UNITED STATES OF AMERICA
before the
COMMODITY FUTURES TRADING COMMISSION

PACIFIC TRADING GROUP, INC.

Complainant,

v.

GLOBAL FUTURES & FOREX, LTD.
and GARY LEE TILKIN,

Respondents.

CFTC Docket No. 02-R080

BFI FOREX FUND, L.L.P.,

Complainant,

v.

GLOBAL FUTURES & FOREX, LTD.
and GARY LEE TILKIN,

Respondents.

CFTC Docket No. 03-R030

INITIAL DECISION

Before: George H. Painter, Administrative Law Judge

Appearances:

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I. PRELIMINARY STATEMENT

Complainants Pacific Trading Group, Inc. ("PTG") and BFI Forex Fund, LLP ("BFI") filed separate reparations complaints seeking to recover damages (including punitive damages) in excess of $1 million from respondents Global Futures & Forex, Ltd. ("Global") and Gary Lee Tilkin ("Tilkin") due to various violations of the Commodity Exchange Act. Complainants allege that Global and its owner Tilkin in participation with Donald C. O'Neill ("O'Neill") improperly traded Complainants foreign currency ("forex") accounts, resulting in losses in excess of $700,000.

The trial of this matter took place on November 3-6, 2003, in Los Angeles, California. The parties have been afforded an opportunity to file post trial briefs, along with recommended findings of fact and conclusions of law. This matter is ready for decision. The findings of fact set out below are based on credible evidence of record.[1]

II. JURISDICTION

As a threshold matter, Complainants must show that the contracts in question were futures contracts. To determine whether the FX transactions marketed by the Respondents were futures contracts, "[t]he transaction must be viewed as a whole with a critical eye toward its underlying purpose." *CFTC v. Co Petro Mkg. Group, Inc.,* 680 F.2d 573, 581 (9th Cir. 1982); *see also, Motzek v. Monex Int'l. Ltd.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,095 at 41,626 (CFTC June 1, 1994) (endorsing a holistic approach); *accord CFTC v. Noble Metals Int'l,* 67 F.3d 766, 772 (9th Cir. 1995). Recently the Commission offered guidance in the definition of futures contracts in the context of FX transactions:

[1] The listed documents are referred to by denoting party surname when appropriate and abbreviations as follows:
"Tr." for Trial transcript
"POSTHG" for Post-hearing memorandum

> Futures contracts are contracts for the purchase or sale of a commodity for delivery in the future at a price established when the contract is initiated, with both parties to the transaction obligated to fulfill the contract at the specified price. The contracts are entered into principally to assume or shift price risk without transferring the underlying commodity. Although the contracts provide for settlement by delivery, delivery can be avoided by offset, cash settlement or cancellation.

In the Matter of Reliant Global Markets, LLC and Maristela, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,502 at 55,162-63 (CFTC 2003) (opinion and order accepting un-litigated settlement).

The FX transactions here in question exhibited the characteristics of futures contracts. The transactions involved the purchase and sale of foreign currency for future delivery, and the parties to the transactions entered into contracts at a price determined at the time the parties entered into the transaction. The parties used the FX transactions to capture price movements and speculate on fluctuations in the value of the currencies without actually transferring the currency. The transactions were settled by offsetting transactions, and never resulted in delivery of the underlying currency. The foreign currency contracts that Global offered therefore were futures contracts. *CFTC v. Int'l Foreign Currency, Inc.,* 2004 U.S. Dist. LEXIS 17652 (D.N.Y., 2004) ("the currency transactions that Defendants offered or entered into are contracts 'of a sale of a commodity for future delivery'"); *CFTC v. Noble Wealth Data Info. Servcs*, 90 F. Supp. 2d 676 (D. Md. 2000) (foreign currency contracts that were for future delivery, could be satisfied by offset or other means to avoid delivery, with prices that were set at the time the contract was entered into, and that were engaged in primarily to speculate, were futures contracts) *vacated in part on other grounds*, 278 F.3d 319, 329 (4th. Cir. 2002).

Next, we must determine whether the subject contracts are exempt under Section 2(c) of the Commodity Futures Modernization Act of 2000, Appendix E to Public L. No. 106-554

(December 21, 2000) ("CFMA"). Section 2(c) purports to clarify the Commission's jurisdiction over foreign currency futures contracts ("FX contracts"). In particular, where one or more parties to a FX transaction is an "eligible contract participants" (as that term is defined in Section 1a(12) of the CFMA[2]) sections 2(c)(2)(B)(ii) & (C) limit the Commission's jurisdiction to violations of section 4b and other fraud and manipulation prohibitions not here relevant.[3] In this case, BFI and PTG were retail customers, not eligible contract participants, and Global, the counterparty to the FX contracts, was an eligible contract participant (a registered FCM), thus, the Commission's fraud jurisdiction (pursuant to section 2(c)(2)(C) of the Act) is limited to sections 4b and 4c(b) of the Act.

III. SUMMARY

In the spring of 2002, Complainant, William Saedlo, President of Complainant PTG contacted Donald C. O'Neill to explore the possibility of engaging O'Neill as a trading advisor for PTG as well as for other investment funds that Saedlo might refer to O'Neill.[4] Saedlo had

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[2] Section 1a(12) defines an eligible contract participant in relevant part as:

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

FX contracts *not* traded by eligible contract participants and not conducted on or subject to the rules of a board of trade, which has been designated or registered by the Commission as a contract market or as a derivative transaction execution facility for such commodity, are in violation of Section 4(a) of the Act. *CFTC v. Baragosh*, 278 F.3d 319, 329 (4th Cir., 2002) ("Under the CFMA, the Commission has jurisdiction over foreign currency futures "offered to or entered into" with any person who is not an "eligible contract participant.").

