U.S. C MODITY FUTURES TRADING COMI SION
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In the Matter of FIRST FINANCIAL TRADING, INC., SCOTT DEWITTE, THOMAS GLOVER, II, and COREY JOHNSON, Respondents.	* * * * * * * * *	CFTC Docket No. 00-35

OPINION AND ORDER ON DEFAULT

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Before: Bruce C. Levine, Administrative Law Judge

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Overview

> The Commission can set a penalty as a deterrent. Doing so, the Commission is exercising the important and delicate function of punishing illegal conduct. . . . In the foreground, and determinative, is the law against any exercise of power by a federal agency that is an assertion of arbitrary power rather than an act of reason grounded on the record before the agency.[1]

This case is, in parts, both ordinary and exceptional. It is ordinary in the sense that it rests on almost stereotypical allegations of fraud in the solicitation of options accounts and orders. It is exceptional for two primary reasons, one stemming from decisions of the respondents, First Financial Trading, Inc., Scott DeWitte, Thomas Glover, II, and Corey Johnson, and the other resulting from the development of the law.

Each of the respondents chose, in midstream, to abandon their defenses. This resulted in the default motion upon which we now rule. Given the defaults and for reasons discussed below, the Division of Enforcement easily made its case that each of the respondents acted in the unlawful manners described in the Commission's complaint. This easy determination brought us to the issue of sanctions and the second exceptional aspect of this proceeding.

Previously, this Court and the Commission had imposed gains-based fines for retail fraud that took into consideration the

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[1] Miller v. CFTC, 197 F.3d 1227, 1236 (9th Cir. 1999) (citations omitted).

revenue that a respondent had earned during the time that proven wrongdoing occurred. While not the most precise method of computing the gains that resulted from unlawful behavior, it was easy to use and tended to result in the levels of penalties that were likely to deter future unlawful behavior. As the result of federal court decisions and the Commission's reaction, revenue-based penalties resting on simplified assumptions have fallen out of fashion. In its place, the Commission has adopted a net profit-based method that requires proof of causation. For reasons discussed below, this new method is unworkable in this case and could result in fines that will have no general deterrent effect.

As a result of the profit-based, causation dependent method's impracticality, we were forced to cast about for an easier method that might serve the goal of deterrence. We found such a method in the Commission's floor practice and record keeping case law, an approach that places social cost at the center of the civil monetary penalty determination. Employing that method as explained below, we conclude that each of the respondents should be fined $1 million for their unlawful acts. In addition, we find that, with respect to each respondent, trading prohibitions and cease and desist orders are merited. Moreover, we conclude that First Financial should be deregistered.

Procedural History

In September 2000, the Commission filed a four-count complaint in which the Division charged Glover and DeWitte with defrauding customers, by overstating the expected profitability and understating the risk associated with speculating in options on futures, and alleged that First Financial and Johnson bore secondary responsibility for those acts of fraud that occurred during Glover's and DeWitte's tenure at First Financial.[2] Both in investigational depositions taken by the Division before the Complaint was filed and in their answers to the Complaint, the jointly-represented respondents steadfastly denied engaging in

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[2] In so doing, the Division alleged that the respondents violated Section 4c(b) of the Commodity Exchange Act ("the Act"), 7 U.S.C. §6c(b), and Commission Regulation 33.10, 17 C.F.R. §33.10. See Complaint and Notice of Hearing Pursuant to Sections 6(c), 6(d), 8a(3) and 8a(4) of the Commodity Exchange Act, as Amended, filed September 28, 2000 ("Complaint"), ¶¶36-49. The Division claimed that, as part of the fraud, Glover and DeWitte also lied about their track records in providing specific trading advice to customers. Id., ¶¶18-25, 30, 33-35. The fourth count of the Complaint sets forth the separate but related charge that First Financial and Johnson failed to diligently supervise their employees for the purpose of preventing the alleged fraud and, thereby, violated Commission Regulation 166.3, 17 C.F.R. §166.3. Id., ¶¶50-54.

The Complaint was filed before the Act was amended by the Commodity Futures Modernization Act ("CFMA"), Pub. L. No. 106-554, 114 Stat. 2763 (2000). However, this amendment resulted in no material change to any provision of the Act that the Complaint alleges respondents violated. All references and citations to the Act and to the United States Code refer to both as they existed prior to the CFMA's enactment.

any wrongdoing.[3] Shortly thereafter, however, the respondents ceased offering resistance to the Division's efforts.

When it came time for discovery, the Division served admission requests upon respondents that went unanswered.[4] The Division then filed incomplete prehearing papers[5] while the respondents filed none at all. On September 10, 2001, the respondents made their non-participation official by notifying the Court of their unwillingness to mount a defense.[6] Shortly

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[3] See Answer of Corey Johnson and First Financial Trading, Inc., filed October 26, 2000 ("Johnson Answer"); Answer of Scott DeWitte, filed October 26, 2000; Answer of Thomas Glover, II, filed October 26, 2000; Testimony of Corey P. Johnson, dated June 21, 2000 ("Johnson Test."); Testimony of Scott DeWitte, dated June 20, 2000 ("DeWitte Test."); Testimony of Thomas Glover, dated June 20, 2000 ("Glover Test."). These depositions are among the exhibits filed by the Division in support of its motion for a default order. See Declaration of Lenora Kay Majors-Guy Pursuant to 28 U.S.C. §1746 ("Majors-Guy Decl."), Ex's 17-19.

[4] See Division of Enforcement's Requests for Admissions Directed to Respondent Corey Johnson, dated March 12, 2001; Division of Enforcement's Requests for Admissions Directed to Respondent Scott DeWitte, dated March 12, 2001; Division of Enforcement's Requests for Admissions Directed to Respondent Thomas Glover, II, dated March 12, 2001.

[5] See In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,654 at 52,553 (CFTC Sept. 26, 2001) ("The Division's prehearing memorandum was incomplete because it did not address the issues of sanctions. In failing to discuss these issues, the Division ignored half of its case."). See also Order Establishing Prehearing Procedures, filed October 26, 2000, at 8-10; Division of Enforcement's Prehearing Memorandum, filed June 8, 2001.

[6] See Notice of Intention to Default, filed September 10, 2001. In the notice, the respondents state that they: (1) are aware of (continued..)

thereafter, the Court issued an order that set the deadline for the Division's filing of any motion for a default order.[7] For a time, the Division balked at the Court's directives.[8] However,

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the allegations against them (2) cannot afford continued legal representation, (3) are unwilling to defend pro se, and (4) are aware that monetary and nonmonetary sanctions may be entered against them in a default proceeding in which they will not participate. Id.

[7] See First Financial, ¶28,654 (instituting default proceedings).

[8] To facilitate the proceeding's resolution, the Court sought the Division's input. Among other things, we directed it to "brief[] and provid[e] findings and conclusions on each and every sanctions issue noticed in the Complaint," whether the Division regarded the imposition of any given sanction as warranted or not. Id. at 52,553-54. We further ordered that "[t]he proposed findings of fact should be detailed, specific, and supported with citations to the documentary record in this case," while "[t]he conclusions of law shall be supported by a demonstration of the underlying reasoning with reference to the case law and other authority." Id. at 52,553.

When the Division filed its papers, they contained no detailed and specific findings, conclusions or discussion of whether the Court should issue any trading prohibitions. See Motion for Entry of Findings of Fact, Conclusions of Law, a Default Order and Imposition of Sanctions Against First Financial Trading, Inc., Corey Johnson, Thomas Glover, II, and Scott DeWitte, filed November 29, 2001; Memorandum of Law in Support of the Division of Enforcement's Motion for Entry of Findings of Fact, Conclusions of Law, a Default Order and Imposition of Sanctions Against First Financial Trading, Inc., Corey Johnson, Thomas Glover, II, and Scott DeWitte, filed November 29, 2001 ("Memorandum"), with exhibits; Proposed Findings of Fact and Conclusions of Law, filed November 29, 2001 ("Proposed Findings"); [Proposed] Default Order Making Findings of Fact and Conclusions of Law and Imposing Sanctions Against Respondents, filed November 29, 2001 ("Proposed Default Order"). Remarkably, when called to account, the Division admitted (albeit obliquely)

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that its failure to comply with the Court's September 26, 2001 order was intentional. See Division of Enforcement's Response to Court Order Dated December 7, 2001, filed December 14, 2002, at 2 n.1, 5. More remarkable still, it sought to excuse its noncompliance based on its interpretation of our instructions as constituting an inappropriate Court exploration of its "prosecutorial discretion." Id.; Division of Enforcement's Response to Court Order Dated January 2, 2002, filed January 16, 2002, at 1-2.

The Division's conduct was outrageous on two counts. First, its interpretation of the Court's order was simply incredible. See In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,683 (CFTC Dec. 7, 2001); In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,700 (CFTC Jan. 2, 2002). The Division's credibility to the side, disagreement with a court order is no excuse for flouting it. A party -- especially the government -- is virtually never justified in simply disobeying a court's order. See Berger v. United States, 295 U.S. 78, 88 (1935); Freeport-McMoRan Oil & Gas Co. v. FERC, 962 F.2d 45, 47 (D.C. Cir 1992). As the Supreme Court has explained,

> We begin with the basic proposition that all orders and judgments of courts must be complied with promptly. If a person to whom a court directs an order believes the order is incorrect the remedy is to appeal, but, absent a stay, he must comply promptly with the order pending appeal. Persons who make private determinations of the law and refuse to obey an order generally risk criminal contempt even if the order is ultimately ruled incorrect. The orderly and expeditious administration of justice by the courts requires that 'an order issued by a court with jurisdiction over the subject matter and person must be obeyed by the parties until it is reversed by orderly and proper proceedings.'

Maness v. Meyers, 419 U.S. 449, 458-59 (1975) (Burger, C.J.) (citations omitted). In short, the Division's options in the

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after some coaxing, it complied.[9] Having obtained the Division's reluctant compliance, we can turn to the merits of its default motion. This begins with a review of basic principles governing default proceedings.

The Commission's Default Procedures

In the event of a respondent's default, the Division may, as it did in this case, move for the entry of findings and conclusions, and an order against the respondent "based upon the matters set forth in the complaint, which shall be deemed to be true for purposes of this determination."[10] The concision of this standard, however, can mislead.

The existence of default does not preordain a judgment against the defaulter.[11] As the Supreme Court explained in the

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face of an order that it does not like may include appeal but they do not include vigilantism.

[9] See First Financial, ¶28,683; First Financial, ¶28,700; Division of Enforcement's Response to Court Order Dated January 2, 2002, filed January 16, 2002; Division's Amendment to Default Order on Sanctions, filed January 16, 2002; Division's Amendment to Proposed Findings of Fact and Conclusions of Law, filed January 16, 2002.

[10] See 17 C.F.R. §10.93.

[11] See Frow v. De La Vega, 82 U.S. 552, 554 (1872) ("The defaulting defendant has merely lost his standing in court. He will not be entitled to service of notices in the cause, nor to appear in it in any way. He can adduce no evidence, he cannot be heard at the final hearing."). The modern cases recognize and (continued..)

"venerable but still definitive case" of Thomson v. Wooster, a default judgment "is not a decree as of course according to the prayer of the bill, nor merely such as the complainant chooses to take it; but that is made (or should be made) by the court, according to what is proper to be decreed upon the statements of the bill assumed to be true."[12] Thus, factual allegations, rather than asserted legal conclusions, determine the outcome of default proceedings.

The last statement is both over and under-inclusive. In a default proceeding, not every allegation of the complaint is deemed true. Rather, only "well-pled allegations of fact" support a default judgment.[13] In addition, as in any other adjudicatory

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apply the rule of Frow. See Haines v. Fisher, 82 F.3d 1503, 1511 (10th Cir. 1996); Atlanta Gas Light Co. v. Semaphore Advert., Inc., 747 F. Supp. 715, 719 (S.D. Ga. 1990); Hunt v. Inter-Globe Energy, Inc., 770 F.2d 145, 147 (10th Cir. 1985); Exquisite Form Industries, Inc. v. Exquisite Fabrics of London, 378 F. Supp. 403, 416 (S.D.N.Y. 1974); United States v. Peerless Ins. Co., 374 F.2d 942, 944-45 (4th Cir. 1967).

[12] 114 U.S. 104, 113 (1885); accord Trans World Airlines, Inc. v. Hughes, 449 F.2d 51, 63 (2d Cir. 1971).

[13] See In re Global Link Miami Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,391 at 46,778 n.2 (CFTC June 26, 1998), rev'd on other grounds, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,669 (CFTC June 21, 1999). See also Nishimatsu Constr. Co. v. Houston Nat'l Bank, 515 F.2d 1200, 1206 (5th Cir. 1975) ("The defendant, by his default, admits the plaintiff's well-pleaded allegations of fact," but "a defendant's default does not in itself warrant the court in entering a default judgment. There must be a sufficient basis in the

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proceeding, the Court engages in fact-finding that considers the entire record,[14] and provides for additional fact-finding when necessary and likely to further the resolution of a proceeding,[15] and draws its legal conclusions based on pertinent authority.[16] We now turn to these tasks.

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pleadings for the judgment [to be] entered."); Kelly v. Carr, 567 F. Supp. 831, 840 (W.D. Mich. 1983) ("Facts not established by the pleadings, or claims which are not well-pleaded, are not binding and cannot support a [default] judgment."); 10A Wright & Miller, Federal Practice and Procedure: Civil, §2688 (3d ed. 1998).

Allegations are not well-pled merely because they are intelligible. Allegations that are not well-pled include: (1) allegations made indefinite by other allegations in the same complaint, (2) allegations that are made erroneous by the same complaint, (3) allegations that are contrary to facts of which the court will take judicial notice, (4) alleged facts that are not susceptible to proof by legitimate evidence and (5) alleged facts that are contrary to the uncontroverted material in the file of the case. Trans World Airlines, 449 F.2d at 63.

[14] Cf. Fed. R. Civ. P. 55(b)(2). ("If, in order to enable the court to enter judgment [by default] or to carry it into effect, it is necessary to take an account or determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the court may conduct such hearings . . . as it deems necessary . . . .").

[15] See Global Link Miami, ¶27,391 at 46,786.

[16] See id. at 46,783-85; Global Link Miami, ¶27,669 at 48,164 ("[T]he ALJ has the inherent authority prior to entering a default judgment to consider issues of law posed by the complaint . . . ."). See also First Financial, ¶28,700 at 52,702 n.6 & 52,703-04.

First Financial, Johnson, DeWitte And Glover

First Financial is a defunct Florida corporation with no known assets.[17] It began operating as an introducing broker in July 1999.[18] At the time that the Commission issued the Complaint, First Financial was still doing business.[19] This did not last long because, in December 2000, the National Futures Association ("NFA") terminated its membership.[20] When this occurred, the firm ceased operating.

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[17] See Complaint, ¶2; Memorandum at 23 n.49; Proposed Findings, ¶61 n.5; Proposed Default Order at 16 n.20.

[18] See Complaint, ¶6. First Financial was a "full-service commodity trading firm, solicited clients, serviced clients, general duties that a full-service commodity trading firm would do." Johnson Test. at 25.

[19] See id., ¶1.

[20] See Majors-Guy Decl., ¶3.

First Financial remains registered with the Commission. At present, however, that registration does it little good. Introducing brokers must generally do business with futures commission merchants in order to service their customers with respect to exchange-traded futures and options. The Commission generally requires persons who are registered (or required to be registered) as futures commission merchants to maintain a membership with a Commission-approved futures association. See 17 C.F.R. §170.15(a). At present, there is only one such self-regulatory association, the NFA. NFA Bylaw 1101 generally prohibits members who must be registered as futures commission merchants from doing customer business with persons who must be registered as introducing brokers but are not NFA members. Thus, an introducing broker that loses its NFA membership but retains Commission registration may be able to operate in compliance with federal law but no futures commission merchant is likely to provide the services necessary for it to operate.

Corey Johnson was the sole owner of First Financial from its inception through June 2000.[21] He exercised day-to-day authority over all of First Financial's operations and performed all important managerial and supervisory functions.[22] For example, Johnson set the commissions, salaries and bonuses at the firm,[23] and made all hiring, disciplinary and firing decisions.[24] He also handled all customer compliance matters.[25] In addition to

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[21] See Johnson Test. at 30; DeWitte Test. at 32-33; Glover Test. at 19. In May 2000, Johnson settled an action brought against him by the NFA, in which it was alleged that Johnson, while a broker at another firm, had made deceptive and misleading sales solicitations which downplayed the risks of, and exaggerated the profits of, commodity futures and options trading. As part of the settlement, Johnson agreed to divest his controlling stake in First Financial. Accordingly, in June 2000, Johnson stepped down as a principal of First Financial and transferred 91% of the ownership to his fiancé, Amy Stoeger. See Complaint ¶¶5, 8; Johnson Test. at 29-30; 41-47. Stoeger never played an active role in the operation of the company. See Johnson Test. at 126.

[22] See Johnson Test. at 124 ("I was the supervisor, the principal").

[23] See Complaint, ¶7; Johnson Test. at 32-33.

[24] See Complaint, ¶7; Johnson Test. at 32; Glover Test. at 22, 80, 98-99.

[25] See Complaint, ¶7. See also Johnson Test. at 32, 48, 92, 94, 125, stating,

> My duties were to make sure everything was done ethically, made sure that conversations -- I monitored phone conversations, you know, just to make sure, as I said, there were no problems arising from that. . . . We've got a small office. I can hear everything that takes place. . . . [I] [m]ade sure that when

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managing the business, Johnson spent about a quarter of his time as an account executive soliciting and servicing customers.[26] Along with Johnson, the firm's primary brokers were DeWitte and Glover.[27]

Prior to working at First Financial, Johnson and DeWitte served as account executives for futures and options clients at another introducing broker, American Financial Group Services, Inc.[28] When Johnson left to start up First Financial, he took DeWitte with him.[29] Prior to working at First American, DeWitte was an associated person of another introducing broker, LMB

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> the accounts came in, I signed off on them. I made sure that people that did open accounts were suitable. I made sure when they placed the trades, that they could afford to put the money in the market.

DeWitte Test. at 123; Glover Test. at 27, 88-89, 95.

[26] See Complaint, ¶¶9, 13, 17, 21, 25; Johnson Test. at 24, 34, 40.

[27] See Complaint, ¶6; Johnson Test. at 62; DeWitte Test. at 32; Glover Test. at 22. Over the course of First Financial's brief run, Johnson hired a number of other account executives who quickly exited. They included Chuck Hawley, Jeremiah Johnson, David Zabaglo, Kevin Graham and Carter Walsh. See Johnson Test. at 24-28; Glover Test. at 22.

[28] See Johnson Test. at 17-21.

[29] See id. at 23. Johnson not only obtained the services of DeWitte, the two persuaded some of their American Financial customers to move their accounts to First Financial. See id.

Trading Group, Inc.[30] At LMB, DeWitte had worked with Glover.[31] When DeWitte moved over to First Financial, he approached Glover who joined him at the new firm in September 1999.[32]

Nearly Every One Of First Financial's Customers Lost Money Trading

Unless they were insensitive to their trading results, First Financial's brief life was unlikely a happy time for its clients. Customers opened and traded at least 63 non-discretionary options accounts with First Financial.[33] They fared poorly. Of the 63 accounts, 62 suffered net losses totaling $542,044 (an average loss of $8,742 per account) while one lucky account holder managed to eke out a net profit of $53.[34] Such results came as

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[30] See Complaint, ¶4.

[31] See Complaint, ¶¶3-4; Glover Test. at 19.

[32] See Complaint, ¶3; Glover Test. at 19. Between his stints at LMB and First Financial, Glover spent a brief time with another introducing broker, Nautica Financial Corp. Id. at 13-19.

[33] See Majors-Guy Decl., ¶10; Complaint, ¶22. The record only contains data through May 2000. See Majors-Guy Decl., ¶9.

[34] See Majors-Guy Decl., ¶10; Complaint, ¶22.

Johnson had a perfect record; all of the accounts that he personally serviced lost money. From September 1999 to May 2000, Johnson opened and traded 15 customer accounts. All 15 suffered net losses that, in aggregate, totaled $108,347. See Majors-Guy Decl., ¶11; Complaint, ¶25. When asked, under oath, how his customers fared during his time at First Financial, Johnson replied, "I would say all in all they're doing poorly." Johnson (continued..)

no surprise to the respondents.[35]

The Respondents Violated The Commission's Antifraud Regulation Governing Options

Regulation 33.10

In the Complaint, the Division charges the respondents with violating Commission Regulation 33.10.[36] This regulation

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Test. at 96. This track record was apparently not unusual at First Financial.

At First Financial, DeWitte serviced 19 accounts, including the firm's single winner ($53). DeWitte's other 18 accounts suffered losses totaling $138,122. See Majors-Guy Decl., ¶13; Complaint, ¶24. Glover brokered 27 accounts at First Financial. Glover's accounts lost a total of $248,680. See Majors-Guy Decl., ¶12; Complaint, ¶23.

[35] Although the record contains no data concerning the accounts serviced by DeWitte at American Financial or Glover at Nautica, it reveals that DeWitte's and Glover's customers at LMB also experienced dismal results. DeWitte solicited and opened 23 customer accounts at LMB. All of these accounts suffered losses which, in aggregate, exceeded $213,000. See Complaint, ¶35; Declaration of Ralph L. White, Jr. Pursuant to 28 U.S.C. §1746 ("White Decl."), ¶7. Glover's record at LMB consists of 1 profitable account ($225 gain) and 58 unprofitable ones (losses totaling $442,020). See Complaint, ¶30; White Decl., ¶7.

