocs., Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,255A (CFTC July 5, 1984) ("Nelson, Ghun I"), and ¶ 22,584 (CFTC May 2, 1985) ("Nelson, Ghun II"). In this context, we have specifically indicated that respondents do not have standing to raise a collectibility challenge to the imposition of a civil money penalty. *In re Murlas Commodities*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,440 at 35,931 (CFTC Apr. 24, 1989).

> procedure can be an effective tool for developing a workable consensus on an appropriate civil money penalty.

Nikkhah II, ¶ 28,275 at 50,678.

CONCLUSION

In light of this analysis, we vacate the ALJ's decision and remand for further proceedings consistent with this Opinion and Order.

IT IS SO ORDERED.

By the Commission (Chairman NEWSOME and Commissioners HOLUM, LUKKEN, and BROWN- HRUSKA).

Jean A Webb

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

Dated: April 11, 2003

Concurring Opinion of Commissioner Sharon Brown-Hruska

Nearly three years after concluding that a $200,000 civil money penalty was warranted by the gravity of Nikkhah's violations, the Commission is remanding this matter to the ALJ for a second try to assess his net worth. Notwithstanding his claim of being incapable of paying *any* financial penalty, Nikkhah has done little to set the record straight. Nikkhah's behavior might strike some as incongruous given that the net worth inquiry is intended to protect him from being subjected to a penalty that is "beyond his financial tolerance."[1] Nevertheless, he has largely impeded the Division's efforts to get at the truth of the matter.[2] In similar circumstances, the Commission has not hesitated to determine this issue on its own, and further, to impose severe penalties on the rationale that such a respondent is in a weak position to complain that his net worth is insufficient to pay a penalty.[3]

The lengthy and frustrating history of this case clearly illustrates the costly impediment that the net worth requirement exacts upon the efficient resolution of our enforcement matters. Despite cooperation that the Commission charitably characterizes as "at best, spotty and grudging," we are compelled to grant Nikkhah yet another opportunity to determine whether he can pay the penalty contemplated here.

From my perspective, the real problem here derives from changes that the Commission adopted in *Nikkhah II* relating to the development of the record on the issue of net worth.[4] These changes, in my opinion, have created disincentives for quick resolution of this issue. Indeed, it appears that respondents today have less incentive than ever to fully cooperate in this process, since the responsibility for creating a record on their ability to pay now lies almost solely with the Division. This incentive compatibility problem in the determination of a respondent's net worth creates a kind of moral hazard in which those who best squander and hide their gains are rewarded with the smallest penalties.

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[1] *In re Nelson Ghun & Associates, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,584 at 30,525 (CFTC May 2, 1985). (*"Nelson Ghun II"*); *In re Rothlin*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,851 at 27,573 (CFTC, Dec. 21, 1981).

[2] At the net worth hearing, Nikkhah produced only "limited documentation" to substantiate his claimed liabilities, and offered an explanation for assets held in the name of his wife and children that the Commission characterized as "facially questionable."

[3] *See In re Gordon*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,326 (CFTC, Mar. 6, 1995), *aff'd without opinion sub nom., Gordon v. CFTR,* 86 F.3d 1169 (11th Cir. 1996); *In re Miller,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,297 at 46,351 (CFTC Mar. 12, 1998), *aff'd in part and remanded in part on other grounds sub nom., Miller v. CFTC,* 197 F.3d 1227 (9th Cir. 1999).

[4] *In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,275 (CFTC Sep. 26, 2000) (*"Nikkhah II"*).

Prior to *Nikkhah II,* the statutory protection provided respondents by Section 6(d) came with a cost--in the form of an obligation placed upon them to demonstrate why a contemplated penalty was beyond their ability to pay. *Rothlin,* ¶ 21,851 at 27,573, *Nelson Ghun II,* ¶ 22,584 at 30,525 n.2.[5] This obligation made eminent sense since it was the respondent, after all, who generally controlled the information directly probative to his financial condition. *Rothlin,* ¶ 21,851 at 27,573. Nevertheless, apparently regarding this as too burdensome for a respondent to incur, the Seventh Circuit in *Slusser v. CFTC,*[6] followed by the Commission in *Nikkhah II,* overturned nearly two decades of our precedent, and transferred this obligation to the Division of Enforcement.

Thus, what was once viewed as a factor that the Commission merely had to "consider" before imposing a financial penalty,[7] instead became a determinative element that the Division was required to affirmatively prove regardless of whether the respondent cooperated. Moreover, what was formerly regarded as essentially an affirmative defense available to the respondent to allow him to show that a proposed penalty was "too severe for his financial circumstances," *Nelson Ghun II,* ¶ 22,584 at 30,525, became a one-sided burden placed upon the Division. Finally, what was once viewed as "a safeguard for the respondent's protection," *Rothlin,* ¶ 21,851 at 27,573, metamorphosed into a shield allowing the respondent an opportunity to frustrate--if he so desired--any effort by the Division to develop a record with respect to his ability to pay.[8] As a result of these changes, the net worth tail wags the penalty dog.