[3] 7 USCS § 2(c)(2)(C):

> Notwithstanding subclauses (II) and (III) of subparagraph (B)(ii), agreements, contracts, or transactions described in subparagraph (B) shall be subject to sections 4b, 4c(b), 6(c) and 6(d) [7 USCS §§ 6b, 6c(b), 9, 15, and 13b] (to the extent that sections 6(c) and 6(d) [7 USCS §§ 9, 15, and 13b] prohibit manipulation of the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any market), 6c, 6d, and 8(a) [7 USCS §§ 13a-1, 13a-2, 12(a)] if they are entered into by a futures commission merchant or an affiliate of a futures commission merchant that is not also an entity described in subparagraph (B)(ii) of this paragraph.

[4] Tr. 106-108.

been impressed by O'Neill's supposed success trading foreign currency futures contracts.[5] After numerous conversations, much correspondence and at least one on-site visit to O'Neill's "trading room", Saedlo decided to engage O'Neill to trade the PTG fund in return for which O'Neill would receive 20% of any profits.[6] Saedlo granted O'Neill a power of attorney over the PTG fund[7] and agreed to O'Neill's requirement that PTG use Respondent Global as its FCM and counterparty.[8] Subsequently, BFI and its manager Daniel O'Connell also granted O'Neill authority over the BFI fund and agreed to pay O'Neill 20% of the profits.[9] O'Connell was also aware of O'Neill's requirement that BFI trade with Global.[10]

Apparently, O'Neill's claims of success were not true: starting in January 2001 and continuing through at least July 2002, O'Neill was the mastermind and central figure of a fraudulent scheme to solicit investments (that totaled at least $13 million) for the ostensible purpose of trading foreign currency futures contracts. O'Neill, and entities controlled by O'Neill, misappropriated at least $10.6 million of those investor funds and used the money for business, personal and luxury expenditures.[11] O'Neill has entered a guilty plea to a federal criminal indictment based on the same underlying facts.[12]

Complainants in the instant matter were among the victims of O'Neill's fraud and Respondents Global and Tilkin were active participants in that fraud. PTG sent Respondents $600,000[13] and BFI sent Respondents $500,000.[14] In eight short days, Respondents had reduced Complainants' total investment by close to 70%.[15]

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[5] Tr. 109-111.
[6] Tr. 124-125; Exhibit L.
[7] Tr. 198-200; Exhibit A 46-47.
[8] Tr. 111-112.
[9] Complainants' Exhibit V.
[10] Tr. 359-360.
[11] *CFTC v. O'Neill*, Order of Permanent Injunction, Civil Action No. 02-61307-civ-Gold at 3-5 (SD Fla. 11/14/03).
[12] *United States v. O'Neill,* 03-CR-20403-ALL (SD Fla. (Miami) 8/10/04).
[13] Complainants' Exhibit T.

The scheme worked like this: Global authorized O'Neill to place trades (for Global) with Refco[16] supposedly to hedge Global's exposure as counterparty to PTG and BFI. Each of Global's trades at Refco was equal (in volume) and the reverse of its subsequent position with Complainants.[17] For example, (as set forth immediately below) on June 11, 2002 O'Neill purchased (for Global's account) 20,000,000 EUR/USD at a price of .9460 and sold it shortly thereafter for .9443 for a loss of .0017 pips or $34,000.00. On the same day O'Neill, acting on PTG's behalf, instructed Global to buy from PTG 20,000,000 EUR/USD at a price of .9462 and sell it shortly thereafter for .9441, for a gain of .0021 pips or $42,000.00 for Global and a loss of .0021 pips or $42,000.00 for PTG. Thus, Global's net gain was $8,000.00 and PTG's loss was $42,000.00.[18]

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[14] Complainants' Exhibit U.
[15] See footnote 19, *infra*.
[16] Respondent Gary Lee Tilkin testified:
A. Mr. O'Neill was given access to call Refco to place trades.
Q. Was he given a discretionary power to trade to Refco, the Global account at Refco?
A. Well, I mean, we weren't telling him how to trade. So I guess --
Q. But you were allowing him to enter trades?
A. Yes.
Q. And you were not requiring that he ask you before he enter a particular trade?
A. No. Although we had controls on it, we did not ask him to check with us before he entered a trade.
Tr. 47-48 (11/03/03)
[17] Respondents Tilkin testified:
Q. So the Refco transactions, once they were made in the Refco account and while they stood in the Refco account, belonged to who?
A. Global Forex.
Q. Okay. And then as I understand it, at some point Mr. O'Neill would contact one or more of your traders by telephone and tell him to allocate the trades to my clients; is that right?
A. Correct.
Tr. 50.
[18] Respondents' Exhibit C-29.

Global		Global P/L	Refco		Refco P/L
Long	Short		Long	Short	
20,000,000 EUR/USD@ .9460				20,000,000 EUR/USD@ .9460	
	20,000,000 EUR/USD@ .9443	(.0017) pips or ($34,000.00)	20,000,000 EUR/USD@ .9443		.0017 pips or $34,000.00
Global		**Global P/L**	**PTG**		**PTG P/L**
Long	Short		Long	Short	
	20,000,000 EUR/USD@ .9462		20,000,000 EUR/USD@ .9462		
20,000,000 EUR/USD@ .9441		.0021 pips or $42,000.00		20,000,000 EUR/USD@ .9441	(.0021) pips or ($42,000.00)
Net P/L		$8,000.00			($42,000.00)

Similar trading sequences were repeated 51 times over eight days. Most, if not all, of the trades in Complainants' accounts during this time, were preceded by opposite trades between Global and Refco at a price that was two pips better than the price subsequently given to Complainants.

After spending a moderate amount of time with a calculator, it becomes clear that this trading arrangement netted Global a tidy profit no matter which way the market moved: up down or not at all. The only variables were the volume and the currency pair. And those variables dictated only the size of Global's profit, not whether or not Global made a profit. Complainants on the other hand, were at the mercy of market moves and for them higher volume meant higher risk.