[36] The Complaint alleges that First Financial's Regulation 33.10 violations occurred from July 1999 until the date of filing (September 28, 2000) and that Johnson's violations took place from July 1999 until he relinquished control of the firm in June 2000. See id., ¶¶1, 5, 8; see also Johnson Test. at 126. DeWitte's fraudulent conduct is alleged to have happened from October 1997 to the filing of the Complaint while at three separate introducing brokers: LMB, American Financial and First Financial. See Complaint, ¶¶46-49. Glover's fraudulent activities allegedly occurred from October 1997 through July 2000 while at two separate introducing brokers, First Financial and

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declares that it is unlawful to "cheat or defraud or attempt to cheat or defraud any other person," to "make or cause to be made to any other person any false report or statement," or "[t]o deceive or attempt to deceive any other person . . . in connection with . . . any commodity option transaction."[37] In order to establish violations of Regulation 33.10 in an enforcement proceeding, the Division must prove that a representation was made that was (1) "in or in connection with" a

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LMB. See id. at ¶¶3, 42-45. Unless otherwise indicated, our findings and conclusions apply to these time periods.

[37] 17 C.F.R. §33.10. See Complaint, ¶¶38-39, 40-41, 44-45, 48-49. Only DeWitte and Glover are charged with primary violations of Regulation 33.10. See id., ¶¶44-45, 48-49. Although the Complaint alleges facts sufficient to have charged Johnson with direct violations as well, it limits its Regulation 33.10 charges against Johnson to those of secondary, "controlling person" liability under Section 13(b) of the Commodity Exchange Act, 7 U.S.C. §13c(b), for DeWitte's and Glover's primary violations while at First Financial. See Complaint, ¶¶13, 17, 21, ¶40. First Financial is charged with another form of secondary liability -- respondeat superior liability -- under Section 2(a)(1)(A)(iii) of the Act, 7 U.S.C. §4, for those alleged primary violations of DeWitte and Glover undertaken while at that firm. See id., ¶¶38-39.

Wherever the Division alleges that the respondents violated Regulation 33.10, it also claims that they violated Section 4c(b) of the Act, 7 U.S.C. §6c(b). See Complaint, ¶¶38, 40-41, 44-45, 48-49. Section 4c(b) leverages a Regulation 33.10 violation into a violation of the Act by prohibiting the offering or entering into any option transaction "contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe." 7 U.S.C. §6c(b).

commodity option transaction, (2) misleading to reasonable customers, (3) made with scienter and (4) material.[38] Upon examination, the default record satisfies each of these elements.

DeWitte And Glover Routinely Promised Their Options Customers High Returns With Virtually No Risk Of Loss

In order to assess the nature of a representation, it is first necessary to determine the representation that was made. As discussed earlier, the respondents, by their default, admit the Complaint's "well-pled allegations of fact." Primarily relying on those allegations, the Court finds that the DeWitte and Glover routinely promised profits to their options customers.[39]

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[38] For an extensive discussion of the elements of commodity sales fraud, and the policies that underlie them, see In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,923-28 (CFTC June 5, 1996), aff'd in relevant part, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997).

[39] The Division filed 15 customer declarations (one unsigned) and a reparations complaint (filed against Glover but dismissed due to settlement) as evidence of the respondents' representations. See Majors-Guy Decl., Ex's 1-16; Gray v. LMB Trading Group, Inc., [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,019 at 49,333 (CFTC Feb. 24, 2000). The declarations do not serve their intended purpose very well. In determining the meaning of a representation, the touchstone is not so much the words of the solicitation, themselves, but the message that those words actually convey. See Staryk, ¶26,701 at 43,924. The understanding of the recipient is not dispositive. Rather, the inquiry focuses on how "a reasonable listener could have understood the statement" in light of the representation's actual content and the surrounding circumstances. Staryk, ¶27,206 at 45,808-09 (emphasis added). Accord Hammond v. Smith Barney, Harris Upham & Co., [1987-1990 Transfer Binder] Comm. Fut. L.
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Both in soliciting potential customers to open accounts and existing customers to trade with First Financial, DeWitte, Glover and Johnson regularly represented that, by following their advice, customers could speculate in options with little or no

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Rep. (CCH) ¶24,617 at 36,657 n.12 (CFTC Mar. 1, 1990); Levine v. Refco, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 at 36,115 n.5 (CFTC July 11, 1989). Customer affidavits generally are of little help in this task. See In re Thompson Medical Research Co., Inc., 104 F.T.C. 648, 789-90; No. 9149, 1984 WL 251754 at *1, 7-8 (FTC Nov. 23, 1984). This case poses no exception to the rule.

The Division's customer affidavits (and the Grey complaint as it relates to Glover) are terribly brief and conclusory. None is longer than three double-spaced pages and the affidavits' actual discussions of the brokers' solicitations are much shorter still. None purports to set forth a detailed and complete account of the broker's conversations with the affiant. Thus, they provide too slim a reed upon which to make findings concerning the actual words uttered by respondents. However, that does not mean that the declarations serve no useful purpose here.

While this evidence is not particularly useful in determining the representations that occurred, when combined with the well pled allegations of the Complaint discussed below, they do serve to patch a hole in that pleading. The Complaint does not clearly indicate how often the respondents made affirmative misrepresentations. The declarations, when read in light of the Complaint's allegations, support the inference that DeWitte and Glover routinely engaged in the type of misrepresentations discussed below during their employment with First Financial as well as their previous employment discussed in footnote 35, supra. See Majors-Guy Decl., Ex's 1-4, 8, 10-14 (referring to Glover's acts); See Majors-Guy Decl., Ex's 5, 6, 9, 15-16 (referring to the representations of DeWitte). See infra text accompanying notes 54-55.

risk of loss.[40] For example, at First Financial, DeWitte told First Financial customers that there was "very little risk involved in trading commodity options,"[41] and that they were "guaranteed to make money."[42] Glover assured various of First Financial customers that their investments would be "safe," "fairly risk free," involved "little to no risk"[43] and were a "sure thing,"[44] and that his strategies for speculation were "virtually foolproof."[45] Johnson also made the same type of representations, referring to his speculative strategies as "conservative," "not . . . risky at all,"[46] and guaranteeing profitable trading.[47] DeWitte and Johnson also promised some customers large profits. DeWitte told at least one customer that he "would get rich" from options speculating,[48] and Johnson told

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40 See Complaint, ¶¶14-17. See supra note 39.

41 Complaint, ¶16.

42 Id., ¶12.

43 Id., ¶15.

44 Id., ¶11.

45 Id., ¶15.

46 Id., ¶17.

47 See id., ¶13.

48 Id., ¶12.

at least one customer that he would make "a substantial profit."[49]

Johnson, Glover and DeWitte fortified their claims of guaranteed profits to First Financial customers with implications that the proof was in the pudding and it had already been born out. Johnson told one or more customers that his accounts enjoyed annual returns of 200% in 1998 and 1999,[50] and both Johnson and Glover claimed that all of their accounts were profitable.[51] At First Financial, DeWitte was a bit more modest. He described his track record as merely "good."[52]

Both DeWitte and Glover had made the same types of claims concerning profit, risk and trading success when brokering at previous employers.[53] DeWitte (while at American Financial and LMB) and Glover (while at LMB) conveyed to some customers that

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[49] Id., ¶13.

[50] See id., ¶21.

[51] See id., ¶¶19, 21.

[52] Id., ¶20.

[53] All of these claims -- whether made at First Financial or elsewhere -- were made "in or in connection with" with commodity options transactions. 17 C.F.R. §33.10. See In re Lexus Fin'ial Group, Inc., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,594 at 47,812 (CFTC April 9, 1999) (finding that solicitations to open commodity options accounts meet the "in or in connection with" requirement of Regulation 33.10 as do representations made in the solicitation of specific orders).

trading commodity options would be "virtually risk free,"[54] and that all of their accounts were profitable.[55]

DeWitte's And Glover's Representations Concerning Profits And Risk Were Misleading

Once it establishes the representations made by respondents, the Division must prove their false or misleading nature. The Division can do this by demonstrating the existence of contrary legislative or adjudicatory facts.[56] Here, the respondents' promises of near certain profits at little or no risk were belied by the record, as well as, fairly undisputable legislative facts.

The trading of futures and options are zero-sum endeavors, meaning that one trader's gain from price movements is wholly derived from another's loss.[57] Although, (putting aside for a

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[54] Id., ¶¶27, 32.

[55] See id., ¶28 (alleging that Glover told customers he "makes money for all of his clients"); id., ¶33 (alleging that DeWitte represented that his other clients were "doing well").

[56] In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,926 (CFTC June 5, 1996), aff'd in relevant part [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997); Syndicate Sys., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,289 at 32,788 (CFTC Sept. 30, 1986).

[57] See In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,576 n.23 (CFTC May 12, 1994); Thomas L. Hazen, Rational Investments, Speculation, or Gambling? -- Derivative Securities and Financial Futures and Their Effect on the Underlying Capital Markets, 86 Nw. U. L. Rev. 987, 1006 (1992).

moment transaction costs) traders break even in the aggregate,[58] the results are not evenly distributed.[59] Transaction costs once again to the side, a relatively small number of traders (trading at relatively high volumes on average) earn profits while the vast majority of traders ("smaller, less sophisticated" traders) lose.[60] Thus, for ordinary retail options customers, trading is risky and profit unlikely. The unexceptional broker who advises

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[58] See Hazen, supra note 57, at 1006. With transaction costs, the net aggregate wash becomes a loss. See id.

[59] For reasons discussed in R&W, it is well accepted by courts that markets such as those for exchange-traded futures and options are informationally efficient in the semi-strong sense. See In re R&W Technical Serv., Ltd., [1996-1998 Transfer Binder] (CCH) ¶27,193 at 45,727 n.75. (CFTC Dec. 1, 1997). But see Rational Expectations and Efficiency in Futures Markets 126-27, 160-61 (Barry A. Goss ed., 1992). This means that, very soon after information becomes public, traders act on it and the price subsequently reflects that information. See Lewis D. Solomon & Howard B. Dicker, The 1987 Crash: a Legal and Public Policy Analysis, 57 Fordham L. Rev. 191, 214 (1988) ("Index arbitrage affects stock prices because the futures market reacts more rapidly to new information than does the stock market."). If this view is correct, no trader can regularly trade profitably without an informational advantage.

[60] See Hazen, supra note 57, at 1006. See also Lynn A. Stout, Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives, 48 Duke L.J. 701, 746 (1999); Lester G. Tesler, Why There are Organized Futures Markets, 24 J.L. & Econ. 1, 9-10 (1981); Richard J. Teweles et al., The Commodity Futures Game: Who Wins? Who Loses Why? 296-97, 303 (1974). This is not to say that one's trading volume has a direct causal relationship with expected success.

customers with non-discretionary accounts is unlikely to change this situation.[61]

DeWitte and Glover's experience reveals that they were not positioned to pick trades for their clients as to which profit was likely and/or the risk of loss minimal. Although they both, at times, laid claim to perfect records of trading success,[62] the truth was remarkably close to the opposite. Not unsurprisingly,

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[61] In the unlikely event that an introducing broker received and processed information as quickly as other market participants (or even marginally faster), the most industrious associated person of the introducing broker servicing non-discretionary accounts is unlikely to impart any informational advantage upon customers. This is so for two interrelated reasons: the need to trade and the time it takes to do so.

Unless acted upon to make trading decisions, a broker's hypothetical informational advantage is of virtually no use to customers. The trade for a nondiscretionary account cannot take place without the specific authorization of the account holder. _See_ 17 C.F.R. §166.2. Thus, in order to impart the benefits of his analysis to customers holding such accounts, the associated person must take the time to call each of his customers, explain the trade and accomplish those ministerial tasks associated with acceptance and transmission of the order. While all this is happening, people are reacting to (or discovering and then reacting to) the information that forms the basis of the hypothetically informationally-advantaged associated person's recommendation. _See supra_ note 59. As a result, there is a high likelihood that the broker's recommendation, even if it was "good" when formulated, will be stale on arrival. More importantly, the assumption that forms the basis of this discussion is really too strong to believe. Retail brokers tend not to have the capacity to impart an informational advantage upon their customers _vis a vis_ floor traders, fund managers, and commodity trading advisors managing discretionary individual accounts.

[62] _See_ Complaint, ¶¶19-20, 28, 33.

44 of the 45 First Financial accounts reflected in the record that either DeWitte or Glover serviced lost money,[63] and 81 out of 82 their LMB accounts were also losers.[64] These track records, in light of the ordinary risks associated with futures and options trading and the ordinary likelihood of retail speculators earning a profit, provides a sufficient basis upon which to conclude that, when DeWitte and Johnson touted trades as having a high probability of turning out profitable and/or involving little inherent risk, their advice was bogus. In addition, they reveal the falsity of respondents' representations concerning their track records. In short, the record establishes the falsity of the representations at issue here. This brings us to the next element, scienter.

DeWitte And Glover Knew That Their Representations Were Misleading

In order to establish a violation of Regulation 33.10, the Division must prove that the misleading statements were made with "scienter."[65] As the Commission has stated, misleading statements

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63 See Majors-Guy Decl., ¶¶12-13; Complaint, ¶¶23-24. See also DeWitte Test. at 73-77; Glover Test. at 33-34.

64 See Complaint, ¶¶30, 35; White Decl., ¶7.

65 See In re Staryk, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,810 (CFTC Dec. 18, 1997). This term of legalese employs the Latin word roughly equivalent to the English "knowingly." See Black's Law Dictionary 1207 (5th ed. 1979).

are made with scienter when, at the time they are made, the "speaker" knows them to be false or harbors a reckless disregard for their truth or falsity.[66]

[66] See Hammond v. Smith, Barney, Harris Upham & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,659 (CFTC Mar. 1, 1990), aff'd sub nom., JCC, Inc. v. CFTC, 63 F.3d 1557 (11th Cir. 1995). Statements are "reckless" if made with so little care that it is "very difficult to believe the [actor] was not aware of what he was doing." Do v. Lind-Waldock & Co., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,516 at 43,321 (CFTC Sept. 27, 1995) (quoting Drexel Burnham Lambert, Inc. v. CFTC, 850 F.2d 842, 848 (D.C. Cir. 1988)). "Mere negligence, mistake, or inadvertence" fail to meet [the] scienter requirement. CFTC v. Noble Metals Int'l, Inc., 67 F.3d 766, 774 (9th Cir. 1995) and cases cited therein.

In Squadrito, the Commission held that recklessness (like knowledge) is a state of mind. See In re Squadrito, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,262 at 38,828 (CFTC Mar. 27, 1992) ("[A] finding of good faith bars a finding of recklessness" (citations omitted)). Without any mention of Squadrito, the Commission may have overturned this holding in Do when it held that recklessness was an objective standard of conduct. See Do, ¶26,516 at 43,321 ("What Lind-Waldock's employee actually believed is irrelevant . . . ."); but see Schurz Communication, Inc. v. FCC, 982 F.2d 1043, 1053 (7th Cir. 1992) (Posner, J.) ("The Commission's [FCC's] treatment of precedent was also cavalier. An administrative agency is no more straight jacketed by precedent than a court is. It can reject its previous decisions. But it must explain why it is doing so."). The pendulum appeared to swing back in Staryk where the Commission found subjective good faith sufficient to preclude a finding of scienter (again without acknowledgment or explanation). See ¶27,206 at 45,811 ("While the deceptive nature of Staryk's solicitations was determined according to an objective standard, his intent in making those representations in a subjective question."); see also In re Staryk, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,515 at 47,378 n.36 (CFTC Dec. 4, 1998). The Commission's latest word on the subject adds still more confusion as it appears to integrate scienter with the heretofore independent element of materiality. See In re R&W Technical Servs., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 at 47,743 (CFTC Mar. 16, 1999)

(continued..)

Making a finding as to a respondent's mental state does not require the trier of fact to read the respondent's mind, or to accept self-serving, but implausible, denials of culpable knowledge.[67] Since a respondent (or, for that matter, anybody else) rarely confesses to engaging in intentional wrongdoing, such a finding may and often results from inferences drawn from circumstantial evidence.[68] On the record before us, we have no trouble finding the requisite scienter. In their investigational depositions, both DeWitte and Glover stated that they knew that

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(finding that a good faith belief that there "was no material difference between an actual trading account and [respondents'] simulated account," does not bar a finding of recklessness where the difference is in fact material and the failure to disclose that advertised results were simulated was "a significant departure from ordinary standards of care" and that, under these circumstances, the respondents' failure to disclose constituted "a reckless disregard for the legal significance of an omitted fact"). For reasons discussed below, there is no need to determine whether, at this point in time in the Commission's eyes, recklessness is a state of mind or an objective standard of conduct. Accordingly, the Court declines to do so.

[67] It is a good thing that we need not do so. See Richard A. Posner, The Problems of Jurisprudence 175 (1990) ("we cannot peer into people's minds, at least not with the clumsy tools of legal procedure").

[68] See In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,579 (CFTC May 12, 1994); see also In re Kolter, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,262 at 42,198 (CFTC Nov. 8, 1994) (finding that an unsupported denial of fraudulent intent is insufficient to defeat motion for summary disposition as "[circumstantial] facts establish scienter, and [respondent] has submitted no controverting evidence").

all or most of their customers closed their accounts at a loss.[69] It therefore inescapably follows that DeWitte and Glover also knew that they were lying when they misinformed customers as to the successfulness of their track records. Moreover, we may confidently infer the both DeWitte and Glover knew that their own customers' unhappy trading experiences belied their promises of near certain profits at little or no risk.[70] In addition, before Glover and DeWitte compiled their sorry track records, the record provides a sufficient basis upon which to infer that they were aware that promises of certain profit, low risk and good track

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[69] See DeWitte Test. at 74; (stating that most of DeWitte's First Financial accounts closed with losses); Glover Test. at 33 (at First Financial, Glover never had a customer close an account with a profit). See also Johnson Test. at 48-58 (admitting that Johnson examined equity runs on DeWitte's and Glover's accounts daily, was aware that most were losing, and discussed these results with them). Although DeWitte's and Glover's testimony do not specifically address whether they monitored the performance of their customers' accounts while working at their previous brokers, it supports the proposition that a broker cannot discuss a client's account without knowledge of its status. See Glover Test. at 31-32 (stating, when asked whether anyone monitors how his clients are doing, "We all do."). From that proposition, we infer that they did.

[70] See In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914 (CFTC June 16, 1995) ("Miller guaranteed profits and promised wildly exaggerated returns. He compared the risk of trading options to investments such as savings accounts and mutual funds. Given the nature of these representations, we have no difficulty inferring that Miller's false statements were intentional rather than reckless."), aff'd in relevant part sub nom. Miller v. CFTC, 197 F.3d 1227 (9th Cir. 1999).

records lacked any basis in fact. In short, scienter is well-established in this record.

DeWitte's And Glover's Misrepresentations Were Material

Neither the Act nor Commission regulations operate to sanction all misrepresentations no matter how distorting or knowingly made. To establish a Regulation 33.10 violation, the Division must prove that the misrepresentation made by a respondent was material.[71] Whether a statement is material depends on the objective standard of whether "it is substantially likely that a reasonable investor would consider the matter important in making an investment decision."[72] Although materiality is "a mixed question of law and fact . . . requiring . . . 'delicate assessments of inferences a reasonable [investor] would draw from a given set of facts and the significance of

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[71] As explained by the Commission, "[t]he function of the materiality requirement is to weed out actions based on trivial or tangentially related representations." Sudol v. Shearson Loeb Rhoades Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,748, at 31,118 (CFTC Sept. 30, 1985). Accord Restatement (Second) of Torts §538(1) ("Reliance upon a fraudulent misrepresentation is not justifiable unless the matter misrepresented is material."). "The most cogent reason for the requirement of materiality is that of promoting stability in commercial transactions." W. Page Keeton et al., Prosser and Keeton on The Law of Torts 753 (5th ed. 1984).

[72] Sudol, ¶22,748, at 31,119 (emphasis in original) (citing TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

those inferences to him,'"[73] some assessments are less delicate than others. DeWitte and Glover's false representations as to the likelihood of profit, the riskiness of options speculation and their historical trading success plainly satisfies Sudol.

As discussed above, futures and options speculation is generally no more than a pure exercise in financial risk-taking, "a zero sum game . . . produc[ing] both winners and losers."[74] Thus, it comes as no surprise that the Commission has long held representations concerning the risk involved in trading and the likelihood of profits to be material as a matter of law.[75] It follows as a matter of logic that broker-specific claims, such as those touting the historical performance of a trading advisor or program, intended to substantiate representations of increased profit and reduced risk are material as well. After all, they concern the same issue – and, for a customer dealing with the broker, more meaningfully – the likelihood of positive and/or negative outcomes of a proposed trade. This is so because supporting claims, such as those touting the historical

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[73] Sudol, ¶22,748 at 31,119 (quoting TSC Industries, Inc., 426 U.S. at 450 (brackets in original)).

[74] JCC, ¶26,080 at 41,576 n.23.

[75] See id. at 41,575; see also Sudol, ¶22,748 at 31,119; Gordon v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,016 at 23,981-82 (CFTC April 10, 1980).

performance of a trading advisor or program, provide information that customers are likely to use in assessing the probability that the investment will perform in the promised manner and whether it is likely to do better or worse that the perceived ordinary outcome.[76] Thus, the misrepresentations of DeWitte and

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[76] See Levine v. Refco, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 at 36,115 (CFTC July 11, 1989) ("[I]n determining whether to rely on a trading program to guide his decisions to enter and exit the futures market, a reasonable customer would think it material that the trading program at issue had never been tested through actual trading."); Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650-51 (CFTC Jan. 17, 1992) (holding that a representation that a trading approach had been tested by actual trading over a 30-month period and had proven successful was material).

As Judge Posner explained,

> [I]n evaluating the cogency of a prediction we should distinguish between the ex ante and ex post perspective. The 'best' prediction in the sense of the one based on the most evidence and the best reasoning may be disconfirmed by events and the worst prediction confirmed. Anyone who in 1985 had made an even-money bet that the Berlin Wall would no longer be standing in five years would have been foolish ex ante, though he would have seemed prescient ex post. . . . . Still the ex post perspective is important. The wisdom of hindsight is not completely spurious. Unless one's predictions are confirmed more often than a random guesser's, we should be suspicious of their quality, however cogent they may have seemed when made.