While Nikkhah's lack of cooperation does not constitute a complete abdication on his part, his conduct nevertheless demonstrates how a respondent can benefit by dragging out the process. But more is at stake than the adverse impact that these changes to the net worth inquiry have had upon our enforcement proceedings. Indeed, my primary concern lies with the impact that such changes have had upon the deterrent value of our penalties.

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[5] The Division's role, by contrast, was limited to recommending an appropriate civil monetary penalty and challenging any presentation that the respondent made. *Rothlin,* ¶ 21,851 at 27,573.

[6] 210 F.3d 783 (7th Cir. 2000).

[7] Prior Commission precedent even permitted the penalty to exceed a respondent's net worth so long as an explanation was given as to why such a penalty was warranted. *In re Murlas,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,440 at 35,932 (CFTC Apr. 24, 1989). No such explanation was required, however, for a penalty that was merely equivalent to a respondent's net worth. *See Gordon,* ¶ 26,326 at 42,592 ($200,000 penalty was "appropriate because it is commensurate with the gravity of Gordon's violations, *while not exceeding his net worth* [of $220,000].") (emphasis added).

[8] *Nikkhah II* also effectively did away with the concept of waiver as a sanction for a respondent's failure to fully cooperate in this process, *see Rothlin,* ¶ 21,851 at 27,574 (failure of respondent to make showing contemplated by Section 6(d) "could fairly be termed a waiver of the protections found therein"), replacing it with the lesser sanction of drawing "adverse inferences" against respondents who fail to comply with their discovery obligations, or either to appear or testify at the net worth hearing. *Nikkhah II,* ¶ 28,275 at 50,678.

Taken together, the changes adopted in *Nikkhah II* inexorably lead us down a path towards ever-lower monetary penalties devoid of any meaningful deterrent value.[9] More than a decade ago, former Commissioner Shelia Bair foreshadowed this development when she observed that "Section 6(d)'s compassion for . . . [a wrongdoer's financial condition] undermines the deterrent value of civil monetary penalties."[10] Her words, unfortunately, apply with even greater force today.

To be sure, the Seventh Circuit's holding in *Slusser v. CFTC* may have forced our hand here. But I question why the Commission is acquiescing to a standard that it acknowledges is "based on a misunderstanding of current Commission precedent." *Nikkhah II*, ¶ 28,275 at 50,677.[11] I, therefore, also question the rationale for the

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[9] This is evidenced not only by the increasing prominence that the net worth consideration now plays in the penalty portion of enforcement proceedings, but also by the manner by which deterrence has been diminished in priority as a factor in our standard for calculating penalties. *Compare In re Grossfeld,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,921 at 44,468 (CFTC Dec. 10, 1996) (financial benefit to respondent and harm suffered by customers as result of wrongdoing "are especially pertinent factors to be considered") *with In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,129 at 49,892 (CFTC May 12, 2000) ("*Nikkhah I*") (relegating the benefit/harm deterrence-based penalty formula to one of five factors to consider for assessing the negative consequences flowing from a respondent's violations, which in turn was one of four factors to consider for determining gravity). *See also Nikkhah II*, ¶ 28,275 at 50,674 n.4.

[10] *In re Shelton,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,332 at 39,087 (CFTC Jul. 14, 1992) (Bair, Comm., concurring). Indeed, the circumstances surrounding this case confirm Commissioner Bair's observation that basing penalties upon a respondent's net worth "leave[s] the door open for the most flagrant of offenders to escape with a mere slap on the hand, if they have squandered their ill-gotten gains before an enforcement action is brought, *or successfully concealed the true size of their holdings in off-shore bank accounts*." *Id.* (emphasis added).

[11] The Commission's response also brings home the fact that some of the collateral damage to our precedent could have been avoided had the Commission sought rehearing from the court regarding its ruling with respect to net worth, as we had previously done in *Gimble v. CFTC*, 872 F.2d 196 (7th Cir. 1989). Indeed, it appears that the court virtually begged the CFTC to more clearly explain its standard:

> The Act is silent on the burden of production, so we would have been attentive to an argument that *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* . . . permits the Commission to regulate that aspect of its own proceedings, provided it shoulders the burden of persuasion in the end. . . . By placing its head deep in the sand, and refusing to acknowledge the adverse judicial views, the Commission disabled itself from making such a pitch.