This trading arrangement was applied to PTG's account for eight days and to BFI's account for three days. During this time PTG lost $468,781.69 and BFI lost $293,420.29.[19] During this same period, Respondents admit to making "spread revenue" of $271,180 of which they paid O'Neill $98,700.[20] In fact, Respondents took in exactly what Complainants lost: $762,201.98, but Respondents were required to incur some "business expenses": for every trade executed in Complainants' accounts, Respondents put on opposite trades for their own benefit with Refco, thus ensuring that any loss they suffered as counterparties to Complainants would be offset by a greater gain from Refco. Unfortunately for Respondents, however, their gains as counterparties to Complainants were also offset by losses with Refco. Yet all was not lost: due to O'Neill and Respondents' careful "fiduciary" planning, the losses at Refco were always smaller than their clients' losses and Respondents' own concomitant gains. As a result, in eight days of trading, Respondents netted $271,180; pretty good work if you can get it.

VI. DISCUSSION

The evidence adduced at trial shows that, Respondents, acting in concert with O'Neill, initiated 52 round turn trades (in Complainants accounts) in eight days[21] with no economic purpose other than generating profits for Respondents and O'Neill. Such trading of commodity futures accounts (a.k.a. "churning") is a violation of the Commodity Exchange Act. *In the*

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[19] The losses are set forth in Respondents' Exhibit W and Complainants' Exhibits S and CC. These exhibits reflect the same losses in BFI's account. Respondents' Exhibit W, however, sets PTG's losses at $425,083.34, $43,698.35 less than Complainants claim. Inasmuch as Complainants' figure is based on a 1099-B, issued by Respondents, (Exhibit S), and there is no evidence in the record that Respondents sought to amend that form 1099-B, Respondents cannot now be heard to claim a different number than that they have filed with the IRS.

Respondents do seem to argue, however, that the amount of losses should be reduced as a result of the fact that Respondents sent O'Neill $98,000 of which $39-40,000 was to be forwarded by O'Neill to Complainants. POSTHG (Respondents) at ¶ 27. Not only do we find Respondents' argument unpersuasive, the mere fact that Respondents sent O'Neill *any* money that might conceivably belong to Complainants, after having decimated Complainants' accounts, is further evidence that Respondents and O'Neill were acting together to loot Complainants' foreign currency trading accounts.

[20] Respondents' Exhibit Z 1-2.

[21] Respondents' Exhibit Z 1-2.

Matter of Murlas Commodities, Inc., et al., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,485 (CFTC 1995),

A. <u>The Elements of Churning</u>

To find a violation of the Commodity Exchange Act for churning, the Complainants have the burden of showing that the trading in their futures account was excessive. This can be shown by reference to certain objective factors. In *Murlas* the Commission has looked to the following factors as a guide:

1. whether the FCM or CTA controlled the frequency and volume of trading in the investor's account (*id.* at n.4) (*dicta*) ;
2. whether the volume of the trading was excessive in relation to the investor's trading objectives (*id.* at n.6);
3. a high level of monthly commission to equity ratios (*id.* at n.5);
4. a high percentage of short-term trades (*id.*);
5. a pattern of in-and-out trading (*id.*);
6. a pattern of trading while the account is under margined (*id.*); and
7. whether the FCM or CTA acted with an intent to defraud or in reckless disregard of the investor's interests.

Id at n.6. *citing, Smith v. Siegel Trading Co.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,105 at 24,452 (CFTC 1980) ("'Churning' is generally defined as the 'excessive trading' of an account by a broker with 'control' of the account, for the purpose of generating commissions, without regard for the investment or trading objectives of the customer."). A proper churning analysis, however, cannot be reduced to a mechanical rule or formula. Rather, the individual factors must be viewed in relationship to one another. *Murlas* at ¶ 26,485.

Moreover, proof of excessiveness does not require a persuasive showing on *all* relevant factors. *Fields v. Cayman Associates, Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,688 at 30,928 (CFTC 1985). As discussed in detail below, the Complainants have met their burden in all respects.

B. <u>The Respondents Churned Complainants' Accounts</u>

Applying the *Murlas* factors listed above, the Court is satisfied that Complainants' accounts were churned and Respondents were responsible for, and benefited handsomely from, that churning.

1. <u>Respondents Controlled Complainants' Accounts Both Directly and Through Their Agent</u>

a. <u>O'Neill was Respondents' Agent</u>

Section 2(a)(1)(B)[22] of the CEA is a codification of the common law principle of *respondeat superior*, and imposes strict liability on a principal provided that the agent's misconduct was in furtherance of the agency. *Rosenthal & Co. v. Commodity Futures Trading Com.*, 802 F.2d 963, 966 (7th Cir. 1986).[23] O'Neill was Respondents' agent as defined by section 2(a)(1)(B) of the Commodity Exchange Act.

Agency is a question of fact; established by the manifest conduct of the parties. *Embieta v. Heinold Commodities*, ['84-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,594 at 30,552 *citing Barefoot v. International Brotherhood of Teamsters*, 424 F.2d 1001, 1004-5, *cert. denied*, 400 U.S. 950 (1970), *Restatement (Second) of Agency* § 1 (1958) ("Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other

[22] The act, omission, or failure of any official, agent, or other person acting for any individual, association, partnership, corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, association, partnership, corporation, or trust, as well as of such official, agent, or other person. 7 USCS § 2(a)(1)(B)

[23] An employer-employee relationship is not required to impose strict liability under 2(a)(1)(B). *Rosenthal & Co. v. Commodity Futures Trading Com.*, 802 F.2d at 966.

shall act on his behalf and subject to his control, and consent by the other so to act."). The parties' intentions and beliefs as to what they have done, in some instances, may inform a finding of agency, but will not stand in contradiction of a finding based on the parties' conduct. *Id., Johnson v. Chilcott,* 658 F. Supp. 1213, 1219 (D. Colo. 1987). As the *Embieta* court so aptly stated: "something that walks like a duck and quacks like a duck may well be a duck, regardless of any signed agreements attesting that it is not in fact a duck." *Embieta v. Heinold Commodities*, ['84-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,594; *see also*, *Restatement (Second) of Agency* § 1 (comment (b)) ("if the agreement results in the factual relation between them to which are attached the legal consequences of agency, an agency exists although the parties did not call it agency and did not intend the legal consequences of the relation to follow").