Richard A. Posner, Public Intellectuals: A Study in Decline 129 (2001). But see Jeffrey J. Rachlinski, A Positive Psychological Theory of Judging in Hindsight, 65 U. Chi. L. Rev. 571, 584 (continued..)

Glover that have been found in this proceeding are material.

With the elements of primary fraud determined in favor of the Division, the Court finds that DeWitte and Glover routinely violated Commission Regulation 33.10 by fraudulently misrepresenting the expected profitability and riskiness of options speculation, and by lying about their customers' past

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(1998) ("people naturally integrate an outcome and the events that preceded it").

Thus, although it is true that past success or failure does not guarantee the same result in the future, it can in some cases be a excellent predictor. See Levine, ¶24,488 at 36,116 n.9. But see Franklin R. Edwards & Cindy Ma, Commodity Pool Performance: Is the Information Contained in Pool Prospectuses Useful?, at 26 (Center for the Study of Futures Markets Working Paper Series No. 166, 1988). For example, if DeWitte's and Glover's accounts had always (or nearly always) been profitable in the past, a reasonable investor might see a powerful statistical case that they were likely to make money for their customers in the future. See In re R&W Technical Servs., Ltd., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,193 at 45,727 n.75 (CFTC Dec. 1, 1997),

> There is good reason for regarding respondents' false claims that the success of their systems had been verified by methodical, forward-looking, actual trading as fraud of the egregious sort. If these claims were in fact true, customers might in fact have reason to believe that Reagan had discovered trading's Elysian fields.

See also In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,929 (CFTC June 5, 1996). Of course, DeWitte's and Glover's claimed historical success was, indeed, too good to be true and far better than the truth. See R&W, ¶27,193 at 45,727 n.75.

success in trading. Given this finding, we must now turn to issues of secondary liability.

Under The Principle Of Respondeat Superior, First Financial Is Strictly Liable For DeWitte's And Glover's Fraud While Employed By The Firm

The Division seeks to establish First Financial's liability for DeWitte's and Glover's violations of Regulation 33.10, during their period of association with the firm, under the theory that the two brokers' wrongdoing was committed within the scope of their employment with the firm.[77] Section 2(a)(1)(A)(iii) of the Commodity Exchange Act provides that "the act, omission, or failure of any official, agent, or other person acting for any other individual, . . . corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, . . . corporation, or trust."[78] Section 2(a) is a variant of the common law principle of respondeat superior, a doctrine that imposes secondary liability on a principal for the wrongdoing of its employees.[79] In the

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[77] See Complaint, ¶¶38-39.

[78] 7 U.S.C. §4.

[79] See Rosenthal & Co. v. CFTC, 802 F.2d 963, 966 (7th Cir. 1986) (Posner, J). The common law principle makes an employer strictly liable -- that is to say, regardless of the presence or absence of fault on the employer's part -- for torts committed by his employees in the furtherance of his business. Id. Section 2(a) departs from the common law in two important respects. First, it expands the doctrine to reach quasi-criminal liability in the
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context of an enforcement proceeding, a respondent's liability under this section depends on proving: (1) that a violation of the Act or Commission regulation occurred, (2) that the person committing the violation was the agent of the respondent and (3) that the violation occurred within the scope of that agency.[80]

We need not encumber this opinion with a lengthy discussion of First Financial's liability under Section 2(a)(1)(A)(iii).[81] First Financial has never disputed that DeWitte and Glover were its agents, and were acting within the scope of their agency when engaging in the complained-of customer solicitations.[82] This is all that is needed to impute to First Financial, DeWitte's and

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enforcement context. Id. ("Strict liability is no stranger to the criminal law either, and anyway, technically at least, section 2(a)(1) is not a source of criminal liability -- though, functionally speaking, a fine is a fine."). In addition, it applies to agents who are not necessarily employees. See id.

[80] See id. at 966-67.

[81] For a much more exhaustive treatment of Section 2(a)(1)(A)(iii) than is necessary here, see Webster v. Refco, Inc., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,578 at 47,694-702 (CFTC Feb. 1, 1999).

[82] See Johnson Answer, ¶9 (admitting paragraph 9 of the Complaint which alleges, "[s]ince approximately July 1999, First Financial, through its A[ssociated] P[erson]s, including Glover, DeWitte and Johnson, solicited members of the general public to trade commodity options."); see also id., ¶6 (admitting paragraph 6 of the Complaint); Johnson Test. at 62; DeWitte Test. at 32; Glover Test. at 19-22.

Glover's violations of Regulation 33.10 during the time of their employment at the firm and we do so here, concluding that First Financial violated Regulation 33.10 by the acts of DeWitte and Glover while in its employment.[83] Having determined First Financial's agency-based responsibility, we next consider Johnson's liability as the "controlling person" of First Financial.

As The Controlling Person Of First Financial, Johnson Is Liable For DeWitte's And Glover's Fraud To The Same Extent As First Financial

Section 13(b) is modeled after the controlling person provisions of federal securities law and exposes "controlling persons" to secondary liability for certain acts of "controlled persons."[84] It provides,

> Any person, who, directly or indirectly, controls any person who has violated any provision of this [Act]

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[83] Once again, in the context of establishing respondeat superior liability in this case, whether First Financial knew about, was involved in or was careless in disregarding DeWitte's and Glover's misconduct is irrelevant. See Rosenthal, 802 F.2d at 967.

[84] 7 U.S.C. §13c(b); see Monieson v. CFTC, 996 F.2d 852, 859 (7th Cir. 1993); Rosenthal, 802 F.2d at 967.

Section 13(b) provides a straightforward method for impeding a principal's ability to shield himself from liability by inserting a corporation between himself and the agent wrongdoer. See Monieson, 996 F.2d at 859 (stating one purpose of Section 13(b) is "to pierce the corporate veil to get at the individuals controlling the corporation"); Rosenthal, 802 F.2d at 967; In re Apache Trading Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,251 at 38,794 (CFTC Mar. 11, 1992).

> or any of the rules, regulations or orders issued pursuant to this [Act] be liable for such violation in any action brought by the Commission to the same extent as such controlled person. In such action, the Commission has the burden of proving that the controlling person did not act in good faith or knowingly induced, directly or indirectly, the act or acts constituting the violation.[85]

Thus, to establish liability under Section 13(b), the Division must prove that the alleged violator: (1) controlled the person or persons who violated the Act, and (2) did not act in good faith or knowingly induced the violation.

The "control" inquiry is two-part. First, general control must be established. Wide-ranging dominance over the operations of an entity at which the violative acts occurred will suffice for this purpose.[86] In this case, the record reveals that Johnson's command over First Financial was virtually absolute from the time that the firm opened for business in July 1999 until Johnson transferred the bulk of his ownership interest to Amy Stoeger in June 2000.[87] During this one-year period, Johnson

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[85] 7 U.S.C. §13c(b).

[86] See In re Spiegel, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,103 at 34,765 n.4 (CFTC Jan. 12, 1988); In re GNP Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. (CCH) ¶25,360 at 39,216 (CFTC Aug. 11, 1992); Apache Trading, ¶25,251 at 38,794; Hickle v. Commodity Fluctuations Systems, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,956 at 31,784 (CFTC Feb. 28, 1986).

[87] See supra note 21 and accompanying text.

was the sole owner of First Financial and exercised hands-on authority over all of its operations in that he: supervised the brokers, monitored their performance, set their pay, hired and had authority to fire them, and handled all customer compliance matters.[88] This is more than adequate to establish Johnson's general "control" over First Financial for purposes of Section 13(b).[89]

In addition to general control over the operations of the entity principally liable, Section 13(b) requires that a person be "possessed [of] the power or ability to control the specific transaction or activity upon which the primary violation was predicated, even if such power was not exercised."[90] Johnson admitted to specifically controlling DeWitte's and Glover's sales solicitations. He testified that among his "duties [was] to make sure that [DeWitte and Glover] service their clients, [to make]

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88 See supra notes 22-25 and accompanying text.

89 See, e.g., Spiegel, ¶24,103 at 34,768 (footnote omitted) (finding general control where respondent was the founder, president, sole shareholder and sole authorized signatory, and possessed the ultimate authority to hire and fire); GNP Commodities, ¶25,360 at 39,216 (finding control when respondent was founder, co-owner, chairman of the board and majority shareholder, had day-to-day control including hiring and firing decisions, set salary levels, resolved disputes regarding commissions, and supervised and gave instructions to top managers).

90 Monieson, 996 F.2d at 859 (citation omitted).

sure everything was done ethically."[91]

Unlike Section 2(a)(1)(A)(iii), secondary liability under Section 13(b) is not strict. It requires culpable conduct on the part of the controlling person, either knowing inducement of the acts constituting the violation, or a failure to act in good faith. Knowing inducement requires a showing that "the controlling person had actual or constructive knowledge of the core activities that constitute the violation at issue and allowed them to continue."[92] The record supports a finding that Johnson possessed the requisite mental state.

There can be no doubt that Johnson knew what DeWitte and Glover were up to and condoned their fraudulent acts. First Financial was housed in "a small office," where Johnson (as well as DeWitte and Glover) could hear "every conversation that [took] place."[93] Moreover, he took additional measures to specifically monitor the brokers' phone calls.[94] Johnson not only allowed

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[91] Johnson Test. at 32. See supra note 25 and accompanying text.

[92] Spiegel, ¶24,103 at 34,767. See also In re Armstrong [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,332 at 42,613 (CFTC Mar. 10, 1995).

[93] Johnson Test. at 94. See also Glover Test. at 88 ("[I]t's a small office. When we put a trade on, we know what the other guy is doing.").

[94] See Johnson Test. at 32 ("I monitored phone conversations, you know, just to make sure, as I said, there were no problems . . . .").

DeWitte and Glover to repeatedly lie to customers about their own track records and about the profit potential and risk of options trading, he encouraged them to do so by engaging in the same type of misconduct.[95] Accordingly, under Section 13(b), we impute liability for First Financial's violations of Regulation 33.10, during the period beginning July 1999 and ending June 2000, to Johnson. With the liability of all four respondents now established, the Court turns to the consideration of appropriate sanctions.[96]

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[95] See supra notes 46-51 and accompanying text. Contrary to his representations to customers, Johnson was aware that his track record was awful. See supra note 34. Thus, he knew that his promises of profits were hokum.

[96] As mentioned earlier, the Complaint also charges First Financial and Johnson with having failed to diligently supervise their employees for the purpose of preventing the alleged fraud in violation of Commission Regulation 166.3, 17 C.F.R. §166.3. See Complaint, ¶¶50-54. The regulation states,

> Each Commission registrant . . . must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised, or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

17 C.F.R. §166.3.

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The Commission has made it clear that "[t]he basic purpose of [Regulation 166.3] is to protect customers by ensuring that their dealings with the employees of Commission registrants will be reviewed by other officials in the firm." Adoption of Customer Protection Rules, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,642 at 22,624 (CFTC July 24, 1978). See also Sherman v. Sokoloff, 570 F. Supp. 1266, 1271 (S.D.N.Y. 1983) ("[I]t is altogether clear from the releases accompanying the proposal and later adoption of §166.3 that its purpose is to insure that *employees* are properly supervised, not to impose a general duty to police the trading in every account carried by the FCM."). The duty includes the supervision of "agents" who are not employees. See Taylor v. Vista Futures, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,165 at 38,430 (CFTC Nov. 20, 1991); Lobb v. J.T. McKerr & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,568 at 36,445 (CFTC Dec. 14, 1989); Rules Pertaining to Registration and Regulatory Requirements for Introducing Brokers, and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity Pool Operators, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,792 at 27,233-34 (CFTC Aug. 3, 1983). Unlike Section 2(a)(1)(A)(iii), liability under Regulation 166.3 is primary, not secondary. See In re Collins, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,194 at 45,744 (CFTC Dec. 10, 1997). Accordingly, Regulation 166.3 liability does not attach for every wrongful act by an employee but requires and attaches to culpable nonfeasance or misconduct in the act of supervision. See In re Collins, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,981 at 44,747 n.114 (CFTC Mar. 5, 1997); Proposed Standards of Conduct for Commodity Trading Professionals for the Protection of Customers, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,474 at 21,934 (CFTC Sept. 6, 1977)

First Financial and Johnson have never disputed that Johnson supervised DeWitte and Glover. See Johnson Answer, ¶7 (admitting paragraph 7 of the Complaint which alleges, "At First Financial, Johnson exercised day to day authority of First Financial's operations, and performed all managerial and supervisory duties."); Johnson Test. at 124 ("I was the supervisor, the principal."). Therefore, the only question left in assessing their liability under Regulation 166.3 is whether Johnson and his wholly-owned firm, First Financial, lacked diligence in overseeing DeWitte's and Glover's customer solicitations. Our

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Sanctions

By the Complaint, the Commission ordered the consideration of sanctions as well as liability.[97] As the Ninth Circuit's

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discussion of Johnson's knowing inducement of the brokers' fraud provides the answer.

Regulation 166.3 requires the employment of a supervisory system and reasonable effort in its application. See Collins, ¶27,194 at 45,744; In re GNP Commodities, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,219 (CFTC Aug. 11, 1992). The record is clear that, at the very least, Johnson and First Financial fell short on the second requirement. As discussed above, they were aware of the fraud committed by Glover and DeWitte and, not only did they not act to stop it, they affirmatively fostered it by example. This was the opposite of diligent supervision and, thus, there is no doubt that First Financial and Johnson fell short of their Regulation 166.3 obligations. See In re Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,469 (CFTC Dec. 10, 1996).

While the failures to supervise are independent violations, they will have no effect on the level of sanctions imposed here other than to help define the scope of any cease and desist order that may be issued. "[I]n determining sanctions our focus is on the overall nature of the wrongful conduct rather than the number of legal theories the Division can successfully plead and prove." In re Interstate Securities Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,954-55 (CFTC June 1, 1992). Accord In re Staryk, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,812 n.13 (CFTC Dec. 18, 1997); In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,936 n.123 (CFTC June 5, 1996). In this case, the failures to supervise were part and parcel of First Financial's fraud by imputation and Johnson's bad-faith control of the firm. Given the violations and secondary responsibility proven with respect to the fraud, finding a failure to supervise is not a substantially aggravating factor.

[97] See Complaint, part V. See also In re Fetchenhier, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,838 at 40,745 (CFTC Aug. 13, 1993) ("Section 6(b) of the Act contemplates a hearing (continued..)

Miller suggests, the imposition of sanctions requires a reasoned application of the material facts to the law.[98] To ensure that

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at which evidence bearing on the issues of liability and sanctions may be presented. . . . [T]he rules themselves do not draw distinctions between liability issues and sanctions issues."); In re Scheck, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,834 at 40,733 (CFTC Aug. 13, 1993); In re Vercillo, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,836 at 40,740 (CFTC Aug. 13, 1993); In re Kenney, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,839 at 40,751 (CFTC Aug. 13, 1993); In re Mosky, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,841 at 40,761 (CFTC Aug. 13, 1993); In re Schneider, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,842 at 40,765 (CFTC Aug. 13, 1993).

There is an unfortunate tendency for the Division to sometimes give the sanctions or remedy part of a case the short shrift. For example, in this case, the Division's prehearing memorandum overlooked the issue of sanctions entirely. See In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,654 at 52,553 (CFTC Sept. 26, 2001). There is some evidence to suggest that this bad habit is ubiquitous among trial lawyers. See FDIC v. W.R. Grace & Co., 877 F.2d 614, 623 (7th Cir. 1989) (Posner J.) ("We have railed repeatedly against the extraordinary casualness that otherwise proficient trial lawyers display at the remedy stage of commercial litigation. All their energies seem to be used up in proving (or disproving) liability." (citation omitted)).

[98] See In re Grossfeld, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,726 at 40,367 (CFTC May 20, 1993) (stating that civil monetary penalty analysis must "reflect[] a reasoned evaluation"); In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,181 (CFTC Mar. 16, 1993) ("Our review focuses on whether the ALJ's choice of sanctions reflects a reasoned application of the factors we have previously identified as relevant to such an assessment."). See also In re Slusser, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 at 48,319 (CFTC July 19, 1999) (acknowledging that an agency's choice of sanctions may be reversed "if unwarranted in law or unjustified in fact"), aff'd in part and remanded on other grounds sub nom., Slusser v. CFTC, 210 F.3d 783 (7th Cir. 2000).

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such an analysis underlies the sanction determination, the law requires transparency -- that is, the decision maker must explain itself.[99] Conclusory generalizations and naked assertions will

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The proper evaluative process frequently involves the legal profession's traditional analytic tool, the case law method. By this inductive approach, the lawyer or judge seeks to isolate the common elements in previous cases to extract a rule for the current case. The most authoritative treatment for reasoning by analogy in law continues to be found in Edward H. Levi, An Introduction to Legal Reasoning (1949). See also Richard A. Posner, Overcoming Law 83-84, 90, 155, 499, 522-23 (1995); Posner, supra note 67, at 86-100.

[99] See 5 U.S.C. §557(c)(3) ("All decisions, including initial, recommended, and tentative decisions, are part of the record and shall include a statement of -- (A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and (B) the appropriate rule, order, sanction, relief, or denial thereof.") As is explained in the legislative history of Section 557(c)(3),

> The requirement that the agency must state the basis for its findings and conclusions means that such findings and conclusions must be sufficiently related to the record as to advise the parties of their record basis . . . .
>
> Findings and conclusions must include all the relevant issues presented in the record in the light of the law involved. . . . It should also be noted that the relevant issues extend to matters of administrative discretion as well as of law and fact. . . . [W]ithout a disclosure of the basis for the exercise of, or failure to exercise, discretion, the parties are unable to determine what other or additional facts they might offer by way of rehearing or reconsideration of decisions.

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not do.[100] In other words, talismanic invocations are "inadequate substitute[s] for an explanation of what facts [are] considered relevant in th[e] particular case and how those facts considered individually or as a whole" control the outcome under pertinent legal authority.[101] With these principles in mind, the Court proceeds to determining the propriety of and, if proper, the terms upon which to impose: (1) cease and desist orders (2) registration revocation, conditioning or suspension; (3) trading prohibitions; (4) civil monetary penalties; and (5) restitution.[102]

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Sen. Rep. 752, 79th Cong. 1st Sess. at 24-25 (1945); H.R. Rep. 1980, 79th Cong. 2nd Sess. at 39 (1946), cited in Attorney General's Manual on the Administrative Procedure Act 86 (1946).

100 For example, the decision maker's statement that an issue involves "a subjective determination . . . based on the unique factual circumstances of [the] individual case" is insufficient as explanation. In re Horn, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,731 at 33,889 (CFTC July 21, 1987).

101 Horn, ¶23,731 at 33,889; accord In re Horn, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,836 at 36,939 (CFTC April 18, 1990). For a discussion of the sources of the law that binds the Court's determinations, see In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,700 at 52,703 n.17 (CFTC Jan. 2, 2002).

102 See Complaint, part V; 7 U.S.C. §§9, 15, 13b, 12a(3) and 12a(4); see also 17 C.F.R. §§10.110-114.

Cease and Desist Orders Are Warranted Against All Four Respondents

Section 6(d) of the Act provides that, when a violation of any of the provisions of the Act or Commission regulations has been proven, a respondent may be directed to cease and desist from engaging in any further violations of the offended provisions.[103] On consideration of the record and the law, we impose this sanction on all four respondents for their violations of Regulation 33.10 (and their derivative violations of Section 4c(b) of the Act),[104] and on First Financial and Johnson for their violations of Regulation 166.3.[105]

Because of its forward-looking nature, a cease and desist order may, at first glance, appear to be a weak remedy. But it

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[103] See 7 U.S.C. §13b ("If any person (other than a contract market) . . . is violating or has violated any of the provisions of this [Act] or of the rules, regulations, or orders of the Commission thereunder, the Commission may, upon notice and hearing, . . . make and enter an order directing that such person shall cease and desist therefrom . . . .").

[104] See supra notes 36-96 and accompanying text.

[105] The Division proposes the entry of cease and desist orders with prohibitions limited to further breaches of Regulation 33.10 and Section 4c(b). See Proposed Default Order at 17. The record does not clearly indicate whether the proposal's omission of cease and desist provisions against First Financial and Johnson tied to future violations of Regulation 166.3 was intentional or merely an oversight. See Memorandum at 17-18. In any event, as we now discuss, the law supports the entry of cease and desist orders covering all sections of the Act and Commission regulations which we have found to have been violated.

is not nearly so feeble. Although it does not immediately level monetary, trading, or registration sanctions against the respondent, a cease and desist order is not merely a badge of shame. It provides the basis for independent public (and private) causes of action.[106] Therefore, while "[a]s a general proposition, cease and desist orders should be entered against those who have been adjudged to have violated the Act," imposition has, in the past, not been automatic.[107]

Traditionally, the Commission conditioned the imposition of a cease and desist order on proof of "a reasonable likelihood that the earlier violations will be repeated."[108] This showing

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[106] Noncompliance with a cease and desist order may result in a monetary penalty of $100,000 or triple the gain of the wrongdoing resulting from noncompliance, and/or imprisonment for a period ranging from six months up to one year. See 7 U.S.C. §13b; 7 U.S.C.A. §13b (West Supp. 2002). In addition, each day of noncompliance is deemed a separate offence. See 7 U.S.C. §13b; 7 U.S.C.A. §13b (West Supp. 2002). Certain violations may result in more severe sanctions, including imprisonment for up to five years. See 7 U.S.C. §13(a)(1); 7 U.S.C.A. §13(a)(1) (West Supp. 2002). Moreover, violations of cease and desist orders that injure others could form the basis of reparations actions. 7 U.S.C. §18(a).

