



U.S. COMMODITY FUTURES TRADING COMMISSION

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1155 21st Street, NW, Washington, DC 20581

In the Matter of

SEAN G. KELLY,

Respondent.

CFTC Docket No. 97-6

INITIAL DECISION

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Before:

Bruce C. Levine, Administrative Law Judge

FILED
FEB 24 9 03 AM '98
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Overview

"Of course, the question of subpoenas should never arise where the Commission's 'inspection powers over boards of trade, reporting traders, and persons required by law to register with the Commission' has been invoked. The Division is entitled by law to obtain immediate and unreserved compliance with a request for access to books and records of any legal entity or individual within these categories.

It also follows that a refusal . . . to provide the Enforcement Division with immediate and unreserved access to books and records is a violation of the Act and the regulations thereunder--and one which we conclude to be extremely serious."¹

Respondent Sean G. Kelly ("Kelly") tested the strength of this policy when he chose to ignore a Division of Enforcement ("Division") request for his records out of indifference and his calculated self-interest. In doing so, he risked being becoming the target of an enforcement action, a possibility that came to fruition in the present case.

On the basis of an undisputed record, the Court concludes, as a matter of law, that Kelly violated Section 4n(3)(A) of the Commodity Exchange Act ("Act") and Commission Regulation 1.31.² Because the undisputed record is substantially complete and the Division has met its burden, the Court concludes that the Division is entitled to summary disposition in its favor.

¹ CFTC Interpretive Letter No. 77-4, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,405 at 21,632 (CFTC Apr. 14, 1977).

² 7 U.S.C. §6n(3)(A), 17 C.F.R. §1.31.

Accordingly, respondent Sean G. Kelly's registration as a commodity trading advisor is **REVOKED**, and he is **ORDERED** to **PAY** a civil monetary penalty of **\$25,000**. The Division's request, however, for a cease and desist order against Kelly is **DENIED**.

Background

This matter is before the Court on Division of Enforcement's motion and respondent Sean G. Kelly's cross-motion seeking summary disposition.³ Since the procedural history and many of the undisputed material facts of this case are intertwined, both are discussed in this section.

³ See Division of Enforcement's Motion for Summary Disposition, dated July 30, 1997; Division of Enforcement's Statement of Undisputed Material Facts, dated July 30, 1997 ("Division's Undisputed Facts"); Division of Enforcement's Memorandum of Law in Support of its Motion for Summary Disposition, dated July 30, 1997 ("Division's Memorandum in Support"); Affidavit of Glenn Spann, dated July 30, 1997, ("Spann Affidavit"); Affidavit of Brett Little, dated July 30, 1997 ("Little Affidavit"); Notice of Cross-Motion, dated August 26, 1997; Respondent's Statement of Undisputed Material Facts, dated August 26, 1997 ("Respondent's Undisputed Facts"); Respondent's Reply to the Commission's Statement of Undisputed Material Facts, dated August 26, 1997 ("Respondent's Reply to Division's Undisputed Facts"); Respondent's Memorandum in Opposition to the Commission's Motion for Summary Disposition and in Support of Respondent's Own Cross-Motion for Summary Disposition and Dismissal, dated August 26, 1997 ("Respondent's Memorandum"); Reply Affidavit of Sean G. Kelly, dated August 27, 1997 ("Kelly Affidavit"); Division of Enforcement's Memorandum in Opposition to Respondent's Cross Motion for Summary Disposition, dated September 29, 1997 ("Division's Memorandum in Opposition"); Affidavit of Brett Little in Opposition to Respondent's Cross Motion, dated September 12, 1997 ("Little Opposition Affidavit").

Kelly is a commodity trading advisor ("CTA")⁴ who has been continuously registered as such since January 12, 1996.⁵ He does business out of Buffalo, New York.⁶ During the summer of 1996, the Division was in the midst of an investigation targeting AVCO Financial Corporation ("AVCO").⁷ Invoking its authority under

⁴ Complaint and Notice of Hearing Pursuant to Sections 6(c), 6(d), 8a(3) and 8a(4) of the Commodity Exchange Act, As Amended, dated February 26, 1997, at ¶1 ("Complaint"); Answer & Defenses, dated June 12, 1997, at ¶1 ("Answer").

Section 1a(5) of the Act, 7 U.S.C. §1a(5), defines a CTA as

"[A]ny person who--

(i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in--

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market;

(II) any commodity option authorized under section 4c; or

(III) any leverage transaction authorized under section 19; or

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i)."

⁵ Complaint at ¶1; Answer at ¶1.

⁶ Complaint at ¶1; Answer at ¶1.

⁷ See Spann Affidavit, Exhibit A, Letter from Glenn Spann, Futures Trading Investigator, Division of Enforcement to Sean Kelly, CTA, dated September 4, 1996 ("Spann Letter"). AVCO manufactured and sold a computer software program called "Recurrence" that generates specific recommendations to advise a customer to buy, sell or exit positions in exchange-traded (continued...)

Commission Regulation 1.31, the Division sent a September 4, 1996 demand for documents to Kelly as part of the investigation.⁸ Kelly failed to comply with the request by the return date of September 18, 1996.⁹

On October 2, 1996, Division staff contacted Kelly by telephone. A Division investigator inquired as to why the Division

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futures contracts on Swiss francs and Japanese yen. The Division's investigation culminated in a pending civil enforcement action brought by the Commission in federal district court in the Southern District of New York. In the three-count complaint, the Commission alleges that in connection with the marketing of Recurrence, AVCO engaged in advertising and solicitation fraud and acted as a CTA without registering in violation of the Commodity Exchange Act. See CFTC v. AVCO Financial Corp., 979 F. Supp. 232, 233-34 (S.D.N.Y. 1997).

⁸ Spann Letter; Complaint at ¶5; Respondent's Reply to Division's Undisputed Facts at ¶2. See Answer at ¶3.

The request directed Kelly to provide by September 18, 1996, inter alia, (1) the names of Kelly's customers, specifying those who traded using the AVCO program; (2) all account documents, trading records and correspondence for each of Kelly's customers who used the AVCO program; and (3) any contracts, agreements, correspondence, or other documents reflecting communications between Kelly and AVCO. Spann Letter.

The Division's interest in Kelly stemmed from his relationship as a customer of AVCO. Kelly had purchased Recurrence from AVCO for his personal trading in 1995. After registering as a CTA in 1996, he began to use the AVCO program to trade for customers. According to Kelly, he became dissatisfied with the program's "function, results, and both short and long term prospects for success," and discontinued its use after several months. Kelly Affidavit at ¶2. At the time of the Division's record request, Kelly "was in negotiations with AVCO to get his money back and have his client losses made good as well." Kelly Affidavit, Exhibit B, Memorandum from Brett Little, Esq. to Files, dated January 6, 1997, at 1; see also Kelly Affidavit at ¶7.

⁹ Complaint at ¶6; Answer at ¶4.

had not received the requested records. Kelly responded that he no longer had them.¹⁰

On January 6, 1997, the Division again attempted to gain access to Kelly's records, this time by subpoena,¹¹ and Kelly held to his original story. On January 15, 1997, he left the following telephone message with the Division: "Hello Brett, this is Sean Kelly As far as records, I don't have any, uh, you have what you, what you got from, uh, DFS, which is the same records as I woulda had, if I, had I kept them, but I didn't."¹² Apparently believing Kelly's story, the Division eventually gave up trying to get his records. However, the Division's resignation brought him no relief.

On February 26, 1997, nearly six months after the Division requested his records, the Commodity Futures Trading Commission ("Commission") issued a one-count Complaint against Kelly. The Complaint charged Kelly with violations of Section 4n(3)(A) of the Commodity Exchange Act ("Act") and Sections 1.31 and 4.33 of the

¹⁰ Compare Complaint at ¶7 ("Kelly informed the Division that he no longer had the required records and books because he had discarded them."); Respondent's Memorandum, Exhibit A, Draft Memorandum to the File from Glenn Spann, dated October 2, 1996 at 1 ("Kelly said . . . all of his records were discarded by him several months ago."); with Answer at ¶5 ("admits that the Commission contacted Kelly to inquire why requested documents had not been provided At that point in time, Kelly believed that he did not have the books and records requested"). See also Respondent's Reply to Division's Undisputed Facts at ¶4; Kelly Affidavit at ¶5.

¹¹ Subpoena Ad Testificandum and Duces Tecum, dated January 6, 1997. The subpoena was never enforced.

¹² Little Affidavit at ¶3; Respondent's Reply to Division's Undisputed Facts at ¶5.

Commission's Regulations.¹³ The Commission based the charges on Kelly's alleged failure to maintain required books and records and furnish them to a representative upon request.¹⁴

The Complaint induced an epiphany of sorts. As Kelly later put it, "I just read through it real quick and seeing that they could fine me all kinds of money and stuff, that's when I decided I'd better do something. I didn't want to be fined."¹⁵ Suddenly enlightened, Kelly began his search and found the records in the first place he looked.¹⁶ The records sat in his garage, located about twenty feet from his home.¹⁷ Having finally retrieved his records, Kelly delivered them to the Division on March 4, 1997.¹⁸

¹³ Complaint at ¶¶9-10. See 7 U.S.C §6n(3)(A); 17 C.F.R. §§1.31 and 4.33.

By the Complaint, the Commission instituted this proceeding to consider whether the Division's allegations are true, and if so, whether Kelly should be sanctioned by the entering of a cease-and-desist order, trading ban, registration revocation, and/or the assessment of a civil monetary penalty. Complaint at Part V.

¹⁴ Complaint at ¶¶9-10.

¹⁵ Spann Affidavit, Exhibit B, Deposition of Sean Kelly, dated May 6, 1997, at 67 ("Kelly Deposition").

¹⁶

Division counsel: "Was the garage the first place that you looked?"

Kelly: "Yeah. Because that's where I put them. So I figured if they're going to be there, that's where they are."

Id.

¹⁷ Id. at 67-68.

¹⁸ Division's Undisputed Facts at ¶7; Respondent's Reply to Division's Undisputed Facts at ¶7.