Conduct indicative of an agency relationship between a futures commission merchant and a commodity trading advisor includes (but is not limited to) the following:

1. Commission-splitting or other compensation by and between the FCM and the CTA.[24]
2. Business generated by the CTA inuring to the benefit of the FCM.[25]
3. Solicitation of accounts by the CTA for the FCM.[26]
4. Distribution and processing by the CTA of account-opening forms and literature of the FCM;[27] and, performance by the CTA of the FCM's disclosure duties.[28]

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[24] *See, e.g., Embieta v. Heinhold Commodities, Inc.*, ['84-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,594; *In re Western Financial Management*, ['82-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,873 at 27,708 (CFTC 1983); *Kuhland v. Lincolnwood, Inc.* ['86-87 Transfer Binder] Comm. Fut. L. Rep.(CCH) ¶ 22,994 (Initial Decision,1986).

[25] *Embieta v. Heinold Commodities*, ['84-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,594; *cf. Dohmen-Ramirez v Commodity Futures Trading Com.* 837 F2d 847, 858-859 (9th Cir. 1988) (fact that principal may not have benefited from agent's fraud does not preclude a finding of agency).

[26] *Embieta v. Heinold Commodities*, ['84-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,594; *International Financial Advisors, K. S. C. v. Donaldson, Luskin, & Jenrette Futures, Inc.* ['87-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,282 (Initial Decision 1988); *Moon v. Stotler & Co.* ['87-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,381 (Initial Decision 1989).

5. Shared control or supervision over accounts of trading adviser by futures commission merchant[29]

6. Access to trading floor.[30]

7. Trading relationship between commodity trading adviser and futures commission merchant; i.e. clearance of trades through futures commission merchant.[31]

When the above criteria are applied to the instant matter, there can be no doubt that O'Neill was Respondents' agent with respect to the transactions between Complainants and Respondents.

In particular, Respondents and O'Neill had a fee sharing agreement that effectively divided the spoils as they looted Complainants' accounts.[32] The fee sharing agreement provided that Respondents would pay O'Neill $7 per lot, per half turn in Complainants' accounts.[33] Respondents netted $271,180 of which they paid O'Neill $98,700.[34] Although the parties disagree as to whether the income generated by the transactions in question is properly

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[27] *Dohmen-Ramirez v. Commodity Futures Trading Com., 837* F.2d at 858 ("the Commission found that Handy's possession of Wellington forms was another indication of an agency relationship."); *Cange v. Stotler & Co.* ['87-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,319 (ND IL 1988) (where an FCM gave its business forms to a CTA (*inter alia*), the court found an agency relationship); *Concor Financial Services, Inc. v Assured Futures, Inc.* ['87-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,409 (Initial Decision 1987) (pursuant to § 2(a)(1)(A) of the Commodity Exchange Act the supplying by a CTA of an FCM's account-opening forms is a factor to be considered in determining whether an agency relationship exists between the CTA and the FCM).

[28] *Oram v. National Monetary Fund,* Comm. Fut. L. Rep. ['86-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,670 (CFTC 1987) (where a CTA distributed and processed an FCM's paperwork, including the risk disclosure forms "[t]he Commission has held that an FCM can be held liable pursuant to Section 2(a)(1)(A) for the acts of a CTA.")

[29] *Dohmen-Ramirez v. Commodity Futures Trading Com.*, 837 F.2d 847, 854 (9th Cir. 1988) (CTA's specific instructions to AP of FCM regarding how to handle customer account considered in determining agency relationship between CTA and AP); *Wirth v. T & S Commodities, Inc.* ['87-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,091 (Initial Decision 1987) (trading discretion (or lack thereof) of FCM over CTA's accounts is an important indication of an agency relationship)

[30] *Stotler & Co. v. Commodity Futures Trading Com.*, 855 F.2d 1288, 1292-93 (7th Cir. 1988) (that the broker is permitted by the FCM to telephone orders directly to the trading floor is a factor to be considered in determining agency relationship)

[31] *Stotler & Co. v. Commodity Futures Trading Com.*, 855 F.2d at 1290 (exclusivity of relationship between CTA and FCM is an element to be considered in determining agency relationship); *Cox v. Eastern Capital Corp.* ['82-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,009 (Initial Decision 1984) (fact that throughout the relevant time period, CTA traded customer account exclusively through FCM is indicia of agency)

[32] POSTHG (Respondents) ¶ 27; Respondents Exhibit L; Tr. 48.

[33] Tr. 384-386; Exhibit L 24-25.

[34] Respondents' Exhibit Z 1-2. This exhibit is a spreadsheet created by Respondents that lists $271,180 as "spread revenue."

denominated as commissions, nobody questions that there was income and that Respondents shared that income with O'Neill. Income sharing as such, regardless of form, is indicia of agency. *See, e.g., Embieta v. Heinold Commodities*, ['84-86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,594; *In re Western Financial Management*, ['82-84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,873 (Initial Decision 1983), *citing Bogard v. Abraham-Rietz & Co.*, ['77-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,963 (Initial Decision 1980). Additionally, O'Neill recommended Respondents' "services" to Complainants and in spite of the fact that Complainants had existing relationships with other FCMs, O'Neill insisted that Complainants' accounts be opened with Global.[35]

As further evidence of an agency relationship, the Court notes that O'Neill provided Complainants with Respondents' account opening and disclosure documents.[36] Saedlo testified that he received all of Global's account opening documents from O'Neill and that in those instances when Global needed additional documentation (e.g. drivers license) Global would contact O'Neill who would contact Saedlo for the information.[37] In particular, Saedlo testified, ". . . to me Don was Global's representative, and I never spoke to any one directly at Global until right before we pulled our accounts."[38] Finally, and of primary significance, Respondents authorized O'Neill to initiate (and O'Neill *did* initiate) each and every trade sequence in Respondents' account that resulted in Complainants' enormous loss and Respondents' concomitant gain.[39] Thus, the Court finds that six of the seven factors listed above are satisfied and, accordingly, the we have no trouble concluding that O'Neill was Respondents' agent.