[107] In re Richardson Securities Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,647 (CFTC Jan. 27, 1981). See Precious Metals Assocs., Inc. v. CFTC, 620 F.2d 900, 912 (1st Cir. 1980).

[108] In re Dillon-Gage, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,574 at 30,482 (CFTC June 20, 1984). See also In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,181 (CFTC Mar. 16, 1993).

has been eased by the Commission's strong endorsement of the inference that, if misconduct had been repeated in the past, it was likely to be repeated in the future.[109] This inference was not conclusive. Even if the proven violations were reoccurring, thereby triggering the presumption of likely future violations, the presumption could be rebutted by evidence of mitigation or rehabilitation.[110]

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[109] In the words of the Commission, "[t]he likelihood of future violations may be inferred from a pattern of past unlawful conduct, but not from an isolated instance of past unlawfulness." Dillon-Gage, ¶22,574 at 30,482-83. Accordingly, in the past, proof of a single violation of the Act or Commission regulations, standing alone, has been insufficient to warrant a cease and desist order -- even in cases where the infraction has been intentional or serious. See In re Brody, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,081 at 32,180-81 (CFTC May 20, 1986); Dillon-Gage, ¶22,574 at 30,483; Richardson Securities Inc., ¶21,145 at 24,647. For a lengthier discussion of the rule that emerges from Brody, Dillon-Gage and Richardson Securities, see this Court's discussion in In re Kelly, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,289 at 46,305 n.124 (CFTC Feb. 24, 1998).

[110] Mitigation and rehabilitation evidence both sharply focus on the nature and circumstances of the disqualifying act but for different reasons. Mitigation "tend[s] to show that the violation was less serious than it appears." In re Schillaci, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,735 at 44,042 (CFTC July 11, 1996). Thus, a mitigation showing consists of "evidence that the wrongdoing at issue arose from a good faith error or some type of exigent circumstance unlikely to be repeated in the future." In re Horn, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,836 at 36,940 n.16 (CFTC April 18, 1990). Rehabilitation looks to whether the respondent has "changed direction in his activities" since the time of his violation. In re Walter, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,215 at 35,013 (CFTC April 14, 1988) (quoting In re Tipton, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,673 at 22,752 (CFTC Sept. 22, 1978)). Rehabilitation (continued..)

Under these standards, this case merits cease and desist orders against all of the respondents with respect to all counts of the Complaint.[111] Over a course of years, DeWitte and Glover

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evidence must directly relate to the wrongful conduct at issue and show that conduct of that nature will not be repeated. See In re Akar, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,927 at 31,709-10 (CFTC Feb. 24, 1986).

In Dillon-Gage, for example, the Commission considered the question of whether the respondent's 11 violations constituted grounds for a cease and desist order and found both mitigation and rehabilitation. As to the first eight, based on record keeping and commingling violations, the Commission characterized them as "one-time errors or apparently good-faith differences of opinion" that occurred during the respondent's start-up (mitigation). Dillon-Gage, ¶22,574 at 30,483. On that basis, the Commission concluded that those violations did not merit a cease and desist order. Id. The Commission considered the remaining violations to be more serious in nature, but reached the same conclusion, this time based on the respondent's subsequent remedial measures and cooperation with the Commission in achieving and maintaining compliance (rehabilitation). Id.

In its consideration of mitigation and rehabilitation evidence, the Commission's law on cease and desist orders parallels the Commission's law considering disqualification from registration -- an area too where proof of misconduct gives rise to a rebuttable presumption of likely recidivism. See infra notes 117-22 and accompanying text.

[111] It is no longer clear that the Commission still adheres to these standards. Two more recent cases appear to require little or no showing (beyond proof of a predicate violation of the Act or Commission regulations) in support of the imposition of a cease and desist order. In New York Currency Research, the Commission imposed, without explanation, a cease and desist order for a single act in violation of the record production requirements of Section 4n(3)(A), 7 U.S.C. §6n(3)(A), and Commission Rule 1.31, 17 C.F.R. §1.31, while ignoring considerable record evidence of mitigation. See In re New York Currency Research Corp., [1996-1998 Transfer Binder] Comm. Fut.

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L. Rep. (CCH) ¶27,223 at 45,915 (CFTC Feb. 6, 1998), rev'd on other grounds, 180 F.3d 83 (2d Cir. 1999). Indeed, the Commission left undisturbed the administrative law judge's finding that the respondent had resisted the production demand in good faith under color of law. Id.; see also In re New York Currency Research Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,222 at 45,905 (CFTC Jan. 12, 1998). Oddly, the Commission's entire discussion of the cease and desist sanction is limited to the declaration that "[o]ur assessment of the record and other relevant factors establishes that a cease and desist order and a civil monetary penalty of $110,000 are warranted," New York Currency Research ¶27,223 at 45,915. This perfunctory treatment seems inconsistent with its previous admonishments that reasoning is to be discussed and not merely asserted. See supra notes 100-01 and accompanying text.

In another more recent record production case, the Commission again imposed a cease and desist order for a single act in violation of the record production requirements and did so despite the fact that, after a de novo review of the record, it found evidence supporting mitigation and rehabilitation. See In re Kelly, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,514 at 47,374 (CFTC Nov. 19, 1998) ("Kelly had been registered for only a short time, and to some extent, his violations [sic -- only one violation was established] may be attributed to his lack of familiarity with the responsibilities attendant upon being a Commission registrant. Kelly's customers were not affected by his violations, and Kelly eventually did produce the documents after this proceeding had been instituted."), rev'g in relevant part, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,289 at 46,305 n.124 (CFTC Feb. 24, 1998). Below, the administrative law judge had found liability but had declined to impose a cease and desist order, reasoning from the case law that "[a] single violation of the Act or regulations, even if intentional and even if serious, does not amount to behavior that supports the imposition of a cease and desist order." Kelly, ¶27,289 at 46,305 n.124. The Commission's reversal, of course, implicitly rejects this rule.

A fair reading of New York Currency Research and Kelly suggests that a cease and desist order may now be automatic (or nearly so) upon a finding of a violation. However, we need not and do not decide the extent, if any, to which the Commission has effected this possible sea change in the law since, in this case,
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repeatedly misrepresented the profit and risk attributes of options speculation, and lied about their customers' past success in trading.[112] As for Johnson, he spent his 12-month run as the sole owner and manager of First Financial leading the way for broker misconduct, by: (1) making the same types of misrepresentations to customers, (2) disregarding his and First Financial's supervisory responsibilities under Commission Regulation 166.3 and (3) encouraging DeWitte's and Glover's continuing wrongdoing.[113]

In short, the respondents' wrongdoing was anything but a good faith error or some other type of excusable mistake. Rather, it was prolonged, willful and egregious. In addition, there is nothing in the record to suggest any "changed direction" by the respondents. If the opportunity were to arise in the

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cease and desist orders are warranted against the respondents even under the more exacting traditional standard governing their imposition.

[112] See supra notes 40-64 and accompanying text. DeWitte's fraudulent conduct took place from October 1997 until September 2000 while at three separate introducing brokers. See Complaint, ¶¶46-49. Glover's fraudulent activities occurred from October 1997 through July 2000 while at two different introducing brokers, First Financial and LMB. Id. at ¶¶3, 42-45. As discussed earlier, First Financial is liable under the principle of respondeat superior for the continuing course of misconduct of these two brokers while in its employ. See supra notes 77-83 and accompanying text.

[113] See supra notes 84-96 and accompanying text.

future to profit from such misconduct, there is every reason to believe that they would act as they have. Under these circumstances, the law steps in to impose the deterring hand of sanctions, including the imposition of cease and desist orders.

First Financial's Violations Of Commission Regulations 33.10 And 166.3 Constitute "Good Cause" For The Revocation Of Its Registration

In cases where respondents are registered, the law authorizes more than deterring sanctions, it permits the imposition of impediments. One of these is deregistration. The Complaint directs the Court to consider whether any registration sanctions are warranted against the respondents, pursuant to Sections 8(a)(3) and 8a(4) of the Act.[114] Under Section 8a(4), the Court may suspend or revoke the registration of "any person registered under the Act if cause exists under [Section 8a(3)] which would warrant a refusal of registration of such person." Section 8a(3) includes a number of specific conditions or circumstances constituting "cause" for refusal of registration -- as well as a catchall provision, Section 8a(3)(M), whereby the Commission may refuse to register a person for "other good

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[114] See 7 U.S.C. §12a(3)-(4). See Complaint, part V.

cause."[115] We consider this catchall provision first and as to First Financial only.[116]

We agree with the Division that First Financial's violations meet the "other good cause" standard for revocation of its registration as an introducing broker.[117] In the absence of any statutory definition for "other good cause," the Commission has

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[115] 7 U.S.C. §12a(3)(M). The 1982 amendments to the Act created the existing statutory structure for disqualification from registration. See Futures Trading Act of 1982, Pub. L. 97-444, 96 Stat. 2294 (1983); see also In re Clark, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,032 at 44,928 (CFTC April 22, 1997). The existence of "other good cause" or any of the other specifically enumerated conditions set forth in Section 8a(3) creates a presumption that the applicant is unfit to act as a Commission registrant. Once one of these conditions is established, the Division's burden of producing evidence is fulfilled. See Walter, ¶24,215 at 35,010. The burden then shifts to the registrant to produce evidence demonstrating that, despite the disqualifying conduct, his continued registration would pose no substantial risk to the public. See Akar, ¶22,927 at 31,708. To overcome the presumption that registration would raise a substantial risk to the public, the registrant (or applicant) presents two types of evidence: mitigation and/or rehabilitation. See Horn, ¶23,731 at 33,889; Akar, ¶22,927 at 31,708. See also 17 C.F.R. §§3.60(b)(2)(ii)(A)-(B), (f)(1)-(2).

[116] The Division points out that First Financial is the only respondent in this proceeding eligible for revocation because it is the only one still registered. See Memorandum at 22-23. Commission precedent confirms the view that enforcement actions are not a forum for the revocation of non-existent revocations or the denials of applications for registration not yet submitted. See In re Commodities Int'l Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,566 (CFTC Jan. 14, 1997); In re Newman, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,356 at 39,191 (CFTC Aug. 6, 1992).

[117] See Memorandum at 22-23.

developed a model by which to evaluate misconduct not otherwise specifically covered in Section 8a(3). The Commission's Interpretative Statement With Respect to Section 8a(3)(M) of the Act states,

> [Section 8a(3)(M)] authorize[s] the Commission to affect the registration of any person if, as a result of any act or pattern of conduct attributable to such person . . . such person's potential disregard of or inability to comply with the requirements of the Act or the rules, regulations or order[s] thereunder, or such person's moral turpitude, or lack of honesty or financial responsibility is demonstrated to the Commission.
>
> Any inability to deal fairly with the public and consistent with just and equitable principles of trade may render an applicant or registrant unfit for registration, given the high ethical standards which must prevail in the industry.[118]

As we have seen, First Financial was, at its core, little more than a three-man operation that routinely sought to defraud options customers. Thus, in its brief active life, First Financial obviously demonstrated an "inability to deal fairly with the public" as well as an utter disregard for "just and equitable principles of trade." Moreover, First Financial's violative conduct indicates more than "a potential disregard of or inability to comply with the Act" or Commission regulations. It indicates an actual disregard for the law.[119]

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[118] 17 C.F.R. pt. 3, app. A, cited in Clark, ¶27,032 at 44,928.

[119] We cannot consider grounds for statutory disqualification the notice of which was not provided in the Complaint. See In re (continued..)

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Riley, [2000- 2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,611 at 52,225 (CFTC Aug. 9, 2001) ("We do not view the ALJ's statements that Riley's conduct violated Sections 4b and 4c(a) as findings of violations under the CEA, because those provisions of the CEA were not charged. . . . The incident of prearranged trading renders Riley disqualified under Section 8a(3)(M) -- and nothing more."); Savage v. CFTC, 548 F.2d 192, 197 n.7 (7th Cir. 1977) (holding that where the Commission affirmed the administrative law judge's denial of an applicant's registration, but under a different subsection of Section 8a(2) than the one relied on by the Judge, the applicant was not prejudiced because "[t]he order initiating the hearing did not limit the inquiry to a particular subsection"). But see Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,181 (CFTC Feb. 25, 1993) (finding statutory disqualification under Section 8a(2), although only Sections 8a(3)and 8a(4) were pled in the complaint); In re Gordon, CFTC Docket No. 90-19, 1990 WL 294100, at *3 (CFTC Aug. 28, 1990) (Commission complaint and notice of hearing) (providing notice of statutory disqualification grounds that included Sections 8a(3)and 8a(4) and not Section 8a(2)). Had the Court been directed to consider First Financial's disqualification under Section 8a(2), 7 U.S.C. §12a(2), there would be additional grounds upon which to presume the firm's unfitness.

Section 8a(2)(E) authorizes the Commission to revoke, after hearing, the registration of any person found to have violated any provision of the Act or Commission regulations "where such violation involves . . . fraud." First Financial's violations of Section 4c(b) and Regulation 33.10 meet this standard. See Gordon, ¶25,667 at 40,181 ("[B]ecause Gordon's violations of Section 4c(b) involve fraud, he is subject to a statutory disqualification from registration pursuant to Section 8a(2)(E) of the Act. Thus, the ALJ's findings raised a presumption that Respondent is unfit for continued registration.") (citations omitted). It is difficult to explain the Commission's failure to proceed under Section 8a(2) as anything other than a drafting oversight, since the pleading of the section would not have required the Division to produce any additional evidence but would have resulted in a stronger presumption of unfitness for registration. Section 8a(2) requires an applicant or registrant to overcome a presumption of unfitness by making a "clear and compelling" showing that his registration would not raise a substantial risk to the public, while Section 8a(3) employs the

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First Financial's proven violations also warrant revocation of registration under another subsection of Section 8a(3). Section 8a(3)(A), in relevant part, creates a presumption that a person is unfit for registration, if "such person has been found by the Commission . . . to have violated . . . any provision of this [Act] or any rule, regulation, or order thereunder (other than a violation set forth in [Section 8a(2)]) . . . ."[120] Since First Financial violated Regulation 166.3, it also meets the specific conditions for disqualification under this subsection.[121]

For the reasons discussed above, the burden shifts to First Financial to rebut the presumption that continued registration would raise a substantial risk to the public. To do this, it

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lesser "preponderance of the evidence" standard. See In re Horn, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,836 at 36,939 (CFTC April 18, 1990); In re Antonacci, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,835 at 36,930 (CFTC April 18, 1990); see also 17 C.F.R. §3.60(e).

120 7 U.S.C. §12a(3)(A). For a discussion of Section 8a(2)(E), see supra note 119.

121 See Monieson v. CFTC, 996 F.2d 852, 863 (7th Cir. 1993) (finding that a violation of Regulation 166.3 triggers a presumption of unfitness for registration).

must present evidence of mitigation and/or rehabilitation.[122] First Financial's default seals its fate on these points. As we discussed when considering the imposition of cease and desist orders and possibly as a result of its default (but, possibly, as a result of the absence of evidence), the record contains no showing of First Financial's rehabilitation or of mitigation. Thus, deregistration is in order.

The Respondents Should Be Permanently Banned From Trading

Section 6(c) of the Act provides that, when a violation of any of the provisions of the Act or Commission regulations have been proven, the Commission may prohibit a respondent from trading on contract markets.[123] Our review of the pertinent authority leads us to conclude that permanent trading bans should be entered against all four respondents.[124]

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122 See supra note 115.

123 See 7 U.S.C. §9.

124 As noted in our discussion of the procedural history, the Court engaged in a considerable struggle with the Division in an effort to have it explain its position as to whether the Court should impose trading prohibitions in this case. See supra note 8.

Initially, the Division stonewalled by merely giving its position but not explaining it. To be more precise, it addressed the question of whether this case merits the imposition of a trading prohibition against one or more of the respondents by simply stating that "[g]iven the specific factual circumstances that are present in this case," the imposition of a trading ban on any of the respondents is not "appropriate." See Memorandum (continued..)

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at 23; Proposed Findings, ¶61; Proposed Default Order at 16. The Division attached a single footnote to this bare conclusion which stated, "The nature of the alleged violation was solicitation fraud by a registered IB [introducing broker] and its APs [associated persons], which caused customers to open, fund and trade accounts at futures commission merchants." Memorandum at 23 n.50; Proposed Findings at ¶61 n.6; see also Proposed Default Order at 16 n.20. Far from illuminating the reasons why the Court should not issue trading bans in this case, this cryptic statement only confounded the issue, since the facts highlighted in the footnote appear to squarely support the imposition of a trading ban under controlling precedent. See In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,683 at 52,669 n.7 (CFTC Dec. 7, 2001) (discussing In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,913-14 (CFTC June 16, 1995)).

When the Court pressed the Division to further explain itself, it at first refused, arguing its position that trading bans were not "appropriate" was an unreviewable exercise in prosecutorial discretion. See Division of Enforcement's Response to Court Order Dated December 7, 2001, filed December 14, 2002, at 2 n.1. "The Division believes that it correctly exercised its prosecutorial discretion in not seeking a trading prohibition in this matter. . . . [S]uch exercise of the Division's discretion is inappropriate for review by the court."). Id. at 5. This argument glossed over the fact that the Division was doing something more here than simply exercising prosecutorial discretion -- it was urging the Court to share in that discretion by signing an order that simply deferred to the Division position. See Proposed Default Order at 16.

Frustrated but undeterred, the Court pressed further and this time reminded the Division of the obvious, that unlike a prosecutor deciding whether to seek a sanction that may be reasonably justified, the Court is bound by law in effecting the Commission's directives. Thus, it may impose sanctions the Division does not seek. See Monieson, 996 F.2d at 862 (affirming a trading ban "even though the Division of Enforcement has not asked for any ban at all"); see also Miller v. CFTC, 197 F.3d 1227, 1235 (9th Cir. 1999) (affirming the Commission's authority to increase a civil monetary penalty above that imposed by the administrative law judge, even though the Division did not seek the higher penalty, and noting that the Administrative Procedure

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Trading prohibitions are appropriate when a nexus connects a respondent's violations to the integrity of the futures market.[125] Such a nexus exists when the respondent's misconduct represents an inherent threat to the market. This threat need not be reflected in the futures and options prices or interfere with normal trading patterns. It is sufficiently present when conduct

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Act, 5 U.S.C. §557(b), "invests the Commission with 'all the power which it would have in making the initial decision.'"). "Moreover, while an exercise of prosecutorial discretion need not be explained, federal law requires the Court to explain itself." In re First Financial Trading, Inc., [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,700 at 52,702 (CFTC Jan. 2, 2002). See supra note 101 and accompanying text. Accordingly, we once again directed the Division to properly submit proposed findings of fact and conclusions of law for the Court's consideration on the issues of whether trading bans should be entered. Id. at 52,704.

The third time was a charm and the Division finally filed the required submissions. See Division of Enforcement's Response to Court Order Dated January 2, 2002, filed January 16, 2002 ("Response to January 2 Order"); Division's Amendment to Default Order on Sanctions, filed January 16, 2002 ("Amended Default Order"); Division's Amendment to Proposed Findings of Fact and Conclusions of Law, filed January 16, 2002 ("Amended Proposed Findings"). In these papers, the Division "conclude[s] that a trading prohibition is warranted under the current law." Response to January 2 Order at 3. See also Amended Default Order at 2; Amended Proposed Findings, ¶4. According to the Division, the law "requires" that Glover be permanently prohibited from trading, DeWitte be banned from trading for ten years, and that First Financial and Johnson be so prohibited for a five-year period. See Amended Default Order at 4; Amended Proposed Findings, ¶10.

[125] See In re Incomco, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537 (CFTC Dec. 30, 1991).

erodes "[p]ublic perception, protection, and confidence in [the] markets."[126] These principles have led the Commission to impose a trading ban on a broker in circumstances materially identical to the present case.

In Miller, the Commission imposed a trading ban on a broker as a consequence of finding that he (like the four respondents in this case) violated Section 4c(b) and Commission Regulation 33.10 by "guarantee[ing] profits and promis[ing] wildly exaggerated returns."[127] Although "there [was] no evidence that Miller . . . engaged in personal trading or ever intend[ed] to do so,"[128] the Commission nonetheless concluded that the "fraudulent solicitation of trades" does "potential harm to the 'integrity of the market in the public eye.'"[129] In so concluding, it noted,

> When the Commission registers an individual as an associated person it gives that individual the right to handle the accounts and, thus, the funds of his customers. Inherent in that right is the requirement of the registrant to discharge his responsibilities in an honest, forthright manner befitting the fiduciary duty bestowed upon him by the [Commodity Exchange Act]. By engaging in unauthorized trading or any other type of fraud, an associated person violates this right, breaches his position of trust, and illegally takes from the customer that which the customer has earned,

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126 Miller, ¶26,440 at 42,914.

127 Id.

128 Id. at 42,915 (Schapiro & Bair, Comm'rs, dissenting).

129 Id. at 42,914 (quoting Monieson, 996 F.2d at 862).

> saved, and sought to invest. The consequence of said violation, breach and illegal act is that the integrity of the futures market is indeed damaged.[130]

Both the holding in Miller and the reasoning supporting it require that trading bans be imposed against all four respondents in this case.[131]

Having concluded that trading prohibitions are warranted, the Court now must decide their length. The Commission has

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[130] Id., 42,913 n.7 (quoting with approval, In re Paragon Futures Assoc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,266 at 38,852 (CFTC Apr. 1, 1992) (Dial, Comm., concurring in part, and dissenting in part)). Accord In re R&W Technical Servs., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 at 47,748 (CFTC Mar. 16, 1999) (finding that the nexus between respondents' violations and the integrity of the futures market insufficient to warrant trading ban, where commodity trading advisors who had failed to register as such and who had engaged in the fraudulent solicitation of customers to purchase computerized trading systems, "did not themselves trade futures, did not manage accounts for clients, and did not seek to manipulate prices.").