Shortly thereafter, settlement discussions began. To this end, the Division and Kelly, who was proceeding pro se at the time, filed a joint motion for an extension of the time to file an answer shortly after this proceeding began.¹⁹ They requested the extension "so that they may complete negotiations of settlement to terminate this action and allow the Division sufficient time to present the recommended settlement for Commission approval."²⁰ The Court granted the motion, extending the time in which to file an answer until April 7, 1997.²¹ Having reached an "agreement in principle" regarding a "settlement of the charges," the Division next filed a motion seeking "an indefinite stay of time" for Kelly to file his Answer.²² The Court granted the motion, staying the proceedings "pending the Commission's acceptance or rejection of the respondent's settlement offer."²³

On May 6, 1997, Kelly voluntarily testified before Division staff as part of the settlement recommendation process.²⁴ At the beginning of the deposition, Division staff noted that Kelly had appeared without counsel and asked him if he wished to proceed

¹⁹ Joint Motion for Extension of Time to Answer Complaint, filed March 17, 1997 ("Joint Motion").

²⁰ Id.

²¹ Order Extending Time in Which to File Answer, dated March 18, 1997.

²² Motion for Indefinite Stay of Time to Answer, filed April 7, 1997 ("Motion for Indefinite Stay").

²³ Order Staying Proceedings, dated April 8, 1997, at 2.

²⁴ Division Memorandum in Opposition at 7; Little Opposition Affidavit at ¶3; Kelly Affidavit at ¶18. See Kelly Deposition.

without an attorney.²⁵ Kelly responded "It depends on what you ask me. Yes."²⁶ The Division attorney then informed Kelly of the possible sanctions for testifying falsely and that his statements could be used against him.²⁷ At this point, the Division's examination began and the Division heard a story markedly different from what Kelly had told it earlier.

During the deposition, Kelly stated that, in response to having received the Division's request for records, he "just looked at it and basically just tossed it."²⁸ When asked why he failed to

²⁵ Kelly Deposition at 4.

²⁶ Id. This was not the first time Kelly was made aware of his right to counsel. See Subpoena Ad Testificandum and Duces Tecum, Statement to Persons Directed to Provide Information Pursuant to A Commission Subpoena or Requested to Provide Information Voluntarily, dated January 6, 1997.

"You may be accompanied, represented, and advised by counsel If you are not accompanied by counsel and decide at any time during the proceeding that you wish to be accompanied, represented or advised by counsel, please so advise the Commission representative taking your testimony. The proceeding will then be adjourned to afford you the opportunity to make necessary arrangements.

. . . .

Information you provide may be used against you."

Id. at 4-5.

See also Kelly Affidavit, Exhibit B, Memorandum from Brett Little, Esq. to Files (memorializing extensive discussion between the Division and Kelly concerning Kelly's right to counsel).

²⁷ Kelly Deposition at 4-7.

²⁸ Id. at 69.

comply with the request, Kelly responded "Because at that time I didn't think I wanted to help you. I didn't want to be involved. I just wanted out of it."²⁹ Thus, for the first time, Kelly conveyed that his failure to produce the requested records had resulted not from inadvertence in misplacing or discarding them, but from willful defiance.³⁰

As a result of Kelly's deposition, the wheels fell off of the settlement negotiations. The Division, surprised by manner in which Kelly's deposition departed from his earlier story, took the position that it would recommend only a settlement that was more severe than originally contemplated.³¹ Kelly refused to accept

²⁹ Id. at 66.

³⁰ Indeed, Kelly admitted that, at the time of the Division's September 4, 1996 request, he had reason to believe that he still had the records and knew where they were located.

Division counsel: "When you got the letter that's marked Exhibit Number 4, the letter from Glenn Spann dated September 4, 1996 asking for these records, in your heart of hearts, did you know you had the records in the garage and just didn't feel like producing them?"

Kelly: "I didn't know for sure they were in the garage, but I really didn't make much of an effort to look for them either. I didn't want to be involved."

Kelly Deposition at 68-69. This response implied some knowledge, especially in light of Kelly's eventual search for the records.

³¹ Division Memorandum in Opposition at 7-8; Little Opposition Affidavit at ¶¶2-4. The terms of the original "agreement in principle" called for Kelly to be sanctioned by "a 90-day suspension, coupled with a cease and desist order and a prohibition on directing customer accounts for a period of two years from the end of the suspension." Id. at ¶2. After Kelly's May 6, 1997 deposition, the Division raised the settlement ante to a five year suspension. Answer at ¶21.

settlement under the Division's new terms, and the parties reached an impasse.³² Accordingly, the Court lifted the stay of proceedings and established dates for prehearing procedures.³³

Kelly filed an Answer through his newly retained counsel on June 13, 1997.³⁴ Essentially admitting to all the material facts set forth in the Complaint,³⁵ he nonetheless denied liability,³⁶ asserting eight affirmative defenses.³⁷

³² The parties informed the Court of this during telephonic prehearing conferences on May 23, 1997 and May 29, 1997. See Notice of Prehearing Conference, dated May 21, 1997; Little Opposition Affidavit at ¶5. Kelly appeared pro se at the May 23 conference, but appeared at the May 29 conference by counsel. See Notice of Appearance, dated May 30, 1997.

³³ Order Lifting Stay and Establishing Prehearing Procedures, dated May 30, 1997.

³⁴ See Answer.

³⁵ Id. at ¶¶1-5.

³⁶ Id. at ¶¶6-7.

³⁷ The First Affirmative Defense is a boilerplate assertion that the Complaint fails to state a claim for relief. Id. at ¶8. The Court finds that that the Complaint stated an adequate claim in enforcement and the First Affirmative Defense, therefore, fails.

The Second Affirmative Defense relies on Kelly's actual possession of the records and his tardy production to the Division as its basis. Kelly asserts that either no violation of the Act or regulations occurred or, in the alternative, that the violation was "de minimis." Id. at ¶9. The Third Affirmative Defense substantially repeats the Second. Kelly asserts that he found and produced the records subsequent to the filing of the Complaint and, therefore, "no statutory or regulatory violation occurred." Id. at ¶¶10-12.

The Fourth, Fifth, Sixth, Seventh, and Eighth Affirmative Defenses all rely on basically the same argument. Kelly asserts that he and the Division reached an agreement wherein Kelly would testify voluntarily before the Division in support of the AVCO investigation, in consideration for the Division's recommendation to the Commission of the proposed settlement containing a three-month registration suspension. Id. at ¶¶15-17. Kelly claims that
(continued...)

The Court now considers the pending motion and cross-motion for summary disposition.

Summary Disposition

As both the Division and Kelly have done in this case, any party may move for summary disposition in its favor if it believes that its case is so strong that it renders an oral hearing unnecessary.³⁸ In order to prevail on such a motion, the movant must establish that "(1) there is no genuine issue as to any material fact, (2) there is no necessity that further facts be

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he voluntarily appeared without counsel, but that the Division reneged on the agreement by failing to recommend the initially agreed upon settlement offer. Id. at ¶¶17-22.

Kelly additionally asserts that the Commission was also a party to this agreement and breached it by not accepting the original settlement terms. Id. at ¶¶20-22. The Court rejects this claim out-of-hand. Kelly's settlement offer was never forwarded to the Commission, much less approved by it. See 17 C.F.R. §10.108. Moreover, Kelly was plainly on notice that the Division had no authority to bind the Commission to any settlement offer. See Joint Motion ("The Division and the Respondent request an extension of sixty (60) days be granted so that they may complete negotiations of settlement to terminate this action and allow the Division sufficient time to present the recommended settlement for Commission approval." (emphasis added)); Motion for Indefinite Stay ("The Division requests an indefinite stay to present the recommended settlement for Commission approval."). See also Order Staying Proceedings (proceedings stayed "pending the Commission's acceptance or rejection of respondent's settlement offer").

³⁸ 17 C.F.R. §10.91(a).

developed in the record, and (3) such party is entitled to a decision as a matter of law."³⁹

The summary disposition inquiry focuses first on whether the movant has developed the record, in accordance with the rules,⁴⁰ such that he is entitled to summary disposition.⁴¹ If the movant has satisfied his burden, then the nonmovant must establish a genuine dispute of material fact such that the movant would not be entitled to a decision as a matter of law.⁴² The establishment of

³⁹ 17 C.F.R. §10.91(e). The Commission's summary disposition procedures are patterned after and closely track the summary judgment procedures of Federal Rule of Civil Procedure 56. In re Saryk, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,807 (CFTC Dec. 18, 1997); In re Collins, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,194 at 45,741 (CFTC Dec. 10, 1997); In re LeClaire, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,974 (CFTC Feb. 1, 1994), remanded on other grounds, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,282 (CFTC Dec. 12, 1994). The purpose of these provisions is the "avoidance of the time and expense of unnecessary hearings." LeClaire, ¶26,282 at 42,428.

⁴⁰ Rule 10.91(b), 17 C.F.R. §10.91(b), provides:

"A motion for summary judgment shall include a statement of material facts as to which the moving party contends there is no genuine issue, supported by the pleadings, and by affidavits, other verified statements, including investigative transcripts, admissions, stipulations, and depositions. The motion may also be supported by briefs containing points and authorities in support of the contention of the party making the motion."

⁴¹ In re Bentley, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,620 at 30,651 (CFTC May 22, 1985).

⁴² "Once the movant has discharged his duty, the onus shifts to the nonmovant, and, once it has, the need to respond with specific facts is well established." Frito-Lay, Inc. v. Willoughby, 863 F.2d 1029, 1033 (D.C. Cir. 1988) (applying Federal Rule of Civil Procedure 56).

a genuine dispute of material fact requires the nonmovant to "do more than simply show that there is some metaphysical doubt as to the material facts."⁴³ In attempting to place material facts in dispute, the nonmovant "may not rest upon mere allegations, but shall serve and file in response a statement setting forth those material facts as to which he contends a genuine issue exists, supported by affidavits or otherwise."⁴⁴ Where the nonmovant comes forward with evidence that meets this test, however, the Court must assume its truth over any conflicting evidence for purposes of ruling on the motion.⁴⁵ Moreover, "if there is any significant doubt that the parties' dispute can be reliably resolved without a hearing, summary disposition is simply not appropriate."⁴⁶

As discussed below, at this stage, the evidence before the Court "is so one sided that [the Division] must prevail as a matter of law."⁴⁷ Accordingly, "neither the parties nor the judge should

⁴³ Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986) (citations omitted).