[35] Tr. 111.
[36] Tr. 113-114.
[37] Tr. 113.
[38] Tr. 114.
[39]
A Mr. O'Neill was given access to call Refco to place trades.
Q Was he given a discretionary power to trade to Refco, the Global account at Refco?
A Well, I mean, we weren't telling him how trade. So I guess --

b. <u>Trading by O'Neill was Within the Scope of His Agency</u>

In addition to finding that O'Neill was Respondents' agent, we find that O'Neill's trading of Complainants' and Respondents' accounts was in furtherance of that agency. *Rosenthal & Co. v. Commodity Futures Trading Com.,* 802 F.2d 963, 966 (7th Cir. 1986) ("section 2(a)(1) imposes strict liability on the principal . . . provided, of course, as the statute also states expressly, that the agent's misconduct was within the scope or (equivalently but more precisely) in furtherance of the agency"). Of primary significance is the fact that Respondents had specifically authorized O'Neill to initiate each trade sequence by entering trades on Respondents' behalf at Refco.[40] Without the Refco trades, Respondents would have simply been counterparties to Complainants and would have won or lost depending on actual market movements. As a result of the Refco trades, however, Respondents and O'Neill benefited from each and every trade sequence regardless of market movements.[41] Thus, Respondents' authorization of O'Neill to trade on their behalf was an integral part of the scheme to churn Complainants accounts; and O'Neill's initiation of those trades was not only well within the scope of the agency, it was the purpose of the agency.

To the extent that Respondents argue that they were simply snookered by O'Neill like everyone else, one need only look to Respondents behavior after Complainants' accounts were emptied and there will be no doubt as to Respondents' intent or culpability. The *Client Referral Agreement* (Respondents' Exhibit L) lays out the terms of the division-of-the-spoils between Respondents and O'Neill and was not signed until July 2, 2002, almost two weeks after the

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Q But you were allowing him to enter trades?
A Yes.
Q And you were not requiring that he ask you before he enter a particular trade?
A No. Although we had controls on it, we did not ask him to check with us before he entered a trade.

Tr. 47-48; Tr. 61-62 ("So we said, if that's going to happen, if you want to go directly to them [Refco] and you get four, then it's going to be five when we put it on the books, right? And he said, yes, of course.").

[40] *See* footnote 16, *supra*.

[41] *See* discussion at pp. 4-6, *supra*.

looting was complete and the screaming and yelling had begun in earnest. Not only did Respondents sign the agreement with O'Neill, they paid him $98,000 pursuant to that *post-hoc* agreement. Had Respondents actually been innocent bystanders, one would naturally expect that they would respond to Complainants' vociferous protestations regarding the handling of their accounts by freezing everything. Instead, Respondents sent O'Neill a check for $98,000 and executed the *Client Referral Agreement* with the following self-serving addendum:

> Although this agreement was entered into on this date [July 2, 2002], its application is retroactive to activity done pursuant to its terms which date back to June 10, 2002 [the day before the trading began].

Exhibit L, p.6. Such is not the behavior of a victim, but of a co-conspirator.[42]

c. Respondents and O'Neill Controlled the Frequency and Volume of Trading in the Complainants' Accounts

The degree of control enjoyed by the Respondents was more than sufficient to allow Respondents to churn Complainants' accounts. In fact, Complainants had executed a power of attorney in favor of O'Neill[43] and O'Neill acted as Respondents' agent when he exercised that power and initiated the trades here in question.[44]

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[42] Even if we were to find that Respondents were unwitting tools of O'Neill's scheme (which we do not), Respondents would nonetheless be liable to return every penny that they gained. *Restatement 1st of Restitution*, § 167 ("[w]here the owner of property transfers it to another, being induced by fraud, duress or undue influence of a third person, the transferee holds the property upon a constructive trust for the transferor, unless before notice of the fraud, duress or undue influence the transferee has given or promised to give value").

[43] O'Neill had trading discretion over Complainants' accounts at Global. Tr. 124-125, Complainants' Exhibit L. In addition to making the trading decisions, O'Neill had effectively prevented the Complainants from reviewing those trading decisions by consciously failing to give Complainants the proper password to access their account information. Tr. 114-117.

[44] When an account is discretionary, absent evidence that the investor actually instructed the broker how to trade his account, there is a presumption that the broker controlled the account. *See Secrest v. Madda* ['87-90 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,627 (CFTC 1989) (while an agreement vesting plenary trading authority in a broker is prima facie evidence that the broker controlled the level of trading in the customer's account, the prima facie case may be rebutted by other relevant evidence); *see also Schmidt v. Murlas Commodities, Inc.*, ['86-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,195 (CFTC 1986) ("grant of discretionary authority . . . create[s] a rebuttable presumption of the exercise of control"). In this instance, no evidence has been offered that Complainants instructed Respondents or O'Neill how to trade the account.