[131] As the Fifth Circuit has stated, "[the] law does not permit an agency to grant to one person the right to do that which it denies to another similarly situated. There may not be a rule for Monday, and another for a Tuesday, a rule of general application, but denied outright in a specific case." Frozen Foods Express, Inc. v. United States, 535 F.2d 877, 880 (5th Cir. 1976) (quoting Mary Carter Paint v. FTC, 333 F.2d 654, 660 (5th Cir. 1965)). In a similar vein, the Commission has cautioned that a decision-maker "must be prepared to explain its failure to reach a similar conclusion in situations that are apparently comparable." In re Horn, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,836 at 36,939 (CFTC April 18, 1990). We note that, although the Division has not asked the Court to impose a trading prohibition against the respondents, it concedes "[s]ince the underlying facts of the fraud in this case are very similar to those in Miller, a trading prohibition is warranted in this case." Amended Default Order at 2; Amended Proposed Findings, ¶1; see supra note 124.

consistently stated that the length of trading ban should correlate with the "gravity" of the offense.[132] Over time, the Commission has provided increasingly detailed explanations of what it means by the "gravity" of particular misconduct.[133] This effort has culminated in the enumerations of factors that include: "(1) the relationship of the violation at issue to the regulatory purposes of the Act; (2) respondent's state of mind; (3) the consequences flowing from the violative conduct; and (4) respondent's post-violation conduct. In addition, [the Commission] consider[s] any mitigating or aggravating circumstances presented by the facts."[134] Under these factors, "defrauding customers — is very serious even if there are mitigating facts and circumstances."[135] It is even more serious

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[132] See Miller, ¶26,440 at 42,914; In re Incomco, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537 (CFTC Dec. 30, 1991).

[133] See R&W, ¶27,582 at 47,748; In re Premex, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,165 at 34,890-92 (CFTC Feb. 17, 1988); In re Sanchez, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,985 at 28,213 (CFTC Jan. 31, 1984); In re Haltmier, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,160 at 20,978 (CFTC May 5, 1976).

[134] R&W, ¶27,582 at 47,748 (citing In re Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,467-68 (CFTC Dec. 10, 1996)).

[135] Grossfeld, ¶26,921 at 44,467 n.28 (citation omitted). In the case at hand, of course, we have fraud without mitigation.

if done intentionally (rather than recklessly) and repeatedly.[136]

While the Commission has explained the components of gravity, determining the bottom-line gravity of misconduct (and assessing the ex ante correctness of that decision in the eyes of the Commission)[137] still requires substantial guesswork. This is so because, eschewing a "specific formula" in the sanctions assessment,[138] the Commission employs "a visceral mixing of incommensurables"[139] -- that is, it engages in a far-ranging inquiry into a multitude of generalized factors without assigning a specific weight to any one of them (or adhering to any other principles of absolute or relative quantification).[140] Obviously, this approach lacks rigor. In addition and across

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136 Id. at 44,467 n.29. See also Miller, ¶26,440 at 42,914;

137 Even if Commission guidance seems clear, literally following it is not a certain method of avoiding error or the need for a remand after Commission review. See In re Zuccarelli, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,637 at 52,432 (CFTC Sept. 7, 2001) ("The remand instruction could have been clearer; its essential intent . . . is not plain on the face of its decision."); In re Collins, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,194 at 45,742 (CFTC Dec. 10, 1997).

138 R&W, ¶27,582 at 47,748.

139 Posner, supra note 67, at 447.

140 See In re Cargill, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,425 at 51,225-26 (CFTC Nov. 22, 2000) (this Court discussing the generic shortcomings of multi-factor, or "holistic," legal approaches).

cases, it can easily lead to disparate results[141] that do not always reveal the promised correlation between the length of the

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[141] See, e.g., In re Nikkhah, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,893 (CFTC May 12, 2000) (respondent's fraudulent allocation scheme which "continued over several months, and resulted in significant harm to customers" warranted a ten-year trading prohibition); In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,561-8-9 (CFTC April 27, 1998) (respondents who engaged in 12 noncompetitive trades over a five month period, and who "had been found guilty of earlier violations" received permanent trading prohibitions); In re Mayer, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,140 (CFTC Feb. 3, 1998) (holding that repeated fraud, prearranged and wash trading and bucketing over the course of 26 months warranted permanent trading prohibitions for some respondents and ten-year bans for others, depending on the level of involvement.); In re Reddy, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (CFTC Feb. 4, 1998) (concluding that respondents, who were involved in a pattern of noncompetitive trading over a period of months, should receive ten-year and five-year prohibitions, depending on the level of involvement); In re Elliott, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,008 (CFTC Feb. 3, 1998) (finding that 32 noncompetitive trades occurring over a two-week period which "impacted the integrity of the market by significantly inflating the volume" warranted a six-month trading prohibition); In re Fetchenhier, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,175 at 45,587-89 (CFTC Oct. 31, 1997) (finding that a floor trader who was convicted of one Section 4b felony, one RICO felony, two felonies for wire fraud and three misdemeanors, all for acts undertaken on the trading floor, should receive a ten-year trading prohibition); In re Rousso, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,311 (CFTC Aug. 20, 1997) (stating that respondents, whose noncompetitive trading during a six-month period "represent[ed] repeated and direct assaults on the integrity of the marketplace," should receive ten-year trading prohibitions); In re Crouch, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,114 at 45,249-50 (CFTC July 14, 1997) (finding that a floor broker, who "was indicted and tried on 39 counts of criminal violations of the Act" and subsequently agreed to plead guilty to one felony count of violating Section 4b, should receive a five-year trading prohibition); In re Ryan, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,049 at 44,984 (CFTC

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trading ban and the "gravity" of the offense.[142] Without any certain method by which to weigh relevant factors, the best we

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April 25, 1997) (finding that a floor trader who was convicted of three Section 4b felonies, one RICO felony and one misdemeanor -- all for acts undertaken on the trading floor -- should receive a six-year trading prohibition; GNP Commodities, ¶25,360 at 39,222 (holding that a broker who, after the fact, systematically allocated winning trades over the course of a 21 months to his personal account and losing trades to customer accounts and who subsequently promoted his account's overwhelming "track record" to prospective investors should receive a permanent trading prohibition, while the broker's firm and controlling person should receive two-year bans).

[142] Compare, In re Commodities International, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. ¶26,943 at 44,566-67 (CFTC Jan. 14, 1997) (finding that commodity pool fraud in which "respondents' violations of the Act involved fraud that continued over a period of many months and involved millions of dollars and hundreds of people," warranted one-year trading bans), with In re Slusser, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 at 48,320 (CFTC July 17, 1999) (holding that commodity pool fraud which took place over nine months, involving millions of dollars and hundreds of customers warranted permanent trading prohibition), aff'd. in relevant part sub nom., Slusser v. CFTC, 210 F.3d 783 (7th Cir. 2000). We note that the one-year trading prohibition meted out in Commodities International is on the low end of the results found in Commission trading ban case law while the permanent trading prohibition imposed in the seemingly comparable Slusser case, of course, defines the high end.

The Division attempts to find a governing principle to harmonize the radically divergent results in Commodities International and Slusser by stressing that the customer losses in Commodities International were "mainly attributable to trading losses, while in the Slusser case, customer losses were attributable to misappropriation by the respondents." Amended Default Order at 2. Under certain circumstances, drawing a distinction in the level of sanctioning between solicitation fraud and fraudulent conversion might make some sense. See In re Fritts, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,255 at 42,132 (CFTC Nov. 2, 1994) (commenting that (continued..)

can do is to search for analogous cases and impose appropriately similar sanctions.[143] Those facts are found in Miller.

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respondents' misconduct was "hard-core fraud in its most egregious form; it went beyond fraudulently inducing unwitting individuals to purchase investments that do not have the traits or value represented – to outright conversion with criminal intent"). However, in comparing Commodities International with Slusser, we see that the distinction between the nature of the customer injuries in the two cases is not nearly so sharp as the Division suggests. After all, although it is true that the losses in Commodities International were "mainly attributable to trading losses," the Division fails to disclose that no small amount of the losses -- nearly $3 million to be more precise -- were the result of fraudulently collected management fees, not trading losses, see In re Commodities Int'l Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,566-67 (CFTC Jan. 14, 1997), and of the $6.5 million in customer losses in Slusser, $3 million resulted from trading (albeit unauthorized). See Slusser, ¶27,701 at 48,318.

Moreover, there is little indication in other cases that the Commission is sensitive to the nature of the fraud or the extent of the customer injury that it causes, in calculating the length of trading bans. To the contrary, the Miller respondent never misappropriated a dime of customers' funds. Nonetheless, the Commission imposed a permanent trading ban on Miller based solely on his fraudulent misrepresentations inducing customers to trade. See Miller, ¶26,440 at 42,914. Indeed, in imposing a permanent trading ban, the Commission expressly declined to consider the extent of the customer losses caused by Miller's fraud, reasoning that the existence alone "of a pattern of fraud over a significant period of time . . . is sufficiently egregious to warrant a permanent trading prohibition." Id. at 42,914 n.8. See also GNP Commodities, ¶25,360 at 39,222 (holding that a broker who misallocated trades and misrepresented his trading track record over the course of 21 months resulting in customer losses of $180,000 should receive a permanent trading prohibition).

[143] See Ryan, ¶27,049 at 44,984 (Tull, Comm., concurring) ("[S]anctions should be assessed based on the seriousness of the
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In Miller, the Commission found that the respondent engaged in a pattern of wrongdoing that took the form of customer solicitations in which the respondent guaranteed profits, promised exaggerated returns and affirmatively misstated the risks inherent in trading options.[144] Observing that permanent trading bans are "reserved for conduct that is both intentional and egregious," the Commission imposed such a ban upon the respondent.[145] Thus, a pattern of intentional sales fraud can merit a permanent trading ban.

The conduct of the four respondents in this case certainly rises to the standard in Miller. As in Miller, the nature of the respondents' misrepresentations was egregious. Respondents DeWitte and Glover (with the encouragement of First Financial and Johnson) guaranteed profits, promised wildly exaggerated returns and, in ways that were material, lied to their customers intentionally and repeatedly. Accordingly, like the Commission

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underlying conduct, with a view toward consistent treatment for similar violations.").

[144] See Miller, ¶26,440 at 42,914.

[145] Id. (citation omitted).

did to the respondent in Miller, we impose permanent trading bans on all four respondents.[146]

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[146] According to the Division, "although a permanent trading prohibition may be appropriate for Respondent Glover, it would not be appropriate for the other respondents in this case." See Amended Default Order at 3 (emphasis added); Amended Proposed Findings, ¶7 (emphasis added); but see Amended Default Order at 4 (permanent trading ban against Glover "require[d]") (emphasis added); Amended Proposed Findings, ¶10 (emphasis added). It argues that lesser bans should be imposed on the others (ten years for DeWitte, and five years for First Financial and Johnson) because (1) their fraudulent misrepresentations were less egregious then those found in Miller and (2) the durations of the wrongdoing was also less. Amended Default Order at 3-4; Amended Proposed Findings, ¶¶8-10. We address these points in turn.

The Division's assertion that "DeWitte's conduct was less egregious" than that of the Miller respondent, and that First Financial's and Johnson's conduct was "far less egregious than that of the other respondents" has no real support in the record. Amended Default Order at 4; Amended Proposed Findings, ¶10. The Miller respondent guaranteed profits and promised wildly exaggerated returns but, as previously discussed, so did DeWitte (and secondarily, so did Johnson's wholly-owned firm, First Financial). See Complaint, ¶¶12-17, 20-22, 31-33. DeWitte, for example, told various customers that they were "would get rich" trading with him, and "all of his other customers were doing well." Complaint, ¶¶12, 33. Johnson encouraged both Glover and DeWitte to make these types of claims, and came up with his own lies as well. For instance, Johnson told customers that his trading strategies were "conservative" and "not . . . risky at all," that all his customers were winners, and that his annual returns were 200%. Id., ¶¶17, 21. These claims are not substantially different from or any less outrageous than those that comprised the sales pitch in Miller. See Miller, 197 F.3d at 1233 (stating that Miller told some customers that they could "double or triple their money"); Miller, ¶26,440 at 42,914 ("[Miller] compared the risk of trading options to investments such as savings accounts and mutual funds").

As for the Division's argument that Miller's proven violations spanned a period of more than four years while DeWitte's violations covered over three years, and Johnson's and

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Stiff Monetary Penalties Must Be Imposed On The Respondents In Order To Promote The Deterrence Of Solicitation Fraud

Statutory Standards

Section 6(c) of the Act permits the Commission to assess a civil monetary penalty against any respondent found to have violated any of the provisions of the Act or Commission regulations.[147] But how much of a penalty? Here, the Act and Commission regulations tell us that the penalty may be not more than the higher of $110,000, or triple the monetary gain to such person for each such violation.[148] This, however, is not very

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First Financial's fraud took place over approximately one year, we find no authority that requires drawing fine durational distinctions in the trading ban assessment once "a pattern of fraud [has occurred] over a significant period of time." Miller, ¶26,440 at 42,914 n.8. See Slusser, ¶27,701 at 48,320 (finding that commodity pool fraud which took place over nine months warranted permanent trading prohibition); In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,561-8-9 (CFTC April 27, 1998) (imposing permanent trading prohibitions upon respondents' who engaged in 12 noncompetitive trades over a five-month period but who "had been found guilty of earlier violations"); In re Mayer, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,140 (CFTC Feb.3, 1998) (imposing permanent trading bans for repeated fraud over the course of 26 months); GNP Commodities, ¶25,360 at 39,222 (imposing a trading ban based on broker's fraud that took place over 21 months).

147 See 7 U.S.C. §9.

148 See Id. As the result of Commission rulemaking, the inflation-adjusted maximum civil monetary penalty for each violation of the Act, or the rules or orders promulgated thereunder, that can be assessed pursuant to an administrative proceeding is "$110,000 or triple the monetary gain" for (continued..)

instructive since it neither directs nor reveals a decisional principle,[149] but simply prescribes an outer bound for the penalty assessment (and, given a carefully drafted complaint, a generally non-constraining outer bound at that).[150] The Act also

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"violations that occurred between November 27, 1996 and October 22, 2000." 17 C.F.R. §143.8(a)(1)(i). In this case, we have found that violations occurred during a time period that began in October 1997 and ended in September 2000. See Complaint, ¶¶1-6, 8-9, 22-25. Accordingly, the per-violation cap on fines in this proceeding is $110,000.

In 1992, Congress statutorily endorsed fines of "triple the [respondents'] monetary gain" (or more) and eliminated provisions of the Act which had had the effect of constraining most penalties to within the limits of the respondent's ability to pay. S. Rep. No. 102-22, at 43-44 (1992), reprinted in 1992 U.S.C.C.A.N. 3103, 3145-46. The 1992 changes were meant to "stiffen[] penalties for violations of the Act." S. Rep. No. 102-22, at 13, reprinted in 1992 U.S.C.C.A.N. 3103, 3115.

[149] While the scope and number of "violations" may offer some insight as to the gravity of the misconduct, it does not dictate the end result of the penalty assessment inquiry. See In re Interstate Securities Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,954-55 (CFTC June 1, 1992) ("[I]n determining sanctions our focus is on the overall nature of the wrongful conduct rather than the number of legal theories the Division can successfully plead and prove."); accord In re Commodities International, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,564, 67 (CFTC Jan. 14, 1997); In re JCC, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,580 (CFTC May 12, 1994). See also Monieson v. CFTC, 996 F.2d 852, 863-65 (7th Cir. 1997) (reducing the Commission's assessed penalty against Monieson from $500,000 to $200,000, even though "[h]e does not argue that [he] violated the CEA fewer than five times").

[150] As Judge Easterbrook noted in Slusser v. CFTC, since most violations of fraud narrated in Commission complaints "entail multiple acts or statutes; it [is] . . . easy to separate the (continued..)

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events into tens if not hundreds of violations, or to allege that each day of [a violation] is a separate violation." 210 F.3d 783, 786 (7th Cir. 2000). In this case, the Division alleges that "[each and every] misrepresentation or omission, and willful deception during the relevant time period" constitutes "a separate and distinct violation." Complaint, ¶¶41, 45, 49. See also id., ¶54 (pleading each failure to diligently supervise as a separate violation).

As discussed earlier, the well-pled allegations and record support the Court's finding that DeWitte and Glover, while employed at First Financial, "routinely" misrepresented that their customers could speculate in options with little or no risk of loss. See supra note 39. By "routinely," we mean that the misrepresentations occurred as a "customary or regular course of procedure." The Random House College Dictionary 1150 (1973). Accordingly, the record supports a finding that DeWitte and Glover fraudulently solicited each of their customers an average of at least two or three times (and, probably, more often than that). As we have also discussed, both First Financial and Johnson are liable for these violations. At First Financial, DeWitte and Glover serviced 19 and 27 accounts respectively. See supra note 34 and accompanying text. Therefore, if they uttered on average only one fraudulent comment (and never repeated it) to each of their customers, the statutory cap on DeWitte's civil monetary penalty would be no less than $2.09 million (19 X $110,000) while Glover's penalty cap would be at least $2.97 million (27 X $110,000). First Financial's and Johnson's penalty ceiling would be the sum of these two or $5.06 million. These are extraordinarily conservative estimates. First, it is likely in their course of dealings that, when DeWitte and Glover lied to a customer, they did so repeatedly. In addition, our calculation ignores DeWitte's and Glover's violations while employed at previous firms. See supra notes 28-31 and accompanying text. Finally and as to First Financial and Johnson, the estimated cap fails to consider their independent violations of Regulation 166.3. See supra note 96.

The discussion above demonstrates that the statutory penalty limit in this case -- like most customer fraud cases -- is likely to pose no real constraint. This could explain why the Commission rarely makes specific findings as to the number of violations, even when imposing quite substantial civil monetary penalties in fraudulent solicitation cases. See, e.g., In re

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directs the decision maker to "consider the appropriateness of [the] penalty to the gravity of the violation."[151] However, as we have seen in the context of considering the appropriate length of trading bans, the notion of gearing sanctions to "gravity" is more in the nature of an aspirational goal, than a short-hand reference to a definite set of working principles for achieving the result.[152] In the area of civil monetary penalties, however,

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Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,467-71 (CFTC Dec. 10, 1996) (imposing a penalty of $1.8 million on an individual for violations of Section 4c(b), and Commission Regulations 33.7, 33.10 and 166.3, and a cease and desist order without making specific findings as to the number of violations). Recently, the Seventh Circuit appears to have condemned this practice. See Slusser, 210 F.3d at 787 (instructing the Commission to reduce a $10,000,000 penalty to a maximum of $600,000 -- calculated by multiplying the then-statutory limit of $100,000 per violation by the number of counts (six) in the complaint - because the Commission's complaint had failed to allege with specificity the number of violations necessary to support a $10 million penalty). Although it declined to file a petition for rehearing, the Commission has not indicated that it acquiesces to the Slusser panel's view that compliance with the statutory cap is narrowly determined by a sum of a complaint's explicitly enumerated violations (or the number of counts into which they are organized).

[151] 7 U.S.C. §9a. As one would expect, this statutory goal is echoed in the case law. See Commodities International, ¶26,943 at 44,567 (stating that civil monetary penalties are "intended to reflect the gravity of the totality of respondents' violations . . . ."); Grossfeld, ¶26,921 at 44,467 (instructing that civil monetary penalties "look[] to the total 'facts and circumstances' of each case and focus[] on the relative gravity of respondent's particular misconduct."). See infra text accompanying note 219.

[152] The Administrative Conference of the United States recommended,

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the Commission has struggled to refine the crude and unpredictable multi-factor approach by a sharpened focus on the economic concept of deterrence.

The Goal Of Deterrence And The Multiplier Principle

In the most general sense, "[s]anctions in Commission enforcement proceedings are imposed to 'further the Act's remedial policies and deter others in the industry from committing similar violations.'"[153] Indeed, the Commission has recognized that "the academic literature suggests that sanctions for violations in regulated industries be based primarily upon

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> In establishing standards, agencies should specify the factors to be considered in determining the appropriate penalty amount in a particular case. To the extent practicable, agencies should specify the relative weights to be attached to individual factors in the penalty calculation, and incorporate such factors into formulas for determining penalty amounts or into fixed schedules of prima facie penalty amounts for the most common types or categories of violation.

Administrative Conference of the United States Recommendation 79-3, 1 C.F.R. §305-79-3, quoted in A Study of CFTC and Futures Self-Regulatory Organization Penalties ("Penalties Study"), [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,264 at 42,211 (CFTC Nov. 1994).

[153] In re Elliott, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,007 (CFTC Feb. 3, 1998) (quoting In re Volume Investors, Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,234 at 38,679 (CFTC Feb. 10, 1992)).

the goal of deterrence."[154] Beginning with the 1992 watershed case of GNP Commodities, the Commission began to structure its civil monetary penalty assessments around the teachings of that literature.

GNP Commodities recognized that there are two dimensions to deterrence, specific and general,[155] and concluded that civil

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[154] See Penalties Study, supra note 152, at 42,209.