⁴⁴ 17 C.F.R. §10.91(b); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 256-257 ("If [such] evidence is merely colorable, or is not significantly probative, summary judgment may be granted." (citations omitted)); In re Kolter, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,262 at 42,197-98 (CFTC Nov. 8, 1994).

⁴⁵ Anderson, 475 U.S. at 255 ("The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." (citation omitted)).

⁴⁶ LeClaire, ¶26,282 at 42,430 n.11 (quoting Levi-Zeligman v. Merrill Lynch Futures, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,236 at 42,031 (CFTC Sept. 15, 1994)).

⁴⁷ Anderson, 477 U.S. at 251-252.

be compelled to waste the time and resources attendant on an oral hearing."⁴⁸

The Division's Motion

Kelly Violated the Record Production Requirement of Section 4n(3)(A) of the Act

Section 4n(3)(A) requires "[e]very commodity trading advisor . . . registered under [the] Act [to] maintain books and records in such form and manner as may be prescribed by the Commission,"⁴⁹ and to open them to inspection by any representative of the Commission. In addition, the statute sets out the following production requirement:

"Upon the request of the Commission, a registered commodity trading advisor or commodity pool operator shall furnish the name and address of each client, subscriber, or participant, and submit samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients, subscribers or participants, or prospective clients subscribers, or participants."⁵⁰

The duty to comply with Section 4n(3)(A) is absolute. All the Division must prove, by a preponderance of the evidence, in order to establish a violation of Section 4n(3)(A) is that (1) Kelly was

⁴⁸ LeClaire, ¶26,282 at 42,429.

⁴⁹ 7 U.S.C. §6n(3)(A).

⁵⁰ Id. (emphasis added).

a CTA,⁵¹ (2) he was registered as such, (3) he had clients or had delivered written material to prospective clients,⁵² and (4) he failed, upon request, to provide any of the information set out above.⁵³

The parties agree as to the relevant facts. Kelly was a CTA registered under the Act during the relevant time period. He had a number of clients.⁵⁴ Kelly received a request for documents and information. The request included the names of Kelly's clients. Kelly failed to respond to the request for nearly six months and

⁵¹ See 7 U.S.C. §1a(5).

⁵² The Division bears the burden of proving first, that a recordkeeping and production requirement applies at the threshold level (in this case that Kelly was a CTA registered under the Act), but also that the CTA generated (or should have generated) the documents or information covered by that provision. Even if a CTA is registered, until the CTA actually has a client or subscriber or until the CTA sends "reports, letters, circulars, memorandums, publications, writings, or other literature or advice" to prospective clients, the CTA does not possess any type of information or document that must be produced under Section 4n(3)(A). 7 U.S.C. §6n(3)(A). It logically follows that if there is no proof that the CTA engaged in activity that actually (or should have) generated the enumerated information or documents, there is no proof of an actual duty to produce a record or document. If there is no concrete duty to produce, ignoring a Division document request cannot form the basis of Section 4n(3)(A) violation. In other words, if a CTA does not have certain information and was not yet required to have generated it, the CTA cannot have violated any provision requiring the production of that information.

⁵³ A registered CTA is strictly liable for failures to comply with Section 4n(3)(A) of the Act. In re Heitschmidt, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,263 at 42,206 (CFTC Nov. 9, 1994); In re Zurich Trading Corp., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,270 at 32,734-35 (CFTC Sept. 12, 1986).

⁵⁴ Kelly Affidavit at ¶¶2, 4-6, 7, 11.

did so only after the Commission initiated this proceeding.⁵⁵ Therefore, the Court concludes that the undisputed facts establish Kelly's violation of Section 4n(3)(A) as a matter of law. In addition, the Court finds that the record is complete and an oral hearing or any further proceeding is unnecessary. Therefore, the Court **GRANTS** summary disposition to the Division on its claim that Kelly violated Section 4n(a)(3) of the Act.⁵⁶

⁵⁵ Section 4n(3)(A) does not specify the time in which to respond to a Commission request. In this case, the Court finds guidance concerning the timeliness assessment of Section 4n(3)(A) production in Commission rulemaking. The Commission's regulation setting forth its general record production requirements is Rule 1.31. Rule 1.31(a)(2) imposes a general production obligation upon persons required to keep "any book or record" under the Act or Commission regulations. Under this rule, a person who has a duty to keep a book or record also must comply with a production request "promptly." The Commission intended the use of the term "promptly" to mean "as expeditiously as is reasonable under the circumstances." General Regulations; Inspection of Books and Records, 46 Fed. Reg. 21, n.6 (CFTC 1981). This standard recognizes that "in practice a requirement to furnish copies immediately in all instances, depending on the extent and nature of a staff request, could impose an unwarranted burden upon the recordkeeper." Id. at 21.

Therefore, the Court holds that a registered CTA has a reasonable amount of time, under the circumstances, to respond to a request for documents or information based on Section 4n(3)(A). Although a Division-imposed return date does not generally control the timeliness determination, Kelly's failure to produce the names and addresses of his clients for nearly six months is sufficiently dilatory as to exceed any notion of reasonableness. Accordingly, Kelly's contention, that he complied with Section 4n(3)(A) by ultimately producing a client list, lacks merit. See Answer at ¶¶9-13.

⁵⁶ In addition to the claim based on a failure to produce the names and addresses of customers, the Division concludes, without discussion (much less, demonstration), that Kelly violated Section 4n(3)(A) based on a failure to have required "books and records open for inspection." Complaint at ¶9; Division's Memorandum in Support at 9. This allegation lacks record support.

It does not automatically follow that a CTA who fails to produce records upon request also fails to properly make them
(continued...)

(...continued)

available for inspection. After all, a recordkeeper may be willing to allow Division staff to inspect records at the Division's expense, but refuse, at his own peril, a Division request to send the records to the Division at the recordkeeper's expense. Thus, a violation of the production requirement does not necessarily amount to a violation of the inspection requirement.

A rule treating production and inspection as distinct is supported by the text of Section 4n(3)(A). The plain language of Section 4n(3)(A) sets out on-site inspection as a distinct investigative tool from production. See Zimmerman v. North American Signal Co., 704 F.2d 347, 353 (7th Cir. 1983) (noting that "a court should not construe a statute in such a way as to make words or phrases meaningless, redundant or superfluous"). Congress not only listed them separately in Section 4n(3)(A), but also treated them differently regarding their respective reaches. "All . . . books and records [required by the Act or Commission regulations] shall be open to inspection by any representative of the Commission . . ." 7 U.S.C. §6n(3)(A). However, only the following information and documents must be provided upon request: "the name and address of each client, . . . samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients . . . or prospective clients, subscribers, or participants." Id.

Not only does the text indicate that the requirements are distinct, but the Division has pointed to no legislative authority contradicting the inference arising from this plain language. Even the Commission's regulations treats the techniques separately. For example, Rule 1.31 initially contained an inspection, but not a production, requirement. The Commission did not impose a general production requirement until 1981. General Regulations, 46 Fed. Reg. 21. The Commission adopted the production requirement as a less intrusive alternative, for the time-consuming record review, to on-site inspections, while retaining both. Id. The Court concludes, therefore, that a failure to produce certain documents upon request does not equate with a failure to open books and records for inspection per se.

The Division could establish a record maintenance and inspection violation if it were to prove (1) that the Division made a request to inspect a CTA's records and he either refused to make the records available or was unable to make the records available, or (2) that such records do not exist. In the latter case, this is so because it automatically follows that a CTA who fails to keep records at all also fails to keep them "open to inspection."

In this case, the Division made no request to inspect Kelly's records on-site. Rather the Division requested production of the records. The Division does not argue, nor would this Court
(continued...)

Kelly Violated the Record Production Requirement of Section 1.31 of the Commission's Regulations

The Commission's regulations impose independent record production requirements that are broader in reach than those of Section 4n(3), both in terms of (1) their coverage of the records required to be kept and (2) who is required to produce them.

The Commission set out the following obligation of CTAs to respond to requests for records in Rule 1.31(a)(2):

(...continued)

entertain speculation, that Kelly would have refused on-site inspection. Therefore, the only manner by which the Division might establish a failure to maintain and keep records open for inspection would be to prove that records were not kept. The Division does not argue that Kelly simply failed to keep records nor has it directed the Court's attention to evidence of such a failure. In fact the parties are agreed that at least some of the required documents were kept and eventually provided to the Division. Division's Memorandum in Support at 4; Respondent's Reply to Division's Statement of Undisputed Material Facts at ¶7.

Therefore, the Court cannot find for the Division that Kelly violated Section 4n(3)(A) in failing to maintain books and records, and to have them open for inspection. However, as noted above, the Division has established, as a matter of law, Kelly's violation of Section 4n(3)(A)'s record production requirement and, as discussed below, Kelly's violation of Commission regulations for an intentional failure to provide records promptly upon demand. At any rate, the number of theories under which the Division may establish violations is generally irrelevant to the sanctions ultimately merited. In re Interstate Securities Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,954-55 (CFTC June 1, 1992).

"A copy of any book or record required to be kept by the Act or by these regulations shall be provided, at expense of the person required to keep the book or record, to a Commission representative upon the representative's request. Instead of furnishing a copy, such person may provide the original book or record for reproduction, which the representative may temporarily remove from such person's premises for this purpose. All copies or originals shall be provided promptly."⁵⁷

Rule 1.31 does not enumerate who must keep records, what records must be kept, or who is required to produce them upon request. Rather, it imposes a general production obligation upon persons required to keep "any book or record" under the Act or Commission regulations. In other words, a person who has a duty to keep a book or record also must "promptly" comply with a production request. The Court, however, must look outside Rule 1.31 in order to determine whether Kelly had a duty to keep the records requested by the Division.

The relevant recordkeeping requirements in this instance are set forth in Rule 4.33. Rule 4.33 requires CTAs to keep and maintain certain specified "books and records in an accurate, current and orderly manner at its main business office and in accordance with §1.31."⁵⁸

⁵⁷ 17 C.F.R. §1.31(a)(2) (emphasis added).

⁵⁸ 17 C.F.R. §4.33(a).