210 F.3d at 787-88 (citations omitted). The Commission also missed an opportunity to remind the Seventh Circuit that our construction of Section 6(d) actually followed the reasoning of that court in *Sellersburg Stone Co. v. Federal Mine Safety and Health Review Comm.*, 736 F.2d 1147, 1153 and n.14 (7th Cir. 1984) (respondent bears burden of producing evidence that payment of civil penalties would adversely affect its ability to continue in business and failure to do so creates

Commission's decision to accord *universal* applicability to this new standard, rather than limiting it to that case or to matters under the Seventh Circuit's jurisdiction.[12] At the same time, I have reservations about the *selective* acquiescence of the Commission; in particular, the rejection of other aspects of that decision on the ground that it conflicts with our precedent.[13]

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presumption that there would be no such effect), and *Stanley v. Board of Governors*, 940, F.2d 267, 274 (7th Cir. 1991) (Board does not bear full burden of proving respondent's financial resources).

[12] Indeed, it appears that the Commission's new standard announced in *Nikkhah II* was adopted primarily because the Seventh Circuit disagreed with its prior interpretation. But this rationale does not provide the "thorough and reasoned" explanation that courts look for in determining the reasonableness of such a policy change. *Atchison, Topeka and Santa Fe Railway Co. v. Pena*, 44 F.3d 437, 442-43 (7th Cir. 1994) (criticizing FRA's adoption of interpretive rule that was inconsistent with twenty-three years of agency enforcement because Ninth Circuit disagreed with prior interpretation); *Orrego v. 833 West Buena Joint Venture*, 943 F.2d 730, 736 (7th Cir. 1991) (criticizing HUD for providing no other rationale for changing prior "well-reasoned" position other than it had lost in district court on that issue). Such an abrupt change violates the well-established rule that an agency cannot depart from its own precedent without a reasonable explanation. *Motor Vehicle Manufacturers Assn. v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 56 (1983) (while an agency is entitled to change its views, it is obligated to explain its reasons for doing so); *PG&E Gas Transmission, Northwest Corp., v. FERC*, 315 F.3d 383, 390 (D.C. Cir. 2003) (FERC's lack of explanation for shift in Commission policy and its "failure to come to terms with its own precedent reflects the absence of a reasoned decisionmaking process"); *Johnson v. Ashcroft,* 286, F.3d 696, 700 (3rd Cir. 2002) ("Although an agency can change or adapt its policies, it acts arbitrarily if it departs from its established precedents without 'announcing a principled reason' for the departure") quoting *Fertilizer Inst. v. Browner*, 163 F.3d 774, 778 (3rd Cir. 1998).

Moreover, the Commission's abandonment of its precedent on net worth in *Nikkhah II* contrasts sharply with its response to other judicial setbacks; in particular, the Ninth Circuit's holding in *Premex v. CFTC,* 785 F.2d 1403 (9th Cir. 1986) that the Division had the burden of producing evidence on the respondent's net worth, and the Seventh Circuit's *initial* decision in *Gimble v. CFTC,* which held that the Division had the burden of proof on that issue. Declining to endorse either of these interpretations, the Commission on remand in *In re Premex, Inc.,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,165 at 24,165 n.2 (CFTC Feb. 17, 1988) and in *Murlas* instead steadfastly reiterated its adherence to net worth procedures originally outlined in *Rothlin.*

[13] While the Commission in *Nikkhah II* adopted the *Slusser* panel's net worth ruling as part of its own standard, it declined to adopt the court's formula for calculating financial penalties (other than to recognize that it is bound by it in the *Slusser* remand matter itself), declaring instead that "we do not determine the appropriate amount of a civil money penalty simply by multiplying the number of proven violations by the $100,000 statutory maximum." *Nikkhah II,* ¶ 28,275 at 50,674. I see no principled reason, however, to justify the Commission's fealty to the *Slusser* court's ruling with respect to net worth, while at the same time, rebuffing it with respect to the proper method for determining the maximum penalty.

Similarly, the Commission in *Nikkhah II* also declined to follow *Slusser* panel's conclusion that the Division had the burden of establishing the "collectibility" of a proposed financial penalty

More generally, this approach abandons the notion of waiver of net worth as a sanction for an uncooperative respondent even though courts have blessed utilizing this tool for this very purpose. *See e.g., Miller v. CFTC*, 197 F.3d at 1235 (respondent's failure to respond with adequate records at net worth hearing operated as *waiver* of right conferred by Sec. 6(d) to have net worth taken into account in assessment of penalty). The removal of this important sanction from our arsenal discourages the kind of cooperation from respondents that we need to develop a satisfactory record on their net worth.