Commentators have stressed that penalty levels in customer fraud cases should be based on the respondent's gain if the goal is to maximize deterrence, and on customers' loss if the goal is to maximize economic efficiency or to optimize deterrence. See, e.g., Richard Crasswell, Deterrence and Damages: The Multiplier Principle and its Alternatives, 97 Mich. L. Rev. 2185 (1999); Richard A Posner, Economic Analysis of Law 223-31 (4th ed. 1992); Michael A. Block, Optimal Penalties, Criminal Law and the Control of Corporate Behavior, 71 B.U. L. Rev. 395 (1991); U.S. Sentencing Commission, Offenses Involving Fraud or Deceit, (1990); Mark A. Cohen, Corporate Crime and Punishment: A Study of Social Harm and Sentencing Practice in the Federal Courts, 26 Am. Crim. L. Rev. 605 (1989); Jeffrey S. Parker, Criminal Sentencing Policy for Organizations: The Unifying Approach to Optimal Penalties, 26 Am. Crim. L. Rev. 573 (1989); Frank H. Easterbrook and Daniel R. Fischel, Optimal Damages in Securities Cases, 52 U. Chi. L. Rev. 611 (1985); A. Mitchell Polinsky and Steven Shavell, The Optimal Use of Fines and Imprisonment, J. Pub. Econ. 89 (1984); William M. Landes, Optimal Sanctions for Antitrust Violations, 50 U. Chi. L. Rev. 652 (1983); A. Mitchell Polinsky and Steven Shavell, The Optimal Tradeoff Between the Possibility and Magnitude of Fines, 69 Am. Econ. Rev. 880 (1979); Gary S. Becker and George J. Stigler, Law Enforcement, Malfeasance, and Compensation (1974); Gary S. Becker, Crime and Punishment: An Economic Approach, 76 J. Pol. Econ. 169 (1968).

[155] See In re GNP Commodities, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,222 (CFTC Aug. 11, 1992).

Specific deterrence seeks to effectively discourage culpable respondents from engaging in further unlawful conduct while general deterrence serves to make examples of these respondents (continued..)

monetary penalties should serve both objectives.[156] Apparently taking the lead of academics, the Commission subsequently directed

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so as to remind others who might be tempted to violate the law "that noncompliance carries a cost." Id.

[156] In the words of the Commission,

> Civil monetary penalties serve a number of purposes. These penalties signify the importance of particular provisions of the Act and the Commission's rules, see e.g., In re Incomco, Inc. [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,535-36, and act to vindicate these provisions in individual cases, particularly where the respondent has committed the violations intentionally. Id. Civil monetary penalties are also exemplary; they remind both the recipient of the penalty and other persons subject to the Act that noncompliance carries a cost.

GNP Commodities, ¶25,360 at 39,222.

Like fines, non-monetary penalties are imposed with regard for the need to prevent future violations. Non-monetary penalties differ in two respects. First, although cease and desist orders operate to deter, trading bans and registration revocations incapacitate for the time they are in place and, only after they are lifted or terminated, do they specifically deter. In addition and although the degree of penalties may turn on considerations that include general deterrence, the Commission decides whether or not to impose non-monetary penalties solely on an evaluation of the respondent in question (and not on the basis of general deterrence considerations). See In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,181 (CFTC Mar. 16, 1993) ("A cease and desist order is appropriate where there is a reasonable likelihood that wrongful conduct will be repeated."); In re Horn, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,731 at 33,889 (CFTC July 21, 1987) (stating that the registration of an applicant or respondent is appropriate, despite commission of disqualifying act, where there (continued..)

that, in customer fraud cases, "[t]he Judge shall either base the civil monetary penalty on the financial benefit to [the respondent] (i.e., his commissions) or the losses suffered by his customers as a result of his wrongdoing, or in the alternative, specifically explain why such a basis is impractical or inappropriate."[157] It also instructed that, under this economic

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is "no substantial likelihood of reoccurrence"); In re Ryan, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,832 at 40,724-25 (CFTC Aug. 13, 1993) (stating that a trading prohibition is inappropriate where respondent is unlikely to "repeat the type of conduct that threatens the integrity" of Commission-regulated markets).

Restitution stands alone among the Commission's arsenal of administrative enforcement sanctions as serving a distinctly different purpose. Unlike the other sanctions, the goal of restitution is not to deter wrongs, but to redress them. In other words, its goal is remedial. See In re Staryk, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,812 (CFTC Dec. 18, 1997) ("[W]e remain mindful that restitution fulfills its purpose only when it tends to make whole those persons harmed by violations of the Act or Commission rules or at least pays a meaningful portion of the damages they suffered. . . . Should the ALJ find that respondent's resources are too limited to make restitution feasible, he should consider imposing an appropriate civil monetary penalty."). See also In re Thomas, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,461 at 47,211 (CFTC Nov. 10, 1998) ("[R]estitution is the archetype of remedial sanctions") (citing Johnson v. SEC, 87 F.3d 484, 491-92 (D.C. Cir. 1996).

[157] Gordon, ¶25,667 at 40,182; accord In re Grossfeld, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,726 at 40,367 (CFTC May 20, 1993). See also In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,582 (CFTC May 12, 1994); In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,913 (CFTC June 16, 1995).

approach, decision makers should apply a multiplier to the determined gains or losses so as to "offset the benefit of engaging in . . . undetected violations" by respondents and others.[158]

The Multiplier Principle In Practice: Challenges and Irresolution

In GNP Commodities, the Commission went about applying the multiplier principle.[159] Almost immediately, the newly developed

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[158] GNP Commodities, ¶25,360 at 39,223 ("The exemplary purpose of the penalty will be served only if its amount reflects a premium to offset the benefit of engaging in these undetected violations."). Under the proper deterrence approach, penalties are set such that the amount of the penalty divided by the perceived probability of detection exceeds the expected gain of the violative act. Similarly, penalties based on customer loss include a premium to account for undetected acts. See infra text accompanying notes 159-64. Recognition of this principle goes back to at least 1802, when Jeremy Bentham reasoned that "the more deficient in certainty a punishment is, the severer it should be." Jeremy Bentham, The Theory of Legislation 325 (C.K. Ogden ed. 1931). Moreover, Congress has endorsed the use of this approach. See supra note 148.

At about the time of GNP Commodities, the courts -- especially economically sophisticated judges -- began to recognize the "multiplier principle" as a possible rationale for punitive damages. See, e.g., BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 592-94 (1996) (Breyer, J., concurring); Kemezy v. Peters 79 F.3d 33, 35 (7th Cir. 1996) (Posner, C.J.); Zazu Designs v. L'Oreal, S.A., 979 F.2d 499, 508 (7th Cir. 1992) (Easterbrook, J.); FDIC v. W.R. Grace & Co., 877 F.2d 614, 623 (7th Cir. 1989) (Posner, J.).

[159] ¶25,360 at 39,222-23. GNP Commodities recognized and addressed one of the potentially vexing problems of the multiplier approach, the imperfect information concerning benefits, costs, and rates of detection and the resulting lack of certain precision on fine calculations. Rather than requiring high degrees of false precision, the Commission charged its (continued..)

law embracing deterrence theory faced challenges in the courts and irresolution at the Commission. In GNP Commodities, the Seventh Circuit unfavorably received the Commission's application of a penalty multiplier.

On review, the Seventh Circuit observed that the Commission had, in part, "based its decision on the exemplary purpose of penalties and the need to inflate the fine in order to compensate for undetected violations."[160] Nonetheless, it dismissed such principles of general deterrence as "a slim justification" for the size of the penalty that the Commission had imposed on the respondent in question.[161] For this reason, the appellate panel

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judges with the task of basing civil monetary penalties on a reasoned estimate that carefully considers the evidence available. See id. at 39,222 ("Civil monetary penalties cannot be calculated with precision. Even so, such penalties may be rationally devised in accordance with the purposes we have outlined."). See also In re Fritts, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,255 at 42,133 (CFTC Nov. 2, 1994).

[160] Monieson v. CFTC, 996 F.2d 852, 864 (7th Cir. 1993).

[161] Id.

The court's hostility to the Commission's methodology probably came as some surprise (before oral argument). After all, the Seventh Circuit had previously recognized the need for a penalty multiplier to deter fraud in the context of private tort actions, having opined,

> Another rationale is that punitive damages provide surer deterrence than actual damages of conduct that we very much want to deter because it is highly anti-social.

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> Fraud, a form of intentional wrongdoing, is in that category. Under this rationale, too, the ratio of punitive to actual damages is highly pertinent. A $100 fraud might be securely deterred by a $500 penalty on top of compensatory damages, making a total of $600; a $25 million fraud would not be securely deterred by a $500 penalty, making a total of $25,000,500.

W.R. Grace, 877 F.2d at 623. Upon reflection and study, there is reason to believe that the reduction of the GNP Commodities fine resulted from a lack of exposition rather than a faulty (in the court's eyes) approach.

The Commission is sometimes reluctant to expressly acknowledge changes in the law. See, e.g., In re Arnold, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,519 at 51,807-13 (CFTC April 16, 2001). This practice has consequences beyond the creation of uncertainty and confusion. One year before it reviewed GNP Commodities, the Seventh Circuit had cautioned,

> The Commission's treatment of precedent was also cavalier. An administrative agency is no more straitjacketed by precedent than a court is. It can reject its previous decisions. But it must explain why it is doing so. Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.,[463 U.S. 29, 43 (1983)]; Illinois Bell Tel. Co. v. FCC, 740 F.2d 465, 470-71 (7th Cir. 1984); Continental Web Press, Inc. v. NLRB, 742 F.2d 1087, 1093-94 (7th Cir. 1984).

Schurz Communication, Inc. v. FCC, 982 F.2d 1043, 1053 (7th Cir. 1992) (Posner, J.). Accord Johnson v. Ashcroft, No. 01-1331, 2002 WL 561340, at *3 (3rd Cir. April 17, 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." (citations and internal quotation marks omitted)). Given this view and the apparent departure of GNP Commodities from the previous approach to calculating fines, it is possible that the case turned on the unexplained change in policy rather than the merits of the then-

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could not accept the proposition that a penalty "far greater than the total harm [$300,000] caused" could bear any "rational relationship to the offense or the need for deterrence."[162] As a result, it reduced the fine imposed on respondent Monieson from $500,000 to $200,000.[163]

Despite this setback, the Commission pressed ahead and, in Grossfeld, assessed a civil monetary penalty of $500,000 against respondent Murray L. Stein, a sales manager of an introducing broker, for his participation in, and encouragement of, systematic fraud in the retail sale of commodity options.[164] In so doing, the Commission found the financial benefit to Stein as the result of his wrongdoing to be "at least $385,714."[165] This

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current approach. See Monieson, 996 F.2d at 864-65 (noting that the amount of the penalty imposed by the Commission on Monieson "dwarfs fines given in similar cases," and "[t]he CFTC and the ALJ, however, did not discuss or distinguish any of these yardstick decisions").

[162] Id.

[163] See id. at 863-65.

[164] See In re Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,471 (CFTC Dec. 10, 1996).

[165] Id. at 44,469. It made no finding as to the losses suffered by customers as a result of Stein's wrongdoing. In the same proceeding, the Commission fined respondent Kenneth R. Grossfeld, the co-owner of the introducing broker, $1.8 million, although it found "insufficient probative evidence to determine the gains Grossfeld obtained as a result of his wrongdoing." The
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penalty reflected "the increasingly important role that sanctions play in deterring wrongful conduct."[166] It was not long, however, before there became reason to question the Commission's continuing commitment to this enhanced role.

Only one month after Grossfeld, in Commodities International, the Commission considered the case of a pool

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Commission, however, "conservative[ly] estimate[ed]" that the customer losses resulting from Grossfeld's wrongdoing totaled over $2.1 million. Id. at 44,470.

[166] Id. at 44,467. In a apparent nod to the Seventh Circuit's concerns expressed in Monieson, the Commission sidled up to something close to an admission that its recent law on civil monetary penalties was a departure from its previous decisions. It acknowledged,

> [O]ur recent precedent does reflect some refinement to our traditional approach to calculating civil money penalties. In particular, we have emphasized that, while the assessment of the gravity of the respondent's wrongdoing must be based on the record as a whole, the financial benefit that accrued to respondent and/or loss suffered by customers as a result of the wrongdoing are especially pertinent factors to be considered. See Miller ¶26,440 at 42,913, n.5; See also Gordon, ¶25,668 at 40,182.

Id. at 44,468. In addition, the Commission noted "that effective deterrence can be undermined by an undue focus on the levels of civil money penalties that we have imposed in prior cases," in part because "a policy of giving substantial weight to civil money penalties imposed in prior cases fails to account for . . . changes in the regulatory environment and sanctioning policy of the Commission." Id.

operator, its president and an undisclosed principal involved in "fraud that continued over a period of many months and involved millions of dollars and hundreds of people."[167] It appears that the financial impact of the respondents' misdeeds exceeded that found in Grossfeld.[168] The Commission explained,

> During the period from June 1981 to December 1982, [the pool operator] had at least 462 customers, most if not all of whom were subjected to misleading material information from an entity that owed them a duty of complete and accurate disclosure. The annual management fee collected as part of the fraudulent scheme amounted to almost $3 million, and the respondents were responsible for even greater losses of their customers.[169]

Despite the magnitude of the Commodities International respondents' tainted operation, the Commission levied fines that paled in comparison to the revenue or customer losses at issue, fines of $210,000, each, against a commodity pool operator and its president, and a fine of $208,000 against the undisclosed principal of the pool operator. In light of the disparity between the penalties imposed in Grossfeld and Commodities International (as well as the degree to which revenues and customer losses exceeded the fines meted out) an explanation

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[167] In re Commodities Int'l Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,566 (CFTC Jan. 14, 1997).

[168] See supra note 165 and accompanying text.

[169] Commodities International, ¶26,943 at 44,566-67.

would have seemed in order (and helpful).[170] There was none. Shortly thereafter, the Commission further signaled an abandonment of multipliers in the calculations of fines.

Eleven months after Commodities International, the Commission issued R&W. The respondents in that case were unregistered commodity trading advisors who systematically misrepresented their own trading experience and the track record of their trading system, and made corresponding "false promises of easy profits."[171] Finding that the R&W respondents had received a minimum of $2,375,000 in revenues from customers who

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[170] About 18 months prior to Commodities International, the Commission seemed to take a dim view of fines that fall below customer losses and the revenue that a guilty respondent reaps through wrong doing. It explained,

> On remand, the ALJ shall calculate the civil money penalty he imposes in a manner consistent with Gordon's clarification of the starting point for the assessment of a civil money penalty. In his decision, the judge found that both the financial losses customers suffered and the financial benefits that [respondent] accrued during the relevant period exceed $800,000. As the Division emphasizes, however, the level of civil money penalty the ALJ imposed is only one quarter of this amount. In the absence of any explanation by the judge, such a substantial discrepancy, standing along, is sufficient to establish an abuse of discretion in calculating a civil penalty.

Miller ¶26,440 at 42,913 (emphasis added and footnotes omitted).

[171] In re R&W Technical Servs., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 at 47,741 (CFTC Mar. 16, 1999).

had purchased their system, this Court adopted the Division's recommendation to treble that amount and assess a civil monetary penalty of $7,125,000.[172] In so doing, the Court explained that the trebling "adjusts respondents' ill-gotten gains by a premium to account for the general likelihood of detection and prosecution under the Act," and concluded that "[g]iven the gravity of respondents' fraud, a lesser civil monetary penalty would not adequately serve to generally deter such conduct."[173]

On appeal, the Commission accepted the Court's findings of fraud[174] and found $2,375,000 to be a reasonable estimate of the monetary gain that the respondents reaped from the sale of their trading system.[175] However, the Commission disagreed with the Court's fine and reduced it to $2,375,000, an amount equal to the wrongly-obtained revenues. In so doing, Commission expressly declined to impose any premium in its assessment of the gains-based penalty in the absence of evidence of additional aggravating circumstances.[176]

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172 In re R&W Technical Serv., Ltd., [1996-1998 Transfer Binder] (CCH) ¶27,193 at 45,732, 45,735 (CFTC Dec. 1, 1997).

173 See id. at 45,735.

174 See R&W, ¶27,582 at 45,745.

175 See id. at 47,748-49.

176 The Commission seems to have taken the view that intentionally wrongful conduct will not be sanctioned with (continued..)

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multiplier-inclusive fines in the absence of proven customer harm. Without record evidence of the customer trading losses resulting from the use of the trading system in question, the Commission rejected the use of a multiplier in R&W. See id. at 47,749. In a later case, the Commission considered the fine when the record supported findings of customer trading losses. In that case, it employed a multiplier, assessed a $10 million monetary penalty and explained that the assessment of a penalty "properly begins with a calculation of the gain to the respondents. The respondents realized approximately $6 million as a result of their violative conduct; this figure provides a 'floor' for the civil monetary penalty." In re Slusser, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 at 48,317-19 (CFTC July 17, 1999). However, as noted earlier, the fine meted out in Slusser did not survive appellate review. See Slusser, 210 F.3d 783, 787 (7th Cir. 2000). Thus, the Commission's approach seems suspect in the eyes of federal courts. It also seems to suffer from a flaw that does not concern those courts so immediately, a tendency to rob fines of their general deterrent effect.

As noted above, general deterrence is the creation of fear that causes persons who were not party to a litigation to eschew certain undesired acts based on the tendency of these other persons to include, in the decision as to whether to act in the undesirable manner, the costs associated with potential detection, prosecution and punishment. Probability or chance is an element in this forward-looking process. The R&W approach introduces an additional layer of chance by conditioning the use of a multiplier (greater than one) on some level of customer harm.

The existence and degree of customer harm resulting from trading is a matter of chance in that a great many of those who pick trades (on the basis of recommendations or trading software) would do just as well by flipping a coin to make buy/sell decisions. See Miller v. CFTC, 197 F.3d at 1234, 1236 (9th Cir. 1999); R&W, ¶27,193 at 45,727 n.75. As a result and as in any probabilistic situation, there is a possibility that particular types of results (i.e. the choice of winning or losing trades) may occur in groups that do not reflect their actual relative occurrences. See In re Gorski, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,742 at 48,503 n.162 (CFTC Aug. 23, 1999). More simply stated, groups of customers who have a less-than-

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Commodities International and R&W[177] raise serious questions as to the Commission's eagerness to employ the multiplier principle of GNP Commodities and Grossfeld to achieve effective deterrence in customer fraud cases.[178] Even if there was no

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even-money chance of trading profitably may beat the odds and, thus, may be perceived, ex post, as not having suffered harm. If a respondent fraudulently offers a bogus product to "lucky" clients, his fine may not include a multiplier under the R&W approach. This possibility would tend to reduce the expected cost of engaging in fraud. Thus, the general deterrent effect of fraud sanctions is lessened in comparison to sanctions that consider only the probability to detection in computing the need for and magnitude of a multiplier.

[177] See also In re Nikkhah, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,893 (CFTC May 12, 2000) (assessing a $200,000 penalty for fraudulent allocation scheme which resulted in indeterminate gains to the respondent, but at least $550,000 in losses to customers); Id. at 49,897 (Erickson, Comm., dissenting) ("Mr. Nikkhah's multiple violations cut to the heart of the anti-fraud provisions of the Act; I would have recommended a much stiffer civil monetary penalty that more accurately reflects the gravity of his multiple, serious violations."); In re Miller, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,297 at 46,350 (CFTC Mar. 12, 1998) (imposing $600,000 penalty where fraudulent solicitations resulted in excess of $637,000 in gains to respondent and $1.35 million in customer losses).

[178] After all,

> A party could not possibly be deterred from committing an act if his expected private benefits exceed the disutility of the highest conceivable expected sanction -- the highest conceivable sanction . . . discounted by the probability of its imposition. Suppose the benefit a party would derive from committing an act is 200, that the disutility of the maximum sanction is 1000, and that the

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reason to pause before including multipliers in fines, more recent action forces us to abandon gains-based, multiplier-inclusive penalty calculations altogether.

As discussed above, the GNP Commodities approach to monetary sanctioning begins with assessing the economic result of the wrongful conduct found to have occurred. In customer fraud cases, this approach involves calculating the financial benefit to the respondent and the losses suffered by his customers flowing from the misconduct. As we will see, the information necessary to determining seemingly precise estimates of these accounting profits and losses may only come at a staggering cost in the typical fraudulent solicitation enforcement case. This problem was recognized by the Administrative Conference of the United States in 1979, when it recommended to federal agencies that "[i]n order to reduce the cost of the penalty calculation process and increase the predictability of the sanction,

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> probability of imposition of sanctions is 10%. Then the party could not possibly be deterred, for the maximum expected sanction would be 10% x 1000 or 100, which is less than 200.

Steven Shavell, Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent, 85 Colum. L. Rev. 1232, 1241 & n.37 (1985).

simplifying assumptions about the benefit realized from or the harm caused by illegal activity should be utilized."[179]

Consistent with the Administrative Conference's recommendation, the Commission simplified its benefit and loss assessments by (1) using gross revenue as a proxy for profit instead of net figures,[180] and (2) presuming causation[181] and

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[179] Administrative Conference of the United States Recommendation 79-3, 1 C.F.R. §305-79-3 (1979), quoted in Penalties Study, supra note 152, at 42,211.

[180] See R&W, ¶27,582 at 47,748-49 (basing financial benefit to respondents in a penalty calculation on "gross sales estimates").

[181] See, e.g., In re GNP Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. (CCH) ¶25,360 at 39,222-23 (CFTC Aug. 11, 1992), stating,

> [A]ccounts controlled by [the respondents] and their associates received trades which showed a net profit of approximately $120,000; in addition, customer accounts received trades which showed a net loss of approximately $180,000. Although these figures show a possible total benefit to respondents of $300,000, we recognize that this figure may overstate the true amount of the gain they realized by their fraudulent conduct because, had the allocation scheme not existed, some portion of the winning trades may possibly have been credited to respondents while some portion of the losing trades may possibly been placed in customer accounts.

See also Monieson v. CFTC, 996 F.2d 852, 864 (7th Cir. 1993).

customer reliance in the measurement of gains[182] and losses[183] resulting from the fraudulent activity. These simplified methods,[184] of course, tend to inflate the "gains" and "losses" estimates used by the Commission in comparison to those that would be justifiable if better information were available. This, in various respects, has troubled two courts of appeals.

In Miller, the Ninth Circuit considered the propriety of a Commission civil monetary penalty that had resulted from the

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[182] See R&W, ¶27,582 at 47,748 n.60 ("[B]ecause Reagan testified that nearly 100% of their customers during the relevant time period learned about the company through the advertisements, it is reasonable to conclude that substantially all of R&W's customers relied on the advertised claims in making their purchase decisions."); In re Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,469 n. 37 (CFTC Dec. 10, 1996) ("Given the pervasive and ongoing nature of the fraud, we may also infer that virtually all the money CCC paid to Stein was a product of his wrongdoing."). See also Miller, ¶27,297 at 46,350.