In promulgating Rule 4.33, the Commission expressly stated that it intended the rule to serve a broader purpose than implementing Section 4n(3)(A) alone. Commodity Pool Operators and Commodity Trading Advisors; Final Rules, 44 Fed. Reg. 1,918, 1,924 (CFTC 1979), reprinted in Adoption of Rules Concerning Commodity Pool Operators and Commodity Trading Advisors, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,725 (CFTC Jan. 8, 1979) ("The rule is intended to implement section 4n(3)(A) of
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In this case, of course, the facts that support Kelly's violation of Section 4n(3)(A) likewise support his violation of Rule 1.31: (1) Kelly was a CTA, (2) he was registered (or required to be registered), (3) Kelly had clients,⁵⁹ (4) he received a request that included certain required business records relating to

(...continued)

the Act and to assist the Commission in monitoring compliance by CTAs with the Act and regulations.") (emphasis added and note omitted). Indeed the Commission's authority to form the rule stemmed not only from Section 4n, but also Sections 2(a)(1), 4c(a)-(d), 4(d), 4(f), 4(g), 4(k), 4(m), 8a, 15, and 17, 7 U.S.C. §§2, 4, 6c(a)-(d), 6f, 6k, 6m, 12a, 19, and 21.

Accordingly, Rule 4.33 reaches CTAs who are required to be registered under the Act, as well as those who actual are. Compare 7 U.S.C. §6n(3)(A) (imposing a recordkeeping obligation upon "Every commodity trading advisor . . . registered under this Act"), with 17 C.F.R. §4.33 (imposing a recordkeeping duty on "Each commodity trading advisor registered or required to be registered under the Act").

In addition, the list of records required to be keep under Rule 4.33, and therefore required to produced under Rule 1.31, is considerably more extensive that required to be produced under Section 4n(3)(A). Compare 7 U.S.C. §6n(3)(A) (requiring production of two categories of records: (1) "name and address of each client, subscriber, or participant," and (2) "samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients, subscribers or participants, or prospective clients subscribers, or participants"); with 17 C.F.R. §4.33(a)-(b) (requiring the keeping of eight additional categories of records, in addition to : (1) "[t]he name and address of each client and each subscriber," (2) "[t]he original or a copy of each report, letter, circular, memorandum, publication, writing, advertisement or other literature or advice . . . distributed or caused to be distributed by the [CTA] to any existing or prospective client or subscriber").

⁵⁹ Kelly Affidavit at ¶¶2, 4-6, 7, 11.

Unless Kelly had clients, or engaged in "commodity interest[s] transactions" or "cash market transactions" himself, he would have no recordkeeping obligations under Rule 4.33 and, therefore, no production obligation under Rule 1.31(a)(2). 17 C.F.R. §4.33(a)-(b).

his clients, and (5) Kelly failed to respond to the request for nearly six months.⁶⁰

In his defense, Kelly argues that the belated document production may "negate" a violation of the rule or, in the alternative, that any violation was de minimis.⁶¹ Kelly's notion that he may somehow "un-ring" the bell fails. There is no "de minimis exception" to Rule 1.31.⁶² The Commission added the production requirement to Rule 1.31 in order to facilitate more thorough and less intrusive inspection of documents through the creation of a less formal and, therefore, more efficient alternative to the subpoena duces tecum.⁶³ Its policies are undercut if CTAs are free to ignore Division requests, impeding investigations, in hope that the Commission will not issue a complaint, or waiting until it does before making production. The plain language of the rule reflects the Commission's policy. Upon

⁶⁰ Like Section 4n(3)(A), Rule 1.31's production obligation is absolute, it admits no exceptions and, therefore, liability for failure to satisfy it is strict. In re Rouso, [Current Transfer Binder] Comm. Fut. L. Rev. (CCH) ¶27,133 at 45,308 (CFTC Aug. 20, 1997) (holding that Rule 1.31 has no "de minimis" or "good faith" exception); In re GNP Commodities Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,217-18 (CFTC Aug. 11, 1992) (holding that Rule 1.31(a) does not contain a scienter requirement). See In re Buckwalter, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,687 (CFTC Jan. 25, 1991).

⁶¹ Answer at See Answer at ¶¶9-13; Respondent's Memorandum at 6.

⁶² Rouso, ¶27,133 at 45,308.

⁶³ See General Regulations, 46 Fed. Reg. 21-22 (drawing a clear distinction between the power to request documents under Rule 1.31 and the Commission's subpoena power).

request, documents "shall be provided promptly."⁶⁴ Once the point of promptness under the circumstances is passed, if the record keeper has failed to produce the requested books or records, the violation is complete.⁶⁵ Not only that, but once the Commission issues a complaint based on Rule 1.31 or Section 4n(3)(A), the violation is generally irreparable.⁶⁶

An undisputed record establishes that Kelly received a request for the names of his clients and did not produce those records promptly. In addition, there is no reason to believe that the record is incomplete. The Division has, as a matter of law, established that Kelly violated Rule 1.31(a)(2). Therefore, the Court **GRANTS** summary disposition in favor of the Division on this claim.⁶⁷

⁶⁴ 17 C.F.R. §1.31(a)(2). See In re Glass, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,787 at 44,238 (CFTC Sept. 11, 1996) (citing In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,580 (CFTC May 12, 1994)).

⁶⁵ In CFTC v. Dominick, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. ¶26,696 at 43,876 (M.D. Fla. Mar. 30, 1996), Commission representatives sought access to inspect the defendant's records. Access to the records was denied by the defendant, until the Commission obtained a temporary restraining order about one month later. Id. Even though the defendant eventually allowed the Commission access to the records, the Court still concluded that the defendant violated Section 4n(3)(A) and Rule 1.31. Id. at 43,878. If a failure to open records for inspection for a one-month period violated Rule 1.31 and Section 4n(3)(A), there is no reason, under the circumstances of this case, that a failure to produce records for almost six months does not achieve the same result.

⁶⁶ See In re Silverman, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,410 at 21,643 (CFTC Mar. 14, 1977), aff'd sub nom Silverman v. CFTC, 562 F.2d 432 (7th Cir. 1977).

⁶⁷ Although immaterial to the issue of Kelly's liability regarding those requests that the Division properly made under Rule 1.31(a)(2), the Court would be remiss in failing to note
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that this case reveals a serious abuse of process by agency staff.

In the words of the Complaint:

"On September 4, 1996, the Division sent Kelly a request pursuant to Section 1.31 of the Regulations. This request required Kelly to provide among other things: (1) the names and addresses of his clients; (2) the opening account documents for those customers; (3) the trading records for those customers; and (4) any correspondence between Kelly and those customers."

Complaint at ¶5 (emphasis added). The Division's demand for the first three items listed in the Complaint was entirely proper. Each of the items is required to be kept under Rule 4.33, and therefore required to be produced upon Commission request under Rule 1.31. See 17 C.F.R. §§ 1.31(a)(2), 4.33(a)(1)-(6).

The Division, however, misrepresented its authority to "direct" Kelly to provide any customer correspondence, since such correspondence is not required to be kept under Rule 4.33. See Spann Letter. But it is the "among other things" demanded by the Division that gives the greatest pause.

In addition to the items listed in the Complaint, the Spann Letter demands "pursuant to §4.g(1) [sic] of the Commodity Exchange Act and §1.31 of the Commission's Regulations" that Kelly provide to the Division the following information:

"1. The names of all associated persons and managers of Sean Kelly, CTA ('Kelly') who previously or currently trade, use, or monitor the AVCO Financial Corp. Recurrence computer software trading program on behalf of Kelly or Kelly's customers.

. . . .

5. Any contracts or agreements between Kelly and AVCO Financial Corp.

6. Any contracts, correspondence, or other documents constituting or reflecting communications between Kelly and AVCO Financial Corp. and/or any person associated with Kelly or AVCO Financial Corp.

(continued...)

Section 4.33 of the Commission's Regulations.

In addition to the above theories, the Division appears to argue that Kelly's failure to provide records independently violated Rule 4.33.⁶⁸ However, as the rule relates only to recordkeeping, this theory fails. Rule 4.33 requires CTAs to keep and maintain certain "books and records in an accurate, current, and orderly manner at its main business office and in accordance with §1.31."⁶⁹ There is no requirement in Rule 4.33 for a CTA to produce information or records "upon request."⁷⁰ Therefore,

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The above requested records are to be provided to the Division by no later than Friday, September 18, 1996."

In fact, none of these records are required to be kept or produced under any section of the Act or Commission regulations. In short, the Division used its Rule 1.31 production request to improperly demand of Kelly documents concerning his relationship with AVCO -- documents that may only be compelled by subpoena.

When the government demands information from citizens under the false color of law, it engages in misconduct of the most serious kind. With this matter now brought to the Commission's attention, the Court trusts that it will take the necessary steps to safeguard against this sort of investigatory abuse.

⁶⁸ Division Memorandum in Support at 9 ("Kelly violated Sections 1.31 and 4.33 of the Regulations in that he failed to promptly provide the said books and records" (emphasis added)).

⁶⁹ 17 C.F.R. §4.33.

⁷⁰ The Court recognizes that there is an interplay between Rules 1.31 and 4.33. As discussed above, Rule 1.31 relies on rules that identify who must keep records and what records must be kept, such as Rule 4.33, in order to determine the scope of its production requirement. In return, Rule 1.31 prescribes how the records must be kept (in addition to setting out inspection and production requirements) and Rule 4.33 requires that records be kept "in accordance with" Rule 1.31. 17 C.F.R. §§1.31, 4.33.

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The Court's analysis of Rule 4.33's reference to Rule 1.31 begins with its plain terms. Reno v. NTSB, 45 F.3d 1375, 1379 (9th Cir. 1995) ("The language of a regulation is the starting point for its interpretation [T]he plain meaning of language governs unless that meaning would lead to absurd results."); T.S. v. Board of Education, 10 F.3d 87, 89 (2d Cir. 1993) ("Plain meaning is ordinarily our guide to the meaning of a statutory or regulatory term." (citations omitted)); Grandview Holding Corp. v. NFA, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,996 at 44,809 (CFTC Mar. 18, 1997) ("Applying the basic principles of rule construction, our starting point is the plain meaning of [the] . . . rule."). The Court will assume that each of the words chosen by the Commission had a purpose, were meant to read consistently, and were not intended to be read as meaningless, redundant or superfluous. See Russello v. United States, 464 U.S. 16, 23 (1983); Salomon Forex, Corp. v. Tauber, F.3d 966, 975 (4th Cir. 1993); Zimmerman, 704 F.2d at 353; Grandview, ¶26,966 at 44,809 ("Because NFA Rule 3-11 refers both to 'accept[ance]' and 'final acceptance,' the Appeals Committee's conclusion that the concepts are synonymous is contrary to the plain meaning of the rule." (brackets in original)).