I would also note that our troubles do not appear to be due to a dearth of explanation. On the contrary, the confusion surrounding these issues occurs despite numerous attempts by the Commission to explain and clarify our standard on net worth and collectibility. Notwithstanding these efforts, it is apparent that the Commission has never succeeded in lifting the fog surrounding these concepts.[14] Indeed, it seems that the

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on the ground that the panel's conclusion was at odds with the Commission's precedent on this issue. *Nikkhah II*, ¶ 28,275 at 50,677 n.15. While there is some ambiguity relating to the *Slusser* panel's reference to "collectibility," *see* nn. 3 & 27 of the Commission's opinion, the court's reliance on *Gimble*, which explicitly referred to collectibility in the context of developing a satisfactory record "on Gimbel's *assets*," along with the Commission's interpretation of the panel's use of that term in footnote 15 of *Nikkhah II*, suggest that the court was also using that term in its traditional sense. *See Nelson Ghun II*, ¶ 22,584 at 30,526 n.3 (term "assets" not interchangeable with term "net worth" as used in Sec. 6(d)).

Moreover, even if one accepts the view that the *Slusser* panel used the term "collectibility" to refer to former Section 6(d)'s consideration of a respondent's ability to remain in business, a similar pattern of selective acquiescence on the part of the Commission is evident. *Compare In re Slusser*, CFTC Docket No. 94-14 (February 28, 2003) slip op. at 7 n.8 (applying "different analysis" to evaluating penalty in light of revoked respondent's ability to remain in business) *with* nn.3 & 27 of the Commission's opinion here (declining to consider Nikkhah's ability to remain in business).

[14] *See Rothlin*, ¶ 21,851 at 27,573 (observing that as a result of "some uncertainty" concerning the net worth burden, "some clarification is in order"); *In re Nelson Ghun & Associates, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,255A at 29,340 (CFTC July 5, 1985). ("*Nelson Ghun I*") (acknowledging that confusion regarding net worth factors "may, to some extent, be a problem of our own creation . . . [and that] certain language in our *Rothlin* opinion . . . may have led the Division" astray, the Commission announced that "we take this opportunity to develop further our approach in *Rothlin*"); *Nelson Ghun II*, ¶ 22,584 at 30,526 (explaining what *Nelson Ghun I* requires of Division). *See also Murlas*, ¶ 24,440 at 35,929-30:

> The brief review of the background of this proceeding . . . demonstrates that the ALJ and the parties do not share a common understanding of the Commission precedent interpreting Section 6(d). *See* [*Rothlin, Nelson Ghun I,* and *Nelson Ghun II*]. Because the broad principles discussed in these cases are subject to a variety of interpretations, it is possible that the type of confusion reflected in the record of this proceeding may continue to detract from the efficiency of the Commission's enforcement program. *In order to clarify the applicable principles*, conserve the resources of the parties and avoid undue delay in the ultimate resolution of the proceeding, we take the unusual step

more we have explained, the more the courts have complained.[15] The problems that continue to plague this area of our law demonstrate anew the importance of both clarity and consistency in stating our governing principles.

While many of these problems will disappear as future misconduct increasingly becomes subject to the provisions of the Futures Trading Practices Act of 1992, they will continue to trouble us when we seek to penalize misconduct that occurred prior to the enactment of that Act. That is why it is so important that we articulate clear and consistent principles in this area of our law.

Commissioner Sharon Brown-Hruska

4/4/03
Date

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of intervening prior to the submission of appellate briefs to offer guidance on the application of Commission precedent in this matter.

(citations omitted) (emphasis added). *See also, Nikkhah II*, ¶ 28,275 at 50,677:

> Unfortunately, in the decade since the *Murlas* decision was issued, neither presiding ALJs nor the Commission itself have been consistent in applying the guidance from Murlas . . . [and] created at least an appearance that the Commission expected the respondent to carry the burden of proof on former Section 6(d)'s mandatory factors unrelated to gravity. . . .
>
> . . . Because the [Seventh Circuit's *Slusser*] panel's decision was partly based on a misunderstanding of current Commission precedent, it helped highlight the risks of permitting ambiguities to creep into relevant Commission case law. Consequently, we take this opportunity to *clarify* the process for developing the record on former Section 6(d)'s mandatory factors unrelated to gravity.

(emphasis added).

[15] This lack of clarity has even adversely affected the judiciary's handling of these issues. Aside from the fact, as we have seen here, that the use of "one word" for two distinct concepts "breeds confusion," *Atchison, Topeka and Santa Fe Railway Co.*, 44 F.3d at 445 (Easterbrook, J., concurring), both the Seventh (*Premex*) and Ninth Circuits (*Gimble, Slusser*) have badly misconstrued our precedent in this area, confusing the mandatory factors of former Section 6(d) with the Commission's precedent on collectibility.