[183] See Miller, ¶27,297 at 46,350 n.13 ("It is appropriate to find that a substantial portion of the customers' losses was due to Miller's misconduct. Miller's fraudulent solicitation appeared fairly standard and consistent with regard to each of the testifying customers and clearly played a significant role in convincing his customers to expose themselves to the risks of commodities markets."). See also In re Slusser, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 at 48,318 (CFTC July 17, 1999); Grossfeld, ¶26,921 at 44,470 & n.41.

[184] "[S]implified" is not used as a derogatory term in this discussion.

Commission's simplified methods of computing gains and losses.[185] The court agreed that that "[t]he Commission can set a penalty as a deterrent" and it noted that, in "[d]oing so, the Commission is exercising the important and delicate governmental function of punishing illegal conduct."[186] However, it disliked the Commission's methods, explaining,

> The Commission stated three assumptions to justify its estimates of Miller's gain and the total of his customers' loss: that he would have treated his other customers as he would the seven [customer witnesses]; that this treatment caused their losses; and that Miller had engaged in similar misconduct in the six years not touched on by the testimony of the seven customers. These three assumptions in effect transferred the burden of proof to Miller so that he had to prove he had not defrauded the other customers and that fraud by him had not caused them substantial loss.
>
> Nothing in the record established that the seven witnesses were representative of Miller's 347 customers, nothing shows that they were a statistically significant group . . . .
>
> In the trading of options on commodities futures, as all agree, there are substantial risks. There are always losers. To attribute all customer losses to the fraud of the broker goes in the face of this fact. Similarly, to attribute all of Miller's income to fraud assumes that he never put a customer in the way of a profit and that never in four years of trading gave one

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[185] See Miller v. CFTC, 197 F.3d 1227 (9th Cir. 1999), remanding for redetermination of civil monetary penalty, Miller, ¶27,297. The remanded case is currently pending before the Commission.

[186] Id. at 1236.

> piece of honest advice. The assumption is arbitrary.[187]

Thus, in determining the benefit realized from or the harm caused by illegal activity for purposes of assessing civil monetary penalties, the Ninth Circuit insisted that the Commission rest gain or loss-based fines on proof of causation rather than presumptions (or assumptions).

In the typical customer fraud case, effecting the Ninth Circuit's instructions raises the complexity and cost of the litigation enormously since causation cannot be determined without a fact-intensive inquiry. In the first instance, the causation inquiry tends to focus on "transaction causation." This involves a "but for" inquiry and raises the issue of whether the violation caused the trade.[188] In fraudulent solicitation

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[187] Id. at 1235-36 (emphasis added).

[188] See Movitz v. First Nat'l Bank of Chicago, 148 F.3d 760, 763 (7th Cir. 1998) (Posner, C.J.); Purdy v. CFTC, 968 F.2d 510, 519 (5th Cir. 1992); Waters v. Int'l Metals Corp., 172 F.R.D. 479, 490 (S.D. Fla. 1996).

After transaction causation, the second stage of the causation inquiry addresses "loss causation." The loss causation inquiry involves consideration of whether the violation (i.e. the misrepresentation or omission in question) has a sufficient relationship to the injury ultimately suffered. This inquiry recognizes that, in the context of trading, factors that were not implicated in the violative conduct at issue may have a bearing on financial losses suffered. Judge Posner illustrates the distinction between "transaction causation" and "loss causation in the following example.

(continued..)

cases, transaction causation centers on the question of reliance.[189] This requires a far-ranging consideration of any

(..continued)

> Suppose that an issuer of common stock misrepresents the qualifications or background of its principals, and if it had been truthful the plaintiff would not have bought any of the stock. The price of the stock then plummets, not because the truth is discovered but because of a collapse of the market for the issuer's product wholly beyond the issuer's control. There is 'transaction causation,' because the plaintiff would not have bought the stock, and so would not have sustained the loss, had the defendant been truthful, but there is no 'loss causation,' because the kind of loss that occurred was not the kind that the disclosure requirement that the defendant violated was intended to prevent.

Movitz, 148 F.3d at 763. Reliance has generally not been an issue discussed in Part 10 fraudulent solicitation cases. However, given the nature of the claims underlying most of those cases, proof of transaction causation would render proof of loss causation virtually certain. This is so because the alleged frauds tend to involve the market characteristics that lead to trading losses (such as the inherent risk or probability of trading outcomes).

[189] See Steen v. Monex Int'l, Ltd., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,245 at 38,726 (CFTC Mar. 3, 1992) (Gramm, Chairman, concurring) (italics in original) ("However, in order to prevail in a case involving deception or misrepresentation, the customer must . . . prove that he relied on any misrepresentations to his detriment, *and* that such reliance was justified." (citing Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1025 (5th Cir. 1990); Royal American Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1016 (2d Cir. 1989)); Jakobsen v. Merrill Lynch, Pierce, Fenner, & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,812 at 31,392 (CFTC Oct. 31, 1985) ("Justifiable reliance is not a theory of contributory negligence, rather it is concerned with (continued..)

number of circumstances,[190] the nature of which may vary considerably from customer to customer and from trade to trade, and which may involve hundreds of customers and thousands of trades.[191] Thus, although the Ninth Circuit left the door open to the possible use of appropriate statistical sampling techniques,[192] the task of proving reliance remains formidable.[193]

(..continued)

the causal connection between the misrepresentation and the complainant's loss") (citing Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983)). See also Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 7, 1992).

190 These include: (1) the sophistication and expertise of each customer in financial, security and commodity matters; (2) the existence of a long-standing business or personal relationship between the respondent and each of his customers;, (3) access of each of the customers to relevant information; (4) the existence of a fiduciary relationship between the respondent and his customers; (5) the degree to which the fraud was concealed; (6) the opportunity of each customer to detect the fraud, (7) whether and to what extent the customers initiated some or all of their trades, and (8) the generality or specificity of specific misrepresentations to each customer. See Schreider v. Rouse Woodstock, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,196 at 32,514 (CFTC July 31, 1986) (citing Jakobsen, ¶22,812 at 31,393 n.1.). See also In re Staryk, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,515 at 47,390-91 (CFTC Dec. 4, 1998).

191 See Muniz, ¶25,225 at 38,651.

192 These are techniques with which the Division has shown little familiarity, much less facility. See In re Gorski, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,742 at 48,499-48,507 (CFTC Aug. 23, 1999); Staryk, ¶27,515 at 47,384-86.

193 See supra note 190.

If the Ninth Circuit shot the legs out from under the Commission's gains-based approach,[194] only two months later, the

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[194] We note that the Ninth Circuit's analysis in Miller appears within the context of its larger concern that the Commission's method of determining civil monetary penalties was "an assertion of arbitrary power rather than an act of reason grounded on the record . . . ." Miller v. CFTC, 197 F.3d 1227, 1236 (9th Cir. 1999). This suggests that, had the Commission better explained its reasoning in support of its approach, it may have fared better. See supra note 161. Such an explanation could have started by pointing out that the consequences of its failure to prove reliance in its penalty assessment are not as dire as they may seem. Although the Commission's GNP Commodities method of calculating deterrence-based penalties is undoubtedly imprecise, there is no reason to believe that the Commission's approach necessarily results in a penalty that is too severe. After all, the quantification of gains and losses is only one of the highly inexact elements in the GNP Commodities deterrence-based equation. Any systematic upward bias in the estimates of these numbers can be offset by the systematic use of low multipliers. Indeed, this appears to be precisely what the Commission has done.

For example, the multipliers applied to the "gain" estimates in Slusser and Grossfeld were 1.66 ($10 million ÷ $6 million) and 1.30 ($500,000 ÷ $385,714), respectively, while the Commission employed a multiplier of less than 1 ($600,000 ÷ 637,000) in Miller. See supra notes 176-77. See supra text accompanying notes 164-65. The reciprocals of these multipliers -- .6 or 60% ($6 million ÷ $10 million) and .77 or 77% ($385,714 ÷ $500,000) -- represent the assumed probability of punishment for wrongdoing under the GNP Commodities model. It surely is within the agency's expertise to recognize that the rate of detection of customer fraud in transactions under the Commission's jurisdiction -- leading to prosecution, then leading to the imposition of fines, then leading to the collection of those fines -- is, at best, a small (perhaps very small) fraction of the rates assumed in its penalty calculations. The use of lower, more realistic rates, would result in correspondingly higher multipliers and larger penalties. For example, an assumed (and, most likely unrealistically high) 10% probability of punishment would result in the use of a multiplier of 10, one that may fall within the statutory limit on penalties. See supra note 150.

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Fifth Circuit took aim at its head. In R&W, the appellate panel found fault with the $2,375,000 fine imposed by the Commission, vacated it, and remanded the case for a new penalty assessment.[195] Unlike its Ninth Circuit brethren, the Fifth Circuit tied the Commission to a formula that could result in the assessment of no civil monetary penalty all.[196]

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The Commission might also have pointed out that any effort to achieve any greater exactitude in the approach would undermine it rather than improve it. As the GNP Commodities Commission and the Administrative Conference both recognized, it is better to achieve the clarity that comes from the adoption of concrete, pragmatic principles than to founder in efforts aimed at the impossibly costly task of obtaining engineering-like precision. See Administrative Conference of the United States Recommendation 79-3; In re GNP Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. (CCH) ¶25,360 at 39,222 (CFTC Aug. 11, 1992) ("Civil monetary penalties cannot be calculated with precision. Even so, such penalties may be rationally devised in accordance with the purposes we have outlined. We begin with the proposition that potential violators will be discouraged from illegal conduct if they know that they are unlikely to profit from it.").

195 See R&W Technical Servs. Ltd. v. CFTC, 205 F.3d 165, 178 (5th Cir. 2000) (holding that "the proper measure of gain to the defendant is net profits, not gross revenues"). Like Miller, this remand is pending before the Commission.

196 Although the Commission had already stripped the R&W fine of any multiplier, the court of appeals concluded that the penalty was "unreasonably excessive," and directed that "a new assessment of the penalty should begin with the petitioner's net profits, which then should be adjusted lower based upon any mitigating evidence the petitioners present with regard to customer satisfaction." Id. at 177-78. Leaving the Commission without the discretion to employ a multiplier or to employ an alternate method for determining the penalty, the Fifth Circuit's instruction may result in the assessment of no penalty even in
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It seems that the Commission has uncritically taken to heart the remand instructions it received in Miller and R&W. The result is illuminating. In Walters, the administrative law judge granted summary disposition in favor of the Division, found that one limited partner perpetrated a fraud upon another in connection with commodity and options trading, and, among other sanctions, assessed a civil monetary penalty of $2.4 million.[197] The $2.4 million was the amount recommended by the Division and "equal[ed] . . . three times the monetary gain that Walters received as a result of his violations."[198] On appeal, the Commission effected a sea change in fine calculations.

It reasoned that, "[b]ecause the Division seeks a civil monetary penalty based on Walters' gain, the record must be sufficiently developed to permit a reliable calculation of

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the absence of mitigating evidence. This is so because the respondents' "net profits" may have been little or nothing. Once again, this suggests that the Commission might have done a better job of educating the court as to the purposes it was seeking to promote in imposing penalties with a sting. After all, "[p]eople [including, presumably, most federal judges] do not spontaneously think in terms of . . . deterrence." Cass R. Sunstein, David Schkade and Daniel Kahneman, Do People Want Optimal Deterrence?, 29 J. Legal Stud. 237, 250 (2000).

197 See In re Walters, CFTC Docket No. 99-15, slip op. at 1-2 (CFTC April 7, 2000); In re Walters, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,459 at 51,459 (CFTC Aug. 9, 1999) (complaint).

198 Walters, ¶28,459 at 51,459.

respondent's net financial benefit."[199] Finding that certain facts concerning causation, revenues and expenses remained in dispute, the Commission vacated the $2.4 million penalty and remanded the case for further discovery and fact finding on the issues material to imposition of a civil monetary penalty based on ill-gotten profit.[200]

Shortly after the remand, the Division took the unprecedented step[201] of filing a motion to "withdraw[] its request for the imposition of a civil monetary penalty," because the proceeding directed by the Commission did "not seem to be a worthwhile use of resources."[202] The administrative law judge

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[199] In re Walters, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,657 at 52,572 (CFTC Oct. 3, 2001) (citing R&W, 205 F.3d at 178).

[200] See id. at 52,571-73.

[201] Or nearly so. Certainly, we know of no other cases where the Division has argued that the imposition of a civil monetary penalty was more trouble than it was worth.

[202] Division of Enforcement's Motion to Withdraw Request for Monetary Sanctions, dated November 19, 2001 ("Withdrawal Motion"), at 1-2. As onerous as the Division apparently found the remand in Walters to be, the case involved just one victim. Thus, it lacked the fact-related complexity present in determining transaction causation in a more typical Commission enforcement action, one alleging fraud involving many customers.

accepted this argument and promptly terminated the remanded case.[203]

There is reason to believe that the Division's decision not to pursue a civil monetary penalty stemmed from a recognition that Walters' synthesis of Miller and R&W demands too much effort.[204] Moreover, it reveals the possibility that a profit

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[203] See In re Walters, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,686 at 52,673 (CFTC Nov. 29, 2001). The result of course was that the civil monetary penalty against Walters was reduced from $2.4 million to $0. The reason given by the Division and adopted by the administrative law judge for this result was that any civil monetary penalty imposed on the respondent was unlikely to be collectible. Id.; Withdrawal Motion at 1-2. We note that this reason had not stopped the Division from seeking a stiff civil monetary penalty against Walters before the remand nor has it stopped the Division from seeking civil monetary penalties in the present case (where it argues for penalties based on the number of counts in the complaint rather than on a calculation of the wrongful gain to the respondents). See infra note 233.

[204] A judicial fact-finding is the soul of compromise. There is no doubt that adversarial proceedings are searches for truth. However, the mechanism is imperfect in a number of respects. First, knowledge comes at a price. See Mirjan Damaska, Truth in Adjudication, 49 Hastings L.J. 289, 301 (1998). In addition, unbounded fact-finding would compromise other values such as preserving constitutional norms and confidences. See Posner, supra note 67, at 207. Thus, various aspects of a legal proceeding, such as rules of discovery and evidence, balance the truth-searching aspects with the costs involved. Id.; Damaska at 301; M. Neil Browne, Terri J. Kelly and Wesley J. Hiers, The Epistemological Role of an Expert Witness and Toxic Torts, 36 Am. Bus. L.J. 1, 39 (1998). In addition, adjudications are bound by an evidentiary record (and, sometimes, noticeable facts), that is generally developed by self-interested parties, rather than all available facts that might inform the process. Cf. 5 U.S.C. §556(d); 17 C.F.R. §10.69. See, e.g., In re Clark, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,370 at 46,693 (CFTC July 22, 1998); Fager v. Nadell, [1996-1998 Transfer Binder] (continued..)

and reliance-based measure may lead to a very light fine (or no fine at all) for activity that the Commission has long held to inflict substantial social harm. Fortunately, there is an alternative that satisfies the deterrence-based policies underlying civil monetary penalties, avoids the pitfalls associated with gains-based analysis (as it has evolved since GNP Commodities) and has a track record of permissible application.

The Goal Of Deterrence And The Social Cost Approach

Let's step back for a moment and restate in the simplest of terms the economic purpose underlying the Commission's authority to impose civil monetary penalties; it is to deter and, thereby, spare the public from the costs of unproductive activity. The measure of the injury associated with such waste is called "social cost" -- a term that economists use for the net loss in wealth to society from an activity.[205]

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Comm. Fut. L. Rep. (CCH) ¶27,351 at 46,598 (CFTC May 7, 1998); In re Elliott, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,000 (CFTC Feb. 3, 1998). The development of the record depends a great deal on the foresight, knowledge and skill of the advocates as well as that of the decisional tribunal. As a result, such a process must inevitably settle for a "realist view of the truth" that separates epistemological truth from pragmatic justification as a basis for factual conclusions. Damaska at 295.

[205] See Posner, supra note 154, at 7 ("A social cost diminishes the wealth of society; a private cost merely rearranges that wealth.").

The social cost arising from fraud is undeniable even if not quantifiable. True fraud is strictly unproductive. The social cost of fraud includes the resources invested to perpetrate the fraud[206] and the marginal effect of fraud on the resources invested by potential victims to protect themselves.[207] It also includes the deadweight loss resulting from any distortion in incentives caused by the misinformation transmitted through fraud, the costs that arise when resources are not controlled by their highest valued users, and any marginal costs associated with any valuable transactions that do not occur because of the fraud.[208] Sometimes these costs will be approximated by the customer losses caused by the fraud but that will not always be so.[209] In addition, a wrongdoer's gain (measured as revenue or profit) is a poor proxy for these costs. After all, social costs

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[206] Fraud includes investments in lying. See Paul G. Mahoney, Precaution Costs and the Law of Fraud in Impersonal Markets, 78 Va. L. Rev. 623, 631 (1992).

[207] If fraud is not deterred, market participants will take expensive precautions to uncover fraud so as to avoid entering into bargains they would not have concluded in an honest market. Id. at 630.

[208] At the margin, persons will shift their investments to other markets or uses that would have lesser value to them in the absence of the fraud that they are seeking to avoid. Id. at 630-31. See also Daniel R. Fischel and Alan O. Sykes, Civil RICO After Reves: an Economic Commentary, 1993 Sup. Ct. Rev. 157, 177-78 (1993).

[209] See Posner, supra note 67, at 447.

include transactions that are not likely to be reflected in a respondent's revenue and, indeed, may include costs born by the respondent which would, ceteris paribus, depress reported profit.[210]

The principal advantage of a social cost approach over the Walters approach is that it does not lose focus on why agencies penalize certain activities in the first place. The main disadvantage stems from the difficulty of quantifying social cost. However, this disadvantage seems to diminish in light of that fact that Miller, R&W and Walters have rendered a gains-based measure impractical in most retail fraud cases.

The Commission has employed the social cost approach for some time, principally in "trade practice" cases. Trade practice cases primarily concern fraud in the execution process at work in impersonal exchange markets. These cases typically involve charges against floor brokers of fraudulently trading ahead of customers, taking the other side of customer orders, trading noncompetitively and creating false records to cover-up the infractions.[211] In trade practice cases, respondent gains and customer losses may be incalculable or, if calculable, quite

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[210] See Mahoney, supra note 206, at 629; Posner, supra note 67, at 447.

[211] See, e.g., In re Rousso, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,310 (CFTC Aug. 20, 1997).

small. In any event, they are unlikely to reflect the substantial social costs resulting from this type of fraud, costs stemming from the fraud's "tend[ency] to damage the integrity of the market and to seriously erode public confidence in the commodity futures industry."[212] In these cases, the Commission has imposed stiff penalties despite the absence of hard (or, more accurately, seemingly hard) numbers on respondent gains, customer losses or the social costs.[213] So far, this approach has withstood appellate review.

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[212] Id.

[213] In Reddy, the Commission explained,

> [R]espondent invokes to no avail the damages rule of In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,182 (CFTC March 16, 1993). Gordon held that, in determining the gravity of the violations and in order to deter fraud, the Commission will consider in establishing a civil monetary penalty the financial benefit to the respondent or the losses suffered by customers when that information is available. The Gordon case, however, involved fraudulent solicitation of customers, and the calculation of the civil monetary penalty reflected those facts. These factors in gauging the gravity of the offenses are not readily transferable to trade practice cases, where the violative conduct has the potential for threatening the integrity of the market and the confidences of all those who rely on them for risk shifting and price discovery.

In re Reddy, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 n.19 (CFTC Feb. 4, 1998). See also In re Slusser, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH)
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In Mayer, for example, the Commission assessed penalties of $500,000 against one of the respondents and $250,000 each, against four others for repeated prearranged trading, wash trading and bucketing that occurred over the course of 26 months.[214] Declining any attempt to quantify the private gains and losses resulting from the violations,[215] the Commission focused explicitly on the concept of social costs.[216] It found

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¶27,701 at 48,318 n.31 (CFTC July 17, 1999) ("The existence of demonstrable financial gain to respondents and loss to customers distinguishes customer fraud cases from trade practice cases, where the violations of the act may be more readily quantifiable and financial impact less quantifiable, and results in the Commission's different approach to civil monetary penalties."); In re Mayer, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,141 (CFTC Feb. 25, 1998). See also Rousso, ¶27,133 (assessing penalties of $200,000 against one trader, $50,000 against another, and $100,000 each against two others for repeated prearranged trading, wash trading and bucketing found to have occurred over a six-month period), aff'd without opinion sub nom., Rousso v. CFTC, Docket No. 97-4232 (2d Cir. March 11, 1998).

[214] See Mayer, ¶27,259 at 46,141.

[215] See id.

[216] See id. at 46,139 n.70 (ellipses in original) ("If trading is 'rigged' on all commodity futures exchanges, there will be less commodity futures trading period, and the social benefits of such trading . . . will be reduced." (quoting United States v. Dial, 757 F.2d 163, 165 (7th Cir. 1985)). In Dial, Judge Posner provided the following summary of the social benefits resulting from exchange trading.

> Commodity futures trading serves a social function other than to gratify the taste for

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that the respondents had "undermined the confidence on which successful trading depends, harming the exchanges, the markets, and society at large that depends on the functioning of these markets."[217] On the basis of this finding it more than doubled the penalties assessed for these violations by the administrative law judge[218] and explained,

> The penalties we impose on these respondents reflect and seek to deter the betrayal of the public interest inherent in respondents' abuse of a regulated public market. We find that the amounts assessed by the [administrative law judge] do not reflect sufficiently the gravity of the violations. We believe that effective deterrence occurs when it is no longer worthwhile for a wrongdoer to risk engaging in acts that threaten the integrity of the markets. In setting the appropriate amount we have also looked at other trade practice cases in which civil monetary penalties were assessed. A severe penalty is particularly appropriate where, as here, the proscribed conduct

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> risks -- two other social functions in fact. It increases the amount of information that the actual consumers of the commodity . . . have about future price trends, by creating incentives for investors and their advisers to study and forecast demand and supply conditions in the commodity. And it enables the risk-averse to hedge against future uncertainties."