Rule 4.33 is only one of several regulations that invokes Rule 1.31 in prescribing recordkeeping requirements. Rule 1.35(a) requires futures commission merchants, introducing brokers, and members of contract markets to retain records "in accordance with the requirements of §1.31." 17 C.F.R. §1.35(a). In the same sentence, Rule 1.35 also requires those covered by the rule to "produce them for inspection . . . as requested by an authorized representative of the Commission." Id. If the Court were to read a requirement of keeping records in accordance with Rule 1.31 as incorporating Rule 1.31(a)(2)'s production requirement, it would reduce the production requirement of Rule 1.35(a) to a mere redundancy. Accordingly, the Court reads Rule 1.35(a)'s invocation of Rule 1.31 as referring to its recordkeeping requirements and not its production requirement.

In order to avoid reading the Rule 1.35 and 4.33 virtually identical invocations of Rule 1.31 inconsistently, the Court must conclude that Rule 4.33's reference to Rule 1.31 does not include a production requirement. This plain-language reading of Rule 4.33 impedes no public policy by the slightest increment since a failure to produce records required to be kept by Rule 4.33, upon request, would violate Rule 1.31. The Court's reading merely precludes the implication of a useless redundancy.

Kelly's admitted failure to do so cannot form the basis of a violation.

While the Court cannot grant summary disposition on this particular theory, that conclusion is of little effect. It does not lessen the gravity of Kelly's violation and, therefore, has no impact on the proper level of sanctions.⁷¹

Kelly's Cross-Motion

In response to the Division's motion, Kelly filed a cross-motion for summary disposition. He bases the motion on alternative grounds. First, Kelly argues that his conduct in performance of an alleged agreement with the Division, and the Division's subsequent breach of that agreement, provides a basis for specific performance of the agreed-upon terms of a settlement, or for dismissal of the Complaint. Kelly alternatively claims that his waiver of counsel at the May 6, 1997 deposition was mechanically insufficient, and that this insufficiency, as well as the Division's breach of its agreement with Kelly, warrant exclusion of purportedly critical Division evidence. As discussed below, Kelly in his cross-motion, seeks relief that is not merited under the circumstances of this case.

⁷¹ Interstate Securities, ¶25,295 at 38,954-55.

Equitable Relief Based on a Settlement Recommendation Agreement: Kelly's Unclean Hands Bar It

Kelly alleges that he and the Division made a bargain. Under this agreement, the Division would recommend a certain settlement to the Commission in exchange for his voluntary cooperation in the AVCO investigation.⁷² Kelly claims that the Division breached the agreement after he kept his part of the bargain by testifying before the Division without counsel.⁷³ He seeks "equitable" relief on this basis,⁷⁴ asking the Court to either (1) impose a suspension not to exceed three months, the terms of the purported original agreement, (2) dismiss the case outright, or (3) quash the inculpatory deposition (material to Kelly's willfulness) that Kelly claims was obtained pursuant to the breached agreement.⁷⁵

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"On or about April 1997, the Commission's Division of Enforcement Staff through Trial Attorney Brett Little, and others, agreed with Kelly to terminate this proceeding, and recommend and impose no more than a three (3) month suspension from practice if Kelly cooperated and voluntarily agreed to testify for the Commission in New York City."

Respondent's Undisputed Facts at ¶1.

⁷³ Id. at ¶2.

⁷⁴ Respondent's Memorandum at 3. The Court notes that the Commission has the broad discretion to consider equitable factors in determining whether to dismiss a complaint and in considering offers of settlement. The Court need not address what, if any, "equitable" powers it may have, because the facts of the case indicate that Kelly, as to the alleged settlement-recommendation agreement, has unclean hands.

⁷⁵ Notice of Cross-Motion at ¶¶1-2; Respondent's Memorandum at 2.

In opposition, the Division merely argues that there was no agreement to recommend a settlement. Division's Memorandum in Opposition at 6-8. This response leaves the Court somewhat
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Before considering whether Kelly has established a basis for equitable relief, the Court must first consider whether he is entitled to it under any circumstances. The Court's inquiry follows "the equitable maxim that 'he who comes into equity must come with clean hands.'"⁷⁶ In other words, equitable relief is available only when the one seeking it "acted fairly and without fraud or deceit as to the controversy in issue."⁷⁷ This requirement is so crucial that the Court may consider it sua sponte.⁷⁸

The doctrine of unclean hands constitutes the negative expression of the above maxim.⁷⁹ The doctrine focuses solely on

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puzzled. Rather than joining the issues of law, the Division chose to argue the facts. This is not the best way to make the case that a hearing is not merited.

⁷⁶ Precision Instrument Mfg. Co. v. Automotive Maintenance Machinery Co., 324 U.S. 806, 814 (1945).

⁷⁷ Id. at 814-15 (citations omitted). This requirement of clean hands is a precondition to asserting an equitable defense as well as lodging a claim in equity. United States v. Internal Brotherhood of Teamsters, 816 F. Supp. 864, 871 (S.D.N.Y. 1992), aff'd, 986 F.2d 15 (2d Cir. 1963). See Grotrian, Helfferich, Schulz, Th. Steinweg Nachf. v. Steinway & Sons, 523 F.2d 1331, 1343-44 (2d Cir. 1975).

⁷⁸ Gaudiosi v. Mellon, 269 F.2d 873, 882 (3rd Cir. 1959), cert. denied, 361 U.S. 902 (1959). The doctrine of unclean hands is a "self-imposed ordinance that closes the doors of a court . . . to one tainted with inequitableness or bad faith relative to the matter in which he seeks relief" Precision Instrument, 324 U.S. at 814, quoted in D.J. Commodities Consultants, Inc. v. Packers Trading Co., Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. ¶25,120 at 38,225 (CFTC Aug. 27, 1991).

⁷⁹ Precision Instrument, 324 U.S. at 815 ("Any willful act concerning the cause of action which rightfully can be said to transgress equitable standards of conduct is sufficient cause for the invocation of the maxim")

the party seeking equity; it does not entail a comparative inquiry.⁸⁰ In other words, "the burden is on . . . the party seeking affirmative judicial relief . . . to show at the threshold that it has come to equity with clean hands."⁸¹

In performing this threshold inquiry, the Court considers whether the party seeking equity has acted good faith⁸² regarding the transaction in question or whether he has engaged in "misconduct,⁸³ fraud or bad faith⁸⁴ toward the party against whom relief is sought in connection with the transaction under consideration."⁸⁵ Therefore, if the Division entered into an

⁸⁰ Gaudiosi, 269 F.2d at 881; Robinson v. American Broad. Companies, 328 F. Supp. 421, 422 (E.D. Ky. 1970) ("Equity does not adjust differences between wrongdoers. At the very threshold, the [parties seeking equity] must be judged; and, not until they have been found free from taint will equity proceed to determine whether they have been wronged by [the opposing parties]." (footnote omitted)), aff'd, 441 F.2d 1396 (6th Cir. 1971).

⁸¹ Great Western Cities, Inc. v. Binstein, 476 F. Supp. 827, 832 (N.D. Ill. 1979), aff'd, 614 F.2d 775 (7th Cir. 1979).

⁸² Good faith is defined as "that state of mind denoting honesty of purpose, freedom from intention to defraud, and, generally speaking, means being faithful to one's duty or obligation." Black's Law Dictionary 693 (6th ed. 1990) (citation omitted).

⁸³ Misconduct occurs when there is a "transgression of some established rules of action, . . . a dereliction from duty, unlawful behavior, . . . [or] improper or wrong behavior" Black's Law Dictionary 999. Misconduct does not have to amount to a punishable crime or action that would justify other legal proceedings. Precision Instrument, 324 U.S. at 815.

⁸⁴ Bad faith is "[t]he opposite of 'good faith,' generally implying or involving actual or constructive fraud, or a design to mislead . . . another, or a neglect . . . to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive." Black's Law Dictionary 139.

⁸⁵ Great Western Cities, 476 F. Supp. at 833. See also Horne v. Radiological Health Servs., P.C., 83 Misc.2d 446, 456, 371 N.Y.S.2d (continued...)

"agreement" on the basis of Kelly's misstatements or material omissions, Kelly would have unclean hands in the matter.⁸⁶

The doctrine of unclean hands is as severe as it is demanding. If the Court finds that a claimant for equitable relief has violated it, "he must be denied all relief whatever may have been the merits of his claim."⁸⁷ In this case, consideration of Kelly's course of dealings with the Division, in light of his May 6, 1997 testimony, leads to the inescapable conclusion that he comes with unclean hands and is, therefore, not entitled to equitable relief.

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948, 961 (N.Y. Sup. Ct. 1975), aff'd, 51 A.D.2d 544, 374 N.Y.S.2d 374 (N.Y. App. Div. 1976).

While the party seeking equity must come before that Court with clean hands, this requirement relates solely to the controversy before the Court. Precision Instrument, 324 U.S. at 814-15; Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488, 492-93 (1942); D.J. Commodities Consultants, ¶25,120 at 38,225; Concor Financial Servs., Inc. v. Assured Futures, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,409 at 35,797-98 (CFTC Nov. 9. 1988).

⁸⁶ Estate of Lennon v. Screen Creations, Ltd., 939 F. Supp. 287, 293-94 (S.D.N.Y. 1996).

⁸⁷ Gaudiosi, 269 F.2d at 881 (quoting Root Refining Co. v. Universal Oil Products Co., 169 F.2d 514, 534 (3d Cir. 1948)).