The FX trades here in question had two legs. First, according to Tilkin's testimony, Global would put on an FX trade with Refco and then (at O'Neill's direction) Global would execute and assign complimentary transactions to BFI and Pacific.[45] During his testimony, Tilkin insisted that the trades with Refco belonged exclusively to Global and were attributable to Complainants only as a hedge of Global's risk as Complainants' counterparty.[46] Global's Chief Dealer, Guy Gengle, also testified that the transactions in the Refco account belonged to Global.[47] As Tilkin testified:

> we have a customer out there who does a trade. It is up to us as a dealer to decide to hold that trade for our own risk or, if we decide we want to take limited or no risk on the trade we can offset the risk at one of our counterparties. We could have, for example, not offset any of the risk done by your clients or taken by your clients.[48]

As Mr. Tilkin describes it, one would assume that the Refco trades were initiated as a hedge to an *existing* risk "at one of our counterparties." In fact, Respondents' trades at Refco, although they did belong to Respondents, were executed before the trades between Respondents and Complainants were executed.[49] Thus, the Refco trades were not a hedge to an *existing* risk "at one of [Respondents'] counterparties." Rather, we find that the Refco trades were nothing more than the initial or wholesale leg of Respondents' ultimate transactions with the Complainants. When O'Neill initiated these wholesale transactions at Refco he first negotiated a favorable pip-spread on Global's behalf with Global's prior approval. Again we look to Tilkin's testimony:

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[45] *See* pp. 4-5, *supra*.
[46] Tr. 50, 349-350.
[47] Tr. 485.
[48] Tr. 349.
[49] Tr. 50.

> Prior to the time Mr. O'Neill was entering orders at Refco, he was entering orders with GFT. He would call our dealing desk and he would say, buy 10 million dollar yen, we would pick up the phone and call one of our counterparties, possibly Refco. And Refco would give us a price. And say they gave us five as the price. And we would go back to Mr. O'Neill and say, you want to buy them, they're six. And he might accept that or he might not accept that. If he accepts it, we buy it from Refco at five, we give it to Mr. O'Neill at six. The price Mr. O'Neill did on that was six. . . . He didn't do them at five and we added a pip; he did them at six. . . . So what changed was Mr. O'Neill said, well, you know, if I do it myself, I think I am so smart that I can get these guys to do it at four rather than five, in this example. And we said, fine, but you know, Don, you realize when we do these transactions, we don't give you the same price we do them at, and of course he realizes. He goes yes, I understand. Everybody's entitled to make a profit. So we said, if that's going to happen, if you want to go directly to them and you get four, then it's going to be five when we put it on the books, right? And he said, yes, of course.

Tr. 61-62. Thus, Mr. Tilkin acting as an officer of Global authorized O'Neill to act on Global's behalf and initiate the FX transactions in question by putting on trades with Refco *prior* to booking those same trades in Complainants' accounts at less favorable prices.

In addition to having and *exercising* the authority to initiate trades for Complainants, Global had the authority to reject any trade offered by Complainants;[50] Global had the authority to raise or lower margin requirements in the Complainants accounts, and did so.[51] And, Global had sufficient *de facto* authority to and did disperse funds from Complainants' accounts.[52] Thus, the Court finds that Respondents had and exercised sufficient control over Complainants' accounts to satisfy the first churning element.

[50] Respondents' Exhibit E-30 ¶ 1, *Foreign Currency Brokerage Agreement*, ("GFT, though, is under no obligation to take any particular trade sought by the Client unless such is a closeout trade . . .").
[51] *Id.* at ¶ 9. *See* discussion and accompanying citations at p. 23, *infra*.
[52] Complainants' Exhibit Z (GFT check for $98,700 payable to Intro FX dated 7/2/02); Complainants' Exhibit P ("Don's 2 Pip Calculation"); Complainants' Exhibit R (Fee Payment Authorization between GFT and Saedlo dated 6/9/02).

2. **The Volume Of The Trading Was Excessive In Relation To The Investor's Trading Objectives**

Although an investor's trading objective is one factor considered in determining whether a particular trading pattern was excessive (*see Gilbert v. Refco*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) P25,081 at 38,059 (CFTC 1991)), such evidence is not required to prove churning. As the Commission stated in the Murals case:

> Customer silence in these circumstances cannot be reasonably construed as a license for [a broker] to disregard a customer's financial interests in selecting trades. Such silence, at most, might suggest that the [broker's] customer is open to a range of trading strategies or techniques. Moreover, even when a customer endorses aggressive trading techniques, evidence may still establish that the [broker] turned his back on his customer's financial interests by trading simply to generate commissions.

In re Murlas, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) P26,485 at 43,157 (CFTC Sept. 1, 1995) (*citing Halterman v. Eastern Capital Corp.*, [1987-1990 Transfer Binder] *Comm. Fut. L. Rep. (CCH) P24,222 at 35,036* (CFTC Apr. 15, 1988)). Moreover, some speculators may have no trading objective or strategy beyond simply hoping to make money. An investor's lack of an articulated trading objective, however, does not give his broker *carte blanche* to trade contrary to his client's best interests. Even in the absence of an investor's articulated trading objective, we will nonetheless scrutinize the broker's trading for a strategy exclusively designed to generate commissions. *Fields*, ¶22,688 at 30,929 ("[a]s we stated in Lehman, we will readily infer neither that a pattern of trading which is reasonably indicative of a strategy designed to generate commissions has a legitimate, but unexplained, basis, nor that such a pattern is consistent with the customer's trading objectives") (*citing Lehman*, ¶22,417 at 29,868 n.3). When a broker's trading strategy is such that an investor stands no reasonable chance of breaking even, let alone making a profit, the burden of proof shifts to the broker who "must be prepared to articulate a reasonable justification for his trading." *Fields*, ¶ 22,688 at 30,929.

Here, Respondents have offered no "reasonable justification" or rationale for the trades nor have they offered other evidence that the specific purchases and sales were consistent with the objective to make trades with a reasonable likelihood of profits. Rather, an examination of the eight days of trading reveals that O'Neill and the Respondents had designed a trading strategy whereby they would make money no matter what (an enviable trading strategy, indeed) and their customers, the Complainants, would win or lose depending on the "luck of the draw."