757 F.2d at 165.

[217] Mayer, ¶27,259 at 46,139.

[218] The administrative law judge had imposed penalties of $200,000 against one respondent, $50,000 against another, and $100,000 each against three others. See id. at 46,138-39.

involves fraud, because such conduct decreases the likelihood of detection.[219]

On appeal, the Second Circuit affirmed the Commission's decision, finding ample support for the Commission's penalty assessments in its consideration (without any attempt at the daunting task of quantification) of the social costs resulting from respondents' misconduct.[220]

In Glass, the presiding administrative law judge found the two respondents (Glass and Guttman) liable for engaging in a series of 12 illegal wash transactions over a five-month period for the purpose of cooking the books of a partnership in order to obtain financing.[221] He fined Glass $150,000 and Guttman

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[219] Id. at 46,141 (footnote omitted).

[220] See Reddy v. CFTC, 191 F.3d 109, 128 (2d Cir. 1999) ("It is certainly reasonable to measure the gravity of the violations by 'betrayal of the public interest' and by the need to deter threats to the integrity of the markets, and 'the calculation of civil money penalties does not lend itself to simple formulaic solutions.'" (citations omitted)).

In the same opinion, the Second Circuit reviewed another Commission proceeding. It affirmed the Commission's decision to impose social-cost-based fines of $300,000 and $150,000 for repeated prearranged and wash trading and bucketing that was found to have occurred over a six-month period. See id., aff'g In re Reddy, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (CFTC Feb. 4, 1998).

[221] See In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,559, 46,561-3 (CFTC April 27, 1998).

$500,000.[222] On appeal, the respondents argued that the civil monetary penalties they received were unjustified and "irrational" because no one profited or lost on the trades.[223] This argument failed.

The Commission found the lack of immediate private harm stemming from the trades in question to be immaterial. "Respondents' prearranged wash trading," the Commission stated, "undermined the open outcry system of trading and threatened the integrity of the market."[224] Reasoning that "[s]erious violations warrant the imposition of substantial civil monetary

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[222] See id. at 46,559-60.

[223] The Commission summarized the respondents' arguments by stating,

> Glass contends that the sanctions imposed by the ALJ are irrational and that the $150,000 civil monetary penalty . . . [is] too severe in light of the absence of customer losses.
>
> Guttman also argues that the sanctions imposed by the ALJ are excessive. Guttman submits that there is no basis to support a $500,000 civil monetary penalty. Guttman asserts that the trades "were not entered into for a profit motive; instead, they were conducted simply as a means of satisfying [the futures commission merchant's] request to reduce debit equity month-end." Guttman contends that there were no victims . . . .

Id. at 46,561-7 (citations omitted).

[224] Id. at 46,561-8.

penalties," and that "[r]espondents' violations go to the core of the Act," the Commission affirmed the $500,000 penalty against Guttman and increased Glass' penalty from $150,000 to $300,000.[225] The Second Circuit again affirmed.[226]

The Commission has not only imposed large penalties when violations pose a substantial, direct social harm, (but do not result in large proven private gains), it has done the same when the social harm involved is indirect, arising from increased costs associated with regulatory enforcement. For example, in New York Currency Research, the Commission found that the respondent performed a single act that violated the record production requirements of Section 4n(3)(A) and Commission Rule

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225 See id. at 46,561-9 ("The penalties that we impose on these respondents reflect and seek to deter the betrayal of the public interest inherent in respondents' abuse of a regulated public market."). But see In re Piasio, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,276 at 50,693 (CFTC Sept. 19, 2000) (assessed penalties of $40,000 and $25,000, respectively, for respondents who knowingly engaged in some or all of 11 wash transactions over two one-month periods undertaken to shift balance sheet profits and losses of a customer), appeal docketed sub nom. Piasio v. CFTC, Docket No. 02-4032 (2d Cir. pending); In re Elliott, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,007-08 (CFTC Feb. 3, 1998) (imposing $50,000 penalties, each, on four floor brokers who engaged in 32 prohibited noncompetitive wash trades over a two week period in the wheat pit of the Chicago Board of Trade and stating that the trades significantly "impacted the integrity of the market by significantly inflating the [trading] volume . . . ."), aff'd sub nom. Elliot v. CFTC, 202 F.3d 926 (7th Cir. 2000).

226 See Guttman v. CFTC, 197 F.3d 33 (2d Cir. 1999) (ruling on the petition of the only appellant, Guttman).

1.31,[227] and left undisturbed the administrative law judge's finding that the respondent had resisted the production demand in good faith under color of law.[228] As punishment, the Commission fined the respondent $110,000.[229] The Commission found such a heavy fine warranted based on the view that the violation interfered with the Commission's ability to police those under its jurisdiction.[230]

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[227] 7 U.S.C. §6n(3)(A); 17 C.F.R. §1.31.

[228] See In re New York Currency Research, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,223 (CFTC Feb. 6, 1998), modified on reconsideration, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,311 (March 31, 1998), rev'd on other grounds, New York Currency Research Corp. v. CFTC, 180 F.3d 83 (2d Cir. 1999). See also In re New York Currency Research Corp., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,222 at 45,905 (CFTC Jan. 12, 1998).

[229] See New York Currency Research, ¶27,223 at 45,915.

[230] See id. The Commission explained,

> Respondent . . . argues that the sanctions imposed by the Commission are not warranted because respondent inflicted no injury on customers or the market and did not benefit from the violation. However, injury to customers and benefit to respondent are criteria more applicable to a choice of sanctions for trade practice violations or fraud than a refusal to comply with the Commission's record production requirements. The Commission's ability to inspect the operations and activities of Commission registrants goes to the heart of the Commission's ability to enforce the CEA. Respondent intentionally disregarded its regulatory obligations under the CEA. The

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Mayer, Glass and New York Currency illustrate that social harm is a sufficient basis upon which to mete out the type of heavy fines that are likely to specifically and generally deter unlawful acts. Stated another way, they demonstrate that the absence of customer harm and/or immediately-resulting pecuniary gain does not preclude a fine that reaches the statutory maximum of $110,000 per violation and far exceeds any revenue or profit that was proven to result from unlawful acts (or merely earned during the period of wrongdoing).[231] In this case, there is a pressing need to impose fines that would have a deterrent effect and no other apparent way to do it than to apply the Mayer, Glass and New York Currency approach.[232] Accordingly, that is what we will do.

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> effectiveness of the record production requirement would be undercut if registrants could selectively comply with them. We find the sanction imposed to be appropriate given the nature and gravity of the violation.

New York Currency Research, ¶27,312 at 46,397. But see In re Kelly, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,514 at 47,374 (CFTC Nov. 19, 1998) (reducing $25,000 penalty imposed on respondent by the administrative law judge for a single violation of the production requirements of Section 4n(3)(A) and Commission Rule 1.31 to $10,000).

[231] See, e.g., New York Currency Research, ¶27,312 at 46,397.

[232] The Division asserts that the respondents' non-participation as defaulters and irreparable holes in the record make calculation of the respondents' net gains or customer losses (continued..)

Applying The Social Cost Approach

Having determined that fine determinations based on respondents' gains or their customers' injuries are unworkable in this proceeding (and, possibly, any proceeding involving a large number of customers), we must apply the social cost-based method. This decision immediately begs the question of how an appropriate penalty can be quantified without making any calculations of revenue, profit or customer loss?[233] The answer is that we must

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(..continued)

impossible. Consequently, it suggests that the Court is free to undertake a different approach to assessing civil monetary penalties in this case than the one directed by the Commission (but never undertaken) in Walters. See Memorandum at 20-21; Proposed Findings, ¶¶55, 58; Proposed Default Order at 14. In support of this position, the Division refers to Gordon. Gordon instructed that, in a retail fraud case, the administrative law judge shall "either base the civil monetary penalty on the financial benefit that accrued to [the respondent] . . . or the losses suffered by his customers as the result of his wrongdoing, or in the alternative, specifically explain why such a basis is impractical or inappropriate." In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,182 (CFTC March 16, 1993) (emphasis added).

[233] The Division urges us to fix the penalties mechanically by reference to the number of counts in the Complaint lodged against each respondent. See Memorandum at 22 ("Since the wrongful gain to the Respondents is indeterminable, the acts were serious violations over an extended period of time, and all the fraudulent acts occurred between November 27, 1996 and October 22, 2000, a civil monetary penalty of $110,000 to each Respondent per count of the Complaint is appropriate.") (footnote omitted); Proposed Findings, ¶58; Proposed Default Order at 15. As we indicated earlier, the Division's approach is contrary to law. Moreover, it lacks common sense.

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go back to the multi-factor test.[234]

The Commission described the test by stating,

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While the scope, number and nature of the regulatory infractions may offer insight as to the overall gravity of a respondent's misconduct, the happenstance of how these factors work their way into the formal pleading structure of "counts" does not. The application of "count counting," in this case, has placed the Division in the odd position of urging that the most severe fines be assessed against those respondents whose conduct the Division regards as the least egregious. See supra note 146.

[234] Or, as Justice Scalia has termed it, "that test most beloved by [agencies] unwilling to be held to rules (and most feared by litigants who want to know what to expect): th' ol' 'totality of the circumstances' test." United States v. Meade Corp., 533 U.S. 218, 241 (2001) (Scalia, J., dissenting).

Here we have an example of "the best being the enemy of the good." As we have seen, the Commission endeavored, through GNP Commodities and its progeny, to develop a principled approach that brought greater precision (and thereby predictability) to the civil monetary penalty assessment in retail customer fraud cases. The courts of appeals, however, rewarded the effort by demanding more exactitude than the approach can practically give. On the other hand, in the trade practice area, where the Commission has attempted no quantification, and done little else to justify the specific size of the penalties it imposes, or their relationship to that imposed in other cases, the courts have been extremely deferential. In short, the less the Commission has sought to develop its approach to monetary penalties, the less the courts have demanded in terms of justification. See, e.g., Reddy v. CFTC, 191 F.3d 109, 125 (2nd Cir. 1999) ("[T]he Commission's selection of sanctions involves judgments that cannot be accompanied by arithmetic exactitude or extended meaningful explication, in particular because they involve a judgment with regard to deterrence of other traders who might be tempted to engage in similar conduct. Such a judgment may be difficult to express in non-conclusory terms . . . . What is required in the way of Commission explanation is . . . simply an indication sufficiently discernable to allow us to exclude arbitrariness as the explanation for a sanction.").

> We do not rely on a specific formula in assessing de novo the appropriate level of sanctions, but instead we look to the total facts and circumstances of the case and focus on the relative gravity of respondents' misconduct in light of the following factors: (1) the relationship of the violation at issue to the regulatory purposes of the Act; (2) the respondent's state of mind; (3) the consequences flowing from the violative conduct; and (4) respondent's post-violation conduct. We also consider any mitigating or aggravating circumstances presented by the facts.[235]

In discussing these factors, the Commission has drawn little distinction between the different types of fraud that violates the Act or its regulations.[236] This is understandable since sales fraud, like trade practice violations, threatens the integrity of and confidence in the futures and options markets as

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[235] In re Glass, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,561-7 (CFTC April 27, 1998) (citing Grossfeld, ¶26,921 at 44,467–68) (citations omitted)).

[236] The Commission explained, "[C]onduct that violates core provisions of the Act -- [whether] manipulating prices or defrauding customers -- is very serious even if there are mitigating facts and circumstances." In re Grossfeld, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,467 n.28 (CFTC Dec. 10, 1996) (citation omitted).

well as the market for trading-related services.[237] When respondents' activity is viewed through the prism of the Glass factors, it may be impossible to quantify the optimal fine but it is also impossible to escape the conclusion that heavy fines are necessary to serve as specific and general deterrents.

As previously discussed, both DeWitte and Glover routinely engaged in sales fraud over a three-year period and Johnson went so far as to launch a corporate enterprise, in which he practiced and encouraged the same illicit sales practices over the course of a year. All three undertook their misdeeds knowingly with the intent of victimizing their customers. Their conduct was unmitigated and they have not demonstrated rehabilitation. Of course, First Financial is proven to have performed no violative act other than those of the individual respondents. However, their acts and mental states are imputed to the firm. Accordingly, First Financial is also deemed to have engaged in misdeeds that go to the core of the Act, were performed knowingly and with the intent of ripping off its customers, and that have not been mitigated. Moreover, there is nothing in the record to suggest that the firm is any more rehabilitated than its former controlling owner or employees.

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[237] See In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914 (CFTC June 16, 1995).

It seems evident that the respondents' misconduct was substantially more egregious (and injurious to the operation of commodities markets) than the handful of fictitious wash sales undertaken over a five-month period that merited fines of $500,000 and $300,000 in Glass. In addition, the misconduct found here is exponentially graver than the one-time record production violation for which the Commission assessed a $110,000 penalty in New York Currency Research. Based on our sense of the social cost of the their misconduct and without belaboring the point much further, we assess civil monetary penalties of $1,000,000 against each of the respondents.[238]

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[238] "If you want to know the law . . . you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict.". Oliver Wendell Holmes, Jr., The Path of the Law, 32 Harv. L. Rev. 40, 41-42 (1918). As the discussion above unfortunately illustrates, the goal of fostering knowledge of potential consequences of wrongdoing is at war with the vagaries of the multi-factor approach. We can, however, minimize the approach's shortcomings as applied to the assessment of civil monetary penalties. We can do this by following clearly stated principles (deterrence) in the penalty analysis and forming those principles based on a better understanding of the end that penalties serve (the minimization of social costs).

If deterrence is the goal, clarity is necessary. As we once said,

> Achieving [the] deterrence goal requires that the method of devising sanctions be clearly articulated. A clearly articulated method of devising sanctions allows the Commission to send a strong signal to individual respondents and the industry as a whole about the expected consequences resulting from involvement in illegal activity. In order to

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Restitution Is Not Warranted

Section 6(c) of the Act provides that, where any violation of the Act or Commission regulations has been proven, the Commission may "require restitution to customers of damages proximately caused by [such] violations . . . ."[239] Unlike the other sanctions that we can order, the purpose of restitution is

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> achieve deterrence, it is not necessary for the industry to know the exact dollar amounts of penalties the Commission will assess in specific cases. It may be sufficient that the industry recognize the process by which the Commission devises penalties.

In re Grossfeld, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,975 at 41,121 n.25 (CFTC Feb. 9, 1994). Simply stated, the ordinary Holmesian "bad man" will be deterred when he recognizes that the benefits of wrongdoing are not worth the risk. Understanding this, and the public's stake in properly functioning commodity markets, leads to the further understanding that penalties for fraud should be predictable and stiff. They must be so stiff that, under the ordinary circumstances, they will never be looked upon by the potential wrongdoer as a cost of doing business or a chance worth taking. See In re Mayer, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,141 (CFTC Feb. 25, 1998) ("We believe that effective deterrence occurs when it is no longer worthwhile for a wrongdoer to risk engaging in acts that threaten the integrity of the markets."). The need for hefty penalties increases in a world of limited enforcement resources where much wrongdoing escapes detection, or is detected but left unprosecuted. As to the misconduct proven in this case, it is the Court's view that nothing less than the $1,000,000 fines that we have assessed will accomplish the goals of specific and, especially, general deterrence.

[239] 7 U.S.C. §9. See also 17 C.F.R §§10.110-10.114.

strictly remedial.[240] Thus, "restitution fulfills its purpose only when it tends to make whole those persons harmed by violations of the Act or Commission rules or at least pays a meaningful portion of the damages they suffered."[241] For this reason, the Commission eschews restitution awards that are little more than symbolic.[242] Accordingly, the Court must scrutinize the respondent's ability to pay restitution before it issues an order directing the respondent to do so.[243] On the ability to pay, as on all other issues relating to liability and sanctions, the Division has the burden of proof.[244]

In this case, the Complaint contains no allegations concerning the net worth or financial assets of any of the respondents. In addition, the Division made no attempt to prove

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240 See supra note 156.

241 In re Staryk, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,812 (CFTC Dec. 18, 1997).

242 Id. ("Should the ALJ find that respondent's resources are too limited to make restitution feasible, he should consider imposing an appropriate civil monetary penalty"). See also 17 C.F.R. §10.110(a). See infra note 246.

243 See supra note 242.

244 Section 7(c) of the Administrative Procedure Act states that "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof." 5 U.S.C. §556(d). See Director, Office of Workers' Compensation Programs, Dep't of Labor v. Greenwich Colleries, 512 U. S. 267, 278-79 (1994).

that any respondent had the ability to pay.[245] Accordingly, on the record before us, restitution is not warranted.[246]

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[245] The Division does not seek restitution in this case because it "is unaware that any Respondent has any meaningful assets." Memorandum at 23 n.49. See Proposed Findings, ¶61 n.5; Proposed Default Order at 16 n.20.

[246] "[T]he decision whether to commit public and private resources to restitution is one grounded in cold, hard reality . . . . The inquiry asks whether restitution is likely to be a fair and efficient mechanism for actually getting money back into the hands of cheated customers." In re Lexus Fin'ial Group, Inc., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,713 at 48,381 (CFTC July 20, 1999) (footnotes omitted); see also 17 C.F.R §10.110(a). In this regard, it is noteworthy that, "[w]hile customer reliance on the deceptive misrepresentations need not be proved in an administrative enforcement action alleging fraud, reliance is a statutory requirement of restitution." Staryk, ¶27,206 at 45,812. Accordingly, the Commission has directed the Court, in determining whether to order restitution, to consider "the degree of complexity likely to be involved in establishing the claims of individual customers." Id. at 45,812 n.15; see also 17 C.F.R §10.110(a). Neither the Complaint's allegations nor any other part of the default record shed light on the damages proximately caused to individual customers by the respondents' violations. Indeed, even if the record were to be more fully developed through a full-blown evidentiary trial, the complexity and costliness of the fact-specific, highly individualized inquiry necessary to establish reliance and damages for the large number of possible claimants militates heavily against awarding restitution in this case.

All other things being equal, the benefits of restitution are more likely to outweigh its costs in cases where the ease of proving reliance is greater. For example, proof of reliance is likely to pose little difficulty in cases where the wrongful activity goes beyond misrepresenting the value of particular trades and involves even harder-core fraud such as a Ponzi scheme. See, e.g., In re Cantillano-Estrada, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,284 at 42,438 (CFTC Jan. 9, 1995)); In re Fritts, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,255 at 42,132 (CFTC Nov. 2, 1994). After all, it is a relatively simple matter to prove that no reasonable (continued..)

Conclusions And Order

For the reasons set forth above, the Court **FINDS** that:

1. Respondents Scott DeWitte and Thomas Glover, II violated Section 4c(b) of the Act, 7 U.S.C. §6c(b), and Commission Regulation 33.10, 17 C.F.R. §33.10;

2. Pursuant to Section 2(a)(1)(A)(iii) of the Act, 7 U.S.C. §4, respondent First Financial Trading, Inc. is liable for those violations set forth in Paragraph 1 which occurred during the period of Scott DeWitte's and Thomas Glover, II's employment at First Financial Trading, Inc., and thereby violated Section 4c(b) of the Act and Commission Regulation 33.10;

3. Respondent Corey Johnson directly or indirectly controlled respondent First Financial Trading, Inc. and did not act in good faith or knowingly induced, directly or indirectly, the violations set forth in Paragraph 2, above, and, by operation of Section 13(b) of the Act, 7 U.S.C. §13c(b), is liable for the violations of Section 4c(b) of the Act and Commission Regulation 33.10 to the same extent as First Financial Trading, Inc.; and

4. Respondents First Financial Trading, Inc. and Corey Johnson failed to diligently supervise Scott DeWitte and Thomas Glover, II for the purpose of deterring violations of Section 4c(b) of the Act and Commission Regulation 33.10 and, thereby, violated Regulation 166.3, 17 C.F.R. §166.3.

Accordingly, it is hereby **ORDERED** that:

1. Respondents First Financial Trading, Inc., Corey Johnson, Scott DeWitte and Thomas Glover, II

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customer would entrust his capital to a person or firm that he knew would convert or steal it, or where the purchase or investment itself was inherently worthless. In the more typical case (such as this one) of a broker overreaching in the widespread solicitation of otherwise legitimate financial products, restitution is unlikely to be an efficient remedy.

CEASE AND DESIST from violating Section 4c(b) of the Act, 7 U.S.C. §6c(b), and Commission Regulation 33.10, 17 C.F.R. §33.10;

2. Respondents First Financial Trading, Inc. and Corey Johnson **CEASE AND DESIST** from violating Commission Regulation 166.3, 17 C.F.R. §166.3;

3. Respondents First Financial Trading, Inc.'s registration as an introducing broker is **REVOKED;**

4. Respondents First Financial Trading, Inc., Corey Johnson, Scott DeWitte and Thomas Glover, II be **PERMANENTLY PROHIBITED**, directly or indirectly, from **TRADING** on or subject to the rules of any contract market, either for their own account or for the account of any persons, interest or equity, and all contract markets are **PERMANENTLY REQUIRED TO REFUSE** First Financial Trading, Inc., Corey Johnson, Scott DeWitte and Thomas Glover, II any trading privileges; and

5. Respondents First Financial Trading, Inc., Corey Johnson, Scott DeWitte and Thomas Glover, II each **PAY** a civil monetary penalty of **$1,000,000** within 30 days of the effective date of this order.

IT IS SO ORDERED.

On this 8th day of July, 2002

Bruce C. Levine

Bruce C. Levine
Administrative Law Judge