Kelly Negotiated with the Division on the Basis of Misrepresentations Concerning His State of Mind

On two occasions, Kelly told the Division that he could not comply with its production request because he had discarded the records in question.⁸⁸ Prior to his deposition, Kelly never told the Division that his belief was less than certain. He never stated or implied that his failure to provide the records was the result of an intentional choice not to search for them. Simply stated, Kelly created the impression that his failure to comply was due to an impossibility as to which he harbored no doubt.

Kelly's affidavit and deposition tell a different story. They reveal that: (1) Kelly had a belief that the requested records were probably still on-hand when he received the Division's request, (2) he intentionally failed to exert any effort to locate the records on the basis of calculated self-interest, and (3) when he decided to retrieve the records, Kelly found them in the first place he looked.⁸⁹

Only one version can be true. Kelly either believed, on the basis of inquiry or certain recollection, that the documents had been discarded or he did not. The Court assumes that Kelly's deposition reflects the truth.⁹⁰ If he merely "tossed" the letter

⁸⁸ On October 2, 1996, Kelly informed the Division that he had discarded the records in question. See supra note 10. In addition, Kelly made substantially the same representation on January 15, 1997. See supra note 12.

⁸⁹ See supra note 16.

⁹⁰ This is the more plausible of the logically possible assumptions. First, it is corroborated by the circumstances of the case. When Kelly looked for the documents, he had no trouble finding them. In addition, Kelly's deposition statements as to
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requesting his records, willfully made no effort to locate and submit them, and had some knowledge, if not complete certainty of their location, then his representations to the Division that he had discarded the records amounted to negotiating the settlement "agreement" in bad faith. Since Kelly's misrepresentation as to his knowledge in failing to comply with the Division's record request was material to the parties' negotiations concerning settlement sanctions, Kelly has unclean hands regarding this purported "agreement."⁹¹ Therefore, Kelly is not entitled to the equitable relief sought on the basis of the Division's breach of the alleged agreement to recommend a less severe sanction.⁹²

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the intentional nature of his inaction were facially against his interest. Finally, the Division made Kelly aware of the consequences of perjured testimony at the beginning of the deposition. Kelly Deposition at 4-6.

⁹¹ The Court reaches the same outcome after considering the alternative, that Kelly negotiated in good faith but testified falsely. Not only would false testimony amount to bad faith in the performance of Kelly's agreement, it would constitute a criminal felony. As the Division warned Kelly prior to his testimony, "whoever, in any matter within the jurisdiction of the . . . Government of the United States, knowingly and willfully-- (1) falsifies, conceals, or covers up . . . a material fact; [or] (2) makes any materially false . . . statement or representation . . . shall be fined . . . or imprisoned not more than 5 years or both." 18 U.S.C. §1001. This bad faith or misconduct would have the effect of diminishing the value of the deposition to the Division. Kelly would again have unclean hands.

⁹² Accordingly, Kelly's equity-based Fourth, Fifth, Sixth, Seventh and Eighth Affirmative Defenses fail.

This is not to suggest that Kelly's allegations against the Division are trivial, or, if proven, are without remedy. Specifically, Kelly charges two Division attorneys with misrepresenting the finality of the Division's position regarding settlement.

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18. "In reliance upon my agreement with the Division of Enforcement, I voluntarily appeared and gave testimony in New York City on May 6, 1997. This appearance was voluntary on my part, was not pursuant to Subpoena, nor was it pursuant to any legal process in the ongoing Complaint proceeding. It was voluntary on my part because I believed there was an agreement in place whereby the [Division] would recommend and agree to a three (3) month suspension penalty. I therefore did everything on my part to produce any further documentation and appear and testify as requested in reliance upon the agreements and promises made by the Division of Enforcement. I would not have appeared nor given testimony in New York on May 6, 1997 without an attorney present if I had not been assured by Mr. Little that Commission Staff would discontinue this case and recommend and impose no more than a three (3) month suspension from practice.

19. The Division of Enforcement knew I was proceeding without the benefit of counsel's advice. I was very hesitant to appear without counsel but was persuaded to appear by the agreement that I would receive a three (3) month suspension from practice. Prior to the testimony on May 6, 1997, I confirmed with Mr. Cooper that I was appearing to testify because of 'the three (3) month deal,' and he affirmed and confirmed that agreement before we went on the record"

Kelly Affidavit at ¶¶18-19.

Both the Model Rules of Professional Conduct and the Model Code of Professional Responsibility prohibit a lawyer from making misrepresentations in the course of representing his client. Model Rules of Professional Conduct Rule 4.1(a); Model Code of Professional Responsibility DR 7-102(A)(5). If Kelly can provide the Commission with reason to believe that Division attorneys (1) in fact agreed to recommend a certain settlement of the Complaint against Kelly, and (2) misrepresented to Kelly their intent to abide by that agreement for the purpose of inducing him to voluntarily appear without counsel, the Commission could institute proceedings to consider the sanctioning of those attorneys.

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Kelly Manifested a Sufficient Waiver of His Right to Counsel

Kelly seeks exclusion of his May 6, 1997 deposition on alternative grounds. Kelly argues that in submitting to the deposition, he "did not clearly manifest a decision and intent to waive" his right to counsel.⁹³ The Court therefore considers the sufficiency of Kelly's waiver.⁹⁴ More particularly, the issue is

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Under Rule 14.8, 17 C.F.R. §14.8,

"[T]he Commission may, after notice and opportunity for hearing in the matter, deny, temporarily or permanently, the privilege of appearing or practicing before it to any person who is found by the Commission by a preponderance of the evidence:

. . . .

(b) To be lacking in character or integrity; or

"(c) To have engaged in unethical or improper unprofessional conduct either in the course of an adjudicatory, investigative, rulemaking or other proceeding before the Commission or otherwise."

⁹³ Respondent's Memorandum at 4.

Kelly additionally argues that even if his waiver of counsel was otherwise sufficient, the deposition should be excluded since the waiver was induced by the Division's misconduct. Respondent's Memorandum in Opposition at 7. However, "[i]n the complex and turbulent history of the [exclusionary] rule, the Court never has applied it to exclude evidence from a civil proceeding, federal or state." INS v. Lopez-Mendoza, 468 U.S. 1032, 1041-42 (1984) (quoting United States v. Janis, 428 U.S. 433, 447 (1976)). See also In re Sprecher, Admin. Proc. File No. 3-8230, 1994 SEC LEXIS 1296 at *6 (SEC Apr. 28, 1994) (rejecting rule to exclude evidence obtained as a result of staff misconduct and quoting the dicta of In re Bertoli, Admin. Proc. File No. 3-4694, 1979 LEXIS 639 at *2 (SEC Sept. 25, 1979)).

⁹⁴ The Court considers the sufficiency of the waiver because, as discussed more fully below, Kelly's waiver satisfies even
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constitutional standards, albeit standards that did not apply to Kelly. The Court does not consider the necessity of an affirmative waiver of the Commission's rights of counsel because it need not in this case. The Court notes, however, that a distinction exists, in administrative proceedings, between circumstances when the statute or regulation requires a tribunal to elicit a waiver of counsel and those that do not. Compare Montilla v. INS, 926 F.2d 162, 166 (2d Cir. 1991), with Yanopoulos v. Department of Navy, 796 F.2d 468 (Fed. Cir. 1986) (per curiam), cert. denied, 479 U.S. 824 (1986). In the latter circumstance, the Federal Circuit has found that, with respect to a hearing, the private litigant need only be informed of his right to counsel. See Yanopoulos, 796 F.2d at 469-70. Even notification may not have been required given the particular circumstances of this case in that Kelly testified as part of his voluntary, bilateral dealings with the Division.

The Seventh Circuit considered a roughly analogous case in which a medical doctor faced a state administrative proceeding. Fleury v. Clayton, 847 F.2d 1229, 1233 (7th Cir. 1988). Illinois law entitled the doctor to a hearing. Id. at 1230. In settlement negotiations, the medical disciplinary board's counsel played hardball and obtained a settlement that the doctor later regretted. Dr. Fleury subsequently brought a civil rights action against the board, claiming that he was deprived of a property interest in violation of the Fourteenth Amendment's due process clause. Id. In particular, the doctor claimed that he was deprived of a hearing. Id. at 1233. Judge Easterbrook noted that the plaintiff did have a right to a hearing and need only to have stood on his rights to obtain one rather than settle. Id. As to the question of whether the board's counsel was required to inform the doctor of his rights, Judge Easterbrook wrote: "An attorney need not inform the adverse party of his procedural rights. The rules of an agency must be knowable, but they need not be known; those who neglect to learn their rights have only themselves to blame." Id. (citations omitted).

Kelly, like Fleury, sought to enter into a bilateral agreement rather than avail himself of an adjudicatory proceeding. In the course of doing so, Kelly had certain rights set out in statute and regulation, rights as to which the government had no codified obligation to specifically inform him. Indeed, the only significant difference between Kelly and Fleury is that Fleury waived a core requirement of due process, his adjudicatory hearing, while Kelly waived a right not directly related to the adjudication of the claim against him. Therefore, it is doubtful whether the Division had an obligation to inform Kelly of his right to counsel, although the Court encourages this practice.

whether a witness sufficiently waived his right to counsel under the following circumstances: (1) Division counsel informed the witness of his right to counsel;⁹⁵ (2) Division counsel also informed the witness that "anything you say [during the deposition] could possibly be used against you, should it in some way be adverse to your interests;"⁹⁶ (3) the witness unequivocally stated that he understood that his testimony may be used against him;⁹⁷ (4) the witness answered "It depends on what you ask me. Yes." when asked whether he wanted to testify without counsel present;⁹⁸ (5) the witness proceeded to answer the Division's questions without either requesting counsel or stating that he would not proceed further without counsel; and (6) the witness had proceeded pro se in his own enforcement proceeding for two months prior to the deposition.

Kelly contends that anything less than "a clear, unequivocal 'Yes'" fails as a waiver.⁹⁹ Kelly points out that his waiver was "conditional,"¹⁰⁰ presuming that such a waiver is never valid. This is not the case. A conditional waiver may be valid and, in this

⁹⁵ Kelly Deposition at ¶8; Division's Memorandum in Opposition at 9; Kelly Affidavit, Exhibit B, Memorandum from Brett Little, Esq. to Files at 1.