An investor's trading objectives are most often defined by whether he is a speculator or a hedger. The trading objectives of speculators and hedgers can include conservative as well as risky trading strategies. It is most unusual, however, for a trader (no matter what his objective) to seek a money-*losing* strategy. In light of the fact that both Complainants had executed a trading advisory agreement with O'Neill,[53] and those agreements provided an incentive fees of 20% of *profits,* not 20% of *losses*, it is fair to assume the Complainants' trading objectives were to make money, not to lose money.

In this instance, we review eight days of trading in the Pacific account and three days of trading in the BFI account. The trading in these two accounts was nothing if it was not excessive. One might aptly describe the results of O'Neill's trading in the two accounts as a train wreck. The BFI account lost $293,420.29 or 58% (in three days of trading) and the Pacific account lost $468,781.69 or 78% (in eight days of trading). It should be noted, however, that these eight days of trading were not a total loss: although the Complainants lost their shirts, the Respondents made out like bandits. To compensate itself for taking absolutely no market risk and providing absolutely no services to its customers, Global reaped a net benefit of $30,189

[53] Complainants' Exhibits L & V (Trading Advisory Agreements).

from BFI's account and $136,897 from Pacific's account. For similar services provided, O'Neill realized $18,172 from BFI's account and $80,528 from Pacific's account.[54] In total, Global and O'Neill netted $265,786 to facilitate their customers' loss of more than $760,000 in eight short days of trading.

3. A High Level of Monthly Commission to Equity Ratios

Although Respondents and O'Neill netted more than $265,000 while Complainants' equity of $1,100,000 plummeted, Respondents have argued that one cannot show a high commission-to-equity ratio because they did not charge "commissions"; rather they argue, their profit was based on "pips, spreads, or fees." To the extent that Respondents seek to label these costs as something other than commissions, we are reminded that a rose by any other name smells as sweet; or, in this instance "sweet" may not be the appropriate modifier.

A "commission" is defined as "[a] remuneration for services or work done as agent, in the form of a percentage on the amount involved in the transactions; a *pro rata* remuneration to an agent or factor." *Oxford English Dictionary* 2nd ed. 1989. For every trade made on behalf Complainants, Respondents received a two-pip advantage. This advantage translated into a profit, the size of which depended "on the amount involved in the transaction."

Additionally, Given the special mechanics of trading foreign currency futures contracts, traditional applications of the notion of "commission to equity ratios" are not necessarily applicable. As the Commission noted in the options context:

> Owing to differences in the mechanics and trading principles underlying futures and options contracts, precedent analyzing excessive trading in the context of futures may be of limited relevance in determining whether excessive trading has occurred in the context of an options account. . . . For instance, undermargined trading, while relevant to futures accounts, ordinarily would not be relevant in the options context where the options purchaser pays

[54] Respondents' Exhibit Z.

> the full option premium or purchase price upon acquiring the position. Similarly, the commission-to-equity ratio is not particularly meaningful in determining whether an options account has been traded excessively. Departure from agreed on strategies and objectives, however, is equally applicable in the futures and options contexts as a measure of excessive trading.

Hinch v. Commonwealth Financial Group, Inc. et al., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,056 (CFTC May 13, 1997) (footnote omitted). As with options the commission-to-equity ratio is "not particularly meaningful" in determining whether a foreign currency futures account has been churned. What is meaningful is the fact that for every transaction in Complainants' accounts, Respondents and O'Neill had established a trading structure by which they were guaranteed a profit the size of which was dependant only on the volume of the transaction in question. Complainants' profits or losses had no effect on the benefit to Respondents. Thus Respondents' profits, like commissions, were tied directly to the volume and frequency of the trading in Complainants' accounts. Accordingly, we find that the payments to Respondents were in all respects the equivalent of commissions.

Even if we assume for the sake of argument that the payments to Respondents were not properly denominated as commissions, the economic reality described by the events of June 11-19, 2002 remains the same: to wit, the Respondents traded the Complainants accounts so that as Complainants' equity decreased, Respondents' remuneration (by dint of fees, commissions, spreads, call it what you will) increased in direct proportion to volume and frequency of trading in Complainants' accounts. Thus, we learn something about Respondents' motivation in initiating and continuing the trading despite the Complainants' massive losses. It is that motivation for trading rather than some mechanical formula or definition of "commission to equity ratio" that informs our decision as to whether the trading in question was done for a proper purpose. *See generally, Hinch v. Commonwealth*, ['96-'98 Transfer Binder] Comm. Fut.

L. Rep. (CCH) ¶ 27,056 (CFTC 1997) ("the commission-to-equity ratio is not particularly meaningful in determining whether an options account has been traded excessively").

4. Respondents Acted With Intent to Defraud or in Reckless Disregard of the Complainants' Interests

Next we examine the Respondents' intent to trade, Complainants' accounts for Respondents' own benefit, as opposed to the Complainants' benefit.[55] A finding of intent can be supported by proof of recklessness and by inferences from circumstantial evidence. *CFTC v. Savage,* 611 F.2d 270, 283 (9th Cir. 1979); *In re JCC, Inc*., ['92-'94 Transfer Binder] Comm. Fut. L. Rep. (CCH) P26.080 at 41,579 (CFTC May 12, 1994), *aff'd sub nom. JCC, Inc. v. CFTC,* 63 F.3d 1557 (11th Cir. 1995).

In determining whether the Respondents knowingly participated in O'Neill's scheme, direct evidence of knowledge is not required; (*In re Lincolnwood,* ['82-'84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,986 at 28,255 (CFTC 1984); *In re Buckwalter,* ['90-'92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,995 at 37,686 (CFTC 1991); *n8 In re Western Financial Management*, ['84-'86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC 1985)) rather, we are "free to infer the requisite knowing conduct from all the attendant circumstances." *In re Lincolnwood*, ¶ 21,986 at 28,255 ("Given the difficulties in probing the minds of men, the Commission is not foreclosed from inferring knowledge from the evidence adduced."). Factors that support a finding of knowing conduct are:

1. a high commission-to-equity ratio;
2. trading accounts that are open for one month or less; and
3. a high percentage of day trades.