⁹⁶ Kelly Deposition at 7.

⁹⁷ Id.

⁹⁸ Id. at 4.

⁹⁹ Respondent's Memorandum at 5.

¹⁰⁰ Id. at 2, 4.

case, the Court finds that Kelly manifested an adequate waiver of the right to counsel.

Even in the context of a right to counsel clearly grounded in the Constitution, determining whether waiver occurred is a circumstantial inquiry.¹⁰¹ There are no magic words. Indeed, "no express statement of waiver is required" in order to waive the Fifth (and Sixth)¹⁰² Amendment right to counsel.¹⁰³ In Scarpa, the Second Circuit considered a case in which a criminal defendant had been informed of his right and had proceeded to speak to police without having expressly waived his right to counsel.¹⁰⁴ In determining whether the defendant waived his right to counsel, the court held that when a suspect is made aware of the right in question and consequences of abandoning the right, a suspect's decision to speak with the police may create the clear, and sufficient, inference that the suspect waived the right.¹⁰⁵

Not only may an individual implicitly waive a constitutional right to counsel, he may conditionally waive it. In United States

¹⁰¹ "When considering whether a defendant waived his constitutional rights, we consider all relevant circumstances" United States v. Scarpa, 897 F.2d 63, 68 (2d Cir, 1990), cert. denied, 498 U.S. 816 (1990).

¹⁰² North Carolina v. Butler, 441 U.S. 369, 373 (1979); Scarpa, 897 F.2d at 68 ("This standard for finding a waiver is the same under the fifth and sixth Amendments. Patterson v. Illinois, 487 U.S. 285, 108 S. Ct. 2389, 2395, 101 L. Ed.2d 261 (1988).").

¹⁰³ Scarpa, 897 F.2d at 68 ("[W]aiver can be clearly inferred from the actions and words of the person interrogated." (quoting Butler , 441 U.S. at 373)).

¹⁰⁴ Id. at 66-67.

¹⁰⁵ Id. at 68.

v. Eaton,¹⁰⁶ the court considered a case in which agents of the Drug Enforcement Administration informed a suspect of his Miranda rights and then asked if the suspect wished to waive those rights and speak without an attorney. The suspect "replied that it depended on what questions were asked" and proceeded to answer the agent's questions.¹⁰⁷ Eaton held that when an individual is informed of his right to counsel and asked if he will answer questions without an attorney, an answer that he would do so depending on what questions were asked amounts to a conditional waiver.¹⁰⁸ The trial court construed such a waiver as tending to indicate "at the very least that the Defendant understood his rights and would exercise them as he saw prudent. By this conditional waiver, Defendant agreed to answer questions but reserved his right to cut off questioning at any time."¹⁰⁹ At that point, the government is free to ask questions and the suspect retains the right to answer questions as he deems prudent.¹¹⁰

¹⁰⁶ 676 F. Supp. 362 (D. Me. 1988), aff'd, 890 F.2d 511 (1st Cir. 1989), cert. denied, 495 U.S. 906 (1990).

¹⁰⁷ Id. at 365.

¹⁰⁸ Id. at 367.

¹⁰⁹ Id.

¹¹⁰ Id. On review, the First Circuit affirmed, drawing a distinction between a response that is "equivocal, in the sense that it indicates to the questioning officer that the defendant may want an attorney" and a response that is equivocal in the sense that it is conditioned on the questions to be asked. United States v. Eaton, 890 F.2d 511, 513-14 (1st Cir. 1989) (emphasis in original), cert. denied, 495 U.S. 906 (1990).

A similar result occurred when a defendant responded to a request for waiver by stating, "Not without my attorney" and then "Well, ask your questions and I will answer those I see fit." Bruni
(continued...)

In the present case, when asked if he wished to testify without counsel, Kelly responded "It depends what you ask me. Yes."¹¹¹ The Division informed him of the possible ramifications of testifying untruthfully and then told him "[Y]ou should know that anything you say here today could possibly be used against you, should it in some way be adverse to your interests."¹¹² With that, Kelly's deposition began and he answered all questions asked of him. Kelly was aware of his right to counsel and the possible ramifications of waiving that right and proceeded to answer the Division's questions. Under these circumstances, the Court could find that Kelly tacitly waived his right to counsel even if he had made no express statement of waiver. However, he appears to have done so, albeit conditionally.

Kelly's words "It depends what you ask me. Yes." are similar to and no more ambiguous than the conditional waivers to Eaton and Bruni. His words communicate a willingness to answer some

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v. Lewis, 847 F.2d 561, 564 (9th Cir. 1988), cert. denied, 488 U.S. 960 (1988), cert. denied, 489 U.S. 1055 (1989). The Ninth Circuit found the first statement to be an invocation of the right of counsel and that the second "effected a selective waiver by indicating an agreement to answer some questions but not others. Therefore, to the extent that [the defendant] chose to answer questions, he waived his right to counsel." Id. When a detective sought to question him after the conditional waiver, the defendant stated "he would answer 'those questions he felt good to answer or that he thought his attorney would probably advise him to answer.'" Id. (brackets omitted). The court held that this also constituted a conditional waiver of the right to counsel rather than an equivocal invocation of the right. Id.

¹¹¹ Kelly Deposition at 4.

¹¹² Id. at 7.

questions without counsel and an unwillingness to answer others.¹¹³ Therefore, the Court concludes that Kelly's response to the Division's question concerning whether he would waive his right to counsel, manifested a valid, express waiver. The Court is especially conformable reaching this conclusion in Kelly's case as he had been proceeding pro se for the two months between the filing of the Complaint and the taking of his deposition. Indeed, even in his pre-Complaint dealings with the Division, Kelly had demonstrated that he understood his right to be accompanied by an attorney.¹¹⁴ If Kelly had wished to obtain counsel, he had ample opportunity to do so. He chose not to, and suffers no injustice from the consequences.¹¹⁵

¹¹³ Kelly tries to create an ambiguity by claiming that the waiver was conditioned on how the deposition was to be used: "When Mr. Cooper asked if I wanted counsel present, my response was intended to state that, if the target and questions involved AVCO and Vartuli, I would testify, but if they intended to pursue me or use the testimony against me I desired counsel." Kelly Affidavit at ¶21; Respondent's Memorandum at 5.

Kelly must expect the Division staff to read minds, because no objective listener would consider the statement "It depends on what you ask me" to express or imply the meaning "It depends on how you intend to use my testimony." Moreover, there was no ambiguity that would require further inquiry on the part of the Division. See Bruni, 847 F.2d at 564 ("[i]nterpretation is only required where the defendant's words, understood as ordinary people would understand them, are ambiguous" (quoting Connecticut v. Barnett, 479 U.S. 523 (1987))).

¹¹⁴ See supra note 26.

¹¹⁵ Although Kelly devotes considerable effort to arguing that his deposition should be quashed, it turns out that the deposition is merely cumulative of other evidence which Kelly, himself, has placed before the Court. Accordingly, even if the Court were to disregard the deposition, the outcome of this proceeding would not change.

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The Division employs Kelly's deposition to demonstrate the seriousness of his misconduct, claiming that Kelly willfully failed to comply with the September 4, 1996 production request. More specifically, the Division asserts that Kelly's initial response to the request was to do nothing. Division Memorandum in Support at 4, 7, 11. In support of this contention, the Division offers Kelly's deposition, in which he admits as much. Id. at 4, 7.

Kelly disputes the willfulness of his failure to provide the records. He offers a bald denial, Respondent's Reply to Division's Undisputed Facts at ¶8, objects to the use of the damning deposition, id., and submits an affidavit, which in part addresses his state of mind, Kelly Affidavit. See Kolter, ¶26,262 at 42,197-98 ("In the face of a motion for summary disposition based on admitted and verified facts, . . . any fact any adverse party wishes to contest must be put at issue through submission of affidavits or other verified documents." (citation omitted)). Ironically, it is Kelly's attempt to place facts in dispute, that has the unintended effect of making the Division's case on Kelly's willfulness, and precluding the need to rely on the deposition.

Kelly's affidavit is instructive in its pronouncements and in its silence. In describing his response to the Division's initial request, Kelly states:

"In September 1996, I received a request for records from the Commission's Division of Enforcement, a copy of which is attached to the [Division's] moving papers as Exhibit A. I did not respond initially to this inquiry for several reasons. First, I had cleared my trades for public customers through a third-party clearing agent, Delong, Freidman & Sukenik in California, and I believed the Commission could obtain complete and full transaction records from that source more easily than from me. I also understood that this request for information was not really directed at me, but that the [Division] was seeking information about AVCO and its computerized trading program. Since I had no relationship with AVCO other than buying their program, I did not believe that I was the target [of the] investigation."

Kelly Affidavit at ¶4 (emphasis added). The Court notes that Kelly did not state that he made any effort to find the records, nor did he include among his list of reasons for his delay in responding the belief that he no longer had the records. He therefore implies
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Sanctions

The Division seeks the following sanctions: (1) a cease and desist order, (2) revocation of Kelly's registration, and (3) a \$25,000 civil monetary penalty.¹¹⁶ The Division bases the

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by omission that he either did not look for the records, or he found and withheld them.

Later in the affidavit, Kelly tries to justify his non-compliance when he states:

"There is no basis for the Commission to argue that I did not make these records and retain them, or refuse to produce them upon request of the [Division]. The only reasons for the delay were first in locating the documents and then discussing with the [Division] whether or how I should produce them given (a) the ongoing investigation of AVCO, (b) my own negotiations with AVCO on behalf of myself and my public customers, and (c) other complicating factors. In fact, I did keep and was able to locate and produce records . . . so as to negate any alleged violations of 7 U.S.C. §6n(3)(A) and 17 C.F.R. §§4.33 and 1.31."

Kelly Affidavit at ¶11 (emphasis added).

Even if this passage is read in isolation from Kelly's initial explanation of his failure to comply with the request, Kelly is not stating that his failure to produce the records upon request was wholly unintentional. Rather, he seems to state that his failure to produce the records was initially due to some undefined and unexplained "delay" in locating them. After that delay, Kelly admits to willfully withholding them for reasons of his calculated self-interest, as if compliance with a Rule 1.31 production request were discretionary.