Murlas, ¶ 26,485 at 43,158 n.16.

[55] A Section 4b violation requires that the wrongdoer acted with scienter. *See Drexel Burnham Lambert, Inc. v. CFTC*, 850 F.2d 742, 748 (D.C. Cir. 1988).

As discussed in more detail above, the nomenclature "commission-to-equity ratio" may be less than completely applicable in the instant situation. Rather, we are dealing here with the cost of each trade (a cost that was paid to the Respondents by the Complainants) as that cost relates to the rapidly diminishing equity in Complainants' accounts. During the eight days in question, PTG lost $468,781.69 and BFI lost $293,420.29. During this same period, Global netted $271,180 and paid O'Neill $98,700. Respondents were updated by Refco and/or O'Neill at least on a daily basis (if not continuously throughout the day) regarding Respondents' trades with Refco and the subsequent, corresponding trades to be placed in Complainants' accounts.[56] There can be no doubt that Respondents were aware, from the first day of trading, that while Complainants accounts were being emptied, Respondents' coffers were filled in equal amounts. It is clear that Respondents had more than ample knowledge of the wrong in which they were participants and beneficiaries.

In further support of a finding that Respondents knowingly churned Complainants' accounts, it should be noted that the looting of Complainants' accounts was completed in eight days and many of the trades were initiated and closed out by Respondents on the same day and in some cases the trades were initiated and closed out in less than 15 minutes.[57] Moreover, after the looting of Complainants' accounts was complete, Complainants objected that the trading in their accounts had continued after the equity in the accounts fell below the minimum margin requirements. In response, Global "magnanimously" cut the margin requirements in half, *ab initio*.[58] Thus, not only do we find that the Respondents knowingly participated in O'Neill's wrongdoing, the fact of Respondents short-term, in-and-out trading in under-margined accounts, more than satisfies the Murlas churning factors 4, 5 & 6 as listed on pages 8 & 9, above.

[56] Tr. 427-437
[57] Complainants' Exhibits T & U.
[58] Tr. 259-260.

Although there is ample evidence that Respondents were willing participants in defrauding Complainants, under section 2(a)(1)(B), we need not reach the issue of scienter or even negligence: principals are strictly liable for their agents' acts in furtherance of their agency. *Rosenthal & Co. v. Commodity Futures Trading Com.,* 802 F.2d 963, 969 (7th Cir. 1986). In this case, Respondents are strictly liable for O'Neill' actions in furtherance of his agency on behalf of Respondents. [59] Although it may seem inequitable that Respondents' are required to bear the entire burden of making Complainants whole while O'Neill is not required, by this Order,[60] to pay anything, we expect that Respondents "will be more careful about whom they grasp to their bosoms as [associated commodity professionals] and this will be all to the good." *Rosenthal,* 802 F.2d at 969. *Caveat actor.*

CONCLUSION

Considering the facts and the law as discussed above, we find that Respondents churned Complainants' accounts in violation of section 4b of the Commodity Exchange Act. Respondents' protestations that they were as surprised as everyone else by O'Neill's fraud, are disingenuous at best. In fact, Respondents were well aware that O'Neill was the subject of a

[59] Had we not found Respondents liable as principals, there is more than sufficient evidence to find them liable for the churning of Complainants' accounts as aiders and abettors. Section 13(a) of the Commodity Exchange Act, 7 U.S.C. §13c(a), states:

> Any person who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission of, a violation of any of the provisions of this Act, or any of the rules, regulations or orders issued pursuant to this Act, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations, or orders may be held responsible for such violation as a principal.

[60] Upon a showing that O'Neill has made any payments to Complainants as a result of his guilty plea or otherwise, Respondents' liability under this Order will be reduced by a like amount.

criminal investigation by the United States Attorney for the Southern District of Florida.[61] While such an investigation (by itself) is insufficient for an adjudication of guilt, it is more than sufficient to raise multiple red fiduciary flags. Rather than seek to protect its clients' best interests, however, Global made inquiries of its counsel as to whether or not there was some way they could continue to do business with O'Neill who, coincidently, had promised Respondents a $300,000,000 account.[62] Respondents chose to gamble with Complainants' money rather than risk losing the promised mammoth account from O'Neill; Respondents have lost their gamble.

Although "[t]he usual measure of damages for churning violations is the amount of commissions and fees charged" (*Hinch v. Commonwealth Financial Group* ['96-'98 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,056)), in this case there is ample proof that none of the trading losses would have occurred "had the account not been churned." *Id.* In fact, Respondents have offered *no* explanation for the trading decisions of their agent O'Neill. Accordingly, the Court finds that Respondents' violations of the Commodity Exchange Act resulted in direct monetary damages to the Complainants in the amount of $762,201.98.[63]

ORDER

Respondents are **ORDERED** to pay to Pacific Trading Group, Inc. the sum of $468,781.69 within 30 days from the date this judgment becomes final, plus interest at the rate of 1.30 per annum from June 11, 2002 to the date of payment, plus the filing fee of $250.00; Respondents are further **ORDERED** to pay BFI Forex Fund, LLP $293,420.29 within 30 days

[61] Tr. 306-309.
[62] Tr. 22; 306-309.
[63] This figure represents the total amount of Complainants' trading losses as well as the total amount of Respondents' gains as counterparty to the Complainants. Given Respondents testimony that the trades at Refco belonged to Global and not to Complainants (Tr. 427-437), Respondents will not be allowed to seek a reduction in their liability based on their losses at Refco.

from the date this judgment becomes final, plus interest at the rate of 1.30 per annum from June 11, 2002 to the date of payment, plus the filing fee of $250.00.

So ordered.

Issued this 16th day of November 2004,

George H. Painter
Administrative Law Judge