Therefore, the Court concludes, solely on the basis of Kelly's affidavit, that there is no dispute on the record regarding Kelly's initial reaction to the September 4, 1996. Kelly intentionally failed to comply with the Division's request.

¹¹⁶ Division's Memorandum in Support at 9-14.

propriety of these sanctions on two factors, the seriousness of Kelly's violation and its intentional nature. Having found that Kelly did intentionally commit a serious violation of the Act and Commission regulations, the Court imposes the sought after civil monetary penalty and the revocation of Kelly's registration. However, the Court declines to issue the cease and desist order because the Division has failed to allege or prove specific grounds sufficient to impose it.

A Cease and Desist Order is Unwarranted When Only One Act in Violation is Asserted and Proved

The Division asks this Court to issue a cease and desist order on the basis of one intentional act that violated the Act and Commission regulations.¹¹⁷ Such an order is merited when there is a reasonable likelihood that the wrong will be repeated.¹¹⁸ In this case, the Division bases its claim for the order on the intentional nature of Kelly's violation alone.¹¹⁹ Therefore, the Court must consider whether, based on a single, intentional violation and nothing else, "such a likelihood may reasonably be inferred."¹²⁰ Commission precedent indicates that it cannot be so inferred.

¹¹⁷ Division's Memorandum in Support at 12.

¹¹⁸ In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,181 (CFTC Mar. 16, 1993).

¹¹⁹ Division's Memorandum in Support at 12.

¹²⁰ In re Richardson Securities Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,647 (CFTC Jan. 27, 1981) (internal quotations omitted).

A cease and desist order is a substantial penalty even though it does not immediately level monetary, trading, or registration sanctions against Kelly. These orders are more than mere badges of shame. They create an independent public cause of action.¹²¹ Therefore, such an order does not automatically follow a finding that a respondent violated provisions of the Act or regulations.¹²² In other words, proof of a violation does not automatically prove that there is a reasonable likelihood that like violations will be repeated.¹²³ "The likelihood of future violations may be inferred from a pattern of past unlawful conduct, but not from an isolated instance of past unlawfulness."¹²⁴ In this case, the Division does

¹²¹ 7 U.S.C. §13b. See Grand Union Co. v. FTC, 300 F.2d 92, 100 (2d Cir. 1962).

¹²² See In re Dillon-Gage, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,574 at 30,483 (CFTC June 20, 1984); Richardson, ¶21,145 at 24,647.

¹²³ Precious Metals Assocs., Inc. v. CFTC, 620 F.2d 900, 912 (1st Cir. 1980).

¹²⁴ Dillon-Gage, ¶22,574 at 30,483; In re Thomson McKinnon Futures, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,753 at 33,971 (CFTC June 25, 1987) ("Thus, our focus centers upon the respondent's conduct and any pattern reflected thereby.").

In Dillon-Gage, the Court considered the question of whether the respondent's eleven violations constituted grounds for a cease and desist order. As to the first eight, based on recordkeeping 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. 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. Id.

The Commission considered the issue of a cease and desist order for a single, but willful, violation of Section 4e by trading
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not allege a pattern of violative behavior. Rather it relies on the intentional nature of a single act. Therefore, the Division has failed to provide a sufficient basis for the Court to infer that Kelly is reasonably likely to commit future violations. As a result, the Court cannot issue the cease and desist order. However, Kelly's actions do merit other sanctions.

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as an unregistered floor broker. In re Brody, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,081 at 32,180-81 (CFTC May 20, 1986). The Commission found that the case constituted the only instance in which it had issued a charge against the respondent. Id. at 32,181. It concluded, "Under these circumstances, we do not believe that it is likely that he will again show the same indifference to the Commission's regulations Thus, a cease and desist order is inappropriate." Id.

In Richardson, the Commission considered whether a single violation of Section 4g's time-stamping requirement merited a cease and desist order. ¶21,145 at 24,646-47. The Division argued that an order was merited based on the respondents' past actions, but listed only the violation of Rule 4g. Id. at 24,647. The Commission held

"The time stamping infraction, while a serious violation of the Act, does not, in and of itself, suggest future repetition by the respondents. There is no evidence of prior violations by respondents and apparently there has been no violation since the one at issue occurred We, therefore decline to issue a cease and desist order at this time based on this record."

Id. (emphasis added). Dillon-Gage, Richardson, and Brody all support the same conclusion. 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. But see In re New York Currency Research Corp., CFTC Docket No. 98-3, slip op. at 11 (CFTC Feb. 6, 1998) (imposing, without discussion, a cease and desist order for single act in violation of the record production requirements of Section 4n(3)(A) and Commission Rule 1.31).

Kelly's Intentional Violation Constitutes "Good Cause" for the Revocation of His Registration

The Division seeks a revocation of Kelly's registration pursuant to Sections 8a(4) and 8a(3)(M) of the Act.¹²⁵ Under Section 8a(4), the Court may suspend or revoke the registration of "any person registered under this Act if cause exists under [Section 8a(3)] which would warrant a refusal of registration of such person." The list of circumstances warranting a refusal of registration under Section 8a(3) includes a catchall provision, Section 8a(3)(M). This provision provides that, in addition to the enumerated circumstances set forth in Section 8a(3), the Commission may refuse to register a person for "other good cause."¹²⁶

¹²⁵ Division's Memorandum in Support at 12-13. See 7 U.S.C. §§12a(4) and 12a(3)(M).

¹²⁶ The 1982 amendments to the Act created the existing statutory structure for disqualification from registration Futures Trading Act of 1982, Pub. L. 97-444, 96 Stat. 2294 (1983).

"The legislative history of the 1982 Act demonstrates that one of Congress's purposes in revising the Act's registration provisions was to streamline and simplify the registration procedures so that those who were fit could be registered expeditiously and those who were unfit could be removed from the industry promptly."

In re Clark, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,032 at 44,928 (CFTC Apr. 22, 1997) (citing In re Walter, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,215 at 35,010 (CFTC Apr. 14, 1988)).

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. Walter, ¶24,215 at 35,010 (citing In re Tipton, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,673 at 22,750 (CFTC Sept. 22, 1978)). The burden then shifts to the registrant
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The Division alleges that Kelly's intentional violation of the Act and regulations amounts to such "other good cause".¹²⁷ Upon consideration, the Court agrees.

In the absence of any statutory definition for "other good cause," the Commission has 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 that 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, although never the subject of formal action or proceeding before either a court or governmental agency, 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."¹²⁸

(...continued)

to overcome the presumption of unfitness by producing evidence that demonstrates that despite the disqualifying conduct, his continued registration would pose no substantial risk to the public. In re Akar, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,927 at 31,708 (CFTC Feb. 24, 1986).

¹²⁷ Division's Memorandum in Support at 12-13.

¹²⁸ 17 C.F.R. Part 3, App. A (emphasis added), cited in Clark, ¶27,032 at 44,928.

In the present case, there is no material dispute that Kelly intentionally violated Section 4n(3)(A) and Rule 1.31. This intentional failure to promptly respond to the Division's production request provides a basis for revoking his registration. The violation's intentional nature 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.¹²⁹

Moreover, Kelly's conduct in response to the Division's production request, constitutes an "act,"¹³⁰ which plainly

¹²⁹ Indeed, if the Commission affirms the Court's findings that Kelly violated Section 4n(3)(A) and Rule 1.31, Kelly will then be subject to a possible Commission registration revocation action under the specific disqualifying conditions of Section 8a(3)(A), 7 U.S.C. §12a(3)(A). This subsection, in relevant part, creates a presumption a person is unfit for registration, if:

"such person has been found by the Commission or by any court of competent jurisdiction to have violated . . . any provision of this Act, or any rule, regulation, or order thereunder"

¹³⁰ Although a single intentional act in violation of the Act and Commission regulations normally is insufficient to support the imposition of a cease and desist order, that same act may warrant the revocation of a person's registration with the Commission. See In re Anderson, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,085 at 32,208 (CFTC May 30, 1986) ("[Section 8a(3)(M)] speaks simply of 'good cause' [A]n 'act' itself, as distinct from a 'pattern,' is sufficient."). This distinction is also reflected in the lesser burden imposed upon the Division in seeking registration revocation. Compare Gordon, ¶25,667 at 40,181 (holding that a cease and desist order requires the Division to prove by preponderance of the evidence "a reasonable likelihood that the wrongful conduct will be repeated") (emphasis added), with Akar, ¶22,927 at 31,708 (ruling that once statutorily prescribed misconduct is established the burden then shifts to the registrant to prove that, despite the disqualifying conduct, his continued registration would pose no substantial risk to the public.).

The differing standards are easily explained. Although a cease and desist is among a mix of sanctions available to
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demonstrates a "lack of honesty." As has been discussed at length, the record indisputably demonstrates that, prior to issuance of the Complaint, Kelly sought to conceal the willful nature of his noncompliance with the Division's request, by misrepresenting his belief as to the existence and whereabouts of the records.

Accordingly, there is no "significant doubt" that the record presently before the Court supports a finding that Kelly is presumptively unfit for Commission registration under the "other good cause" provision of Section 8a(3)(M).

Therefore, Kelly's failure to make any significant showing to rebut the presumption that he is unfit, seals his fate. To overcome the presumption that continued registration would raise a substantial risk to the public, Kelly must present one of two types of evidence: mitigation and/or rehabilitation.¹³¹ The record contains no showing of either.

Both mitigation and rehabilitation evidence sharply focus on the nature and circumstances of the disqualifying act. A

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generally and specifically deter violative conduct by the registered and unregistered alike, the Commission can most immediately ensure that a registrant's wrongdoing is not repeated by the exercise of its authority to debar participants from the industry that it regulates. In this manner, the Commission safeguards "the high ethical standards which must prevail in the industry." 17 C.F.R. Part 3, App. A. See also In re Horn, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,836 at 36,953 (CFTC Apr. 18, 1990) (Albrecht, C., separate views) ("Unwavering application of the registration standards set forth in the Act not only promotes the Congressional goals of fairness and uniformity, it fulfills our highest duty as a regulatory body -- protection of the public interest.").

¹³¹ Akar, ¶22,927 at 31,708-09.

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."¹³²

Rehabilitation evidence focuses on the registrant's "changed direction in his activities" since the time of his violation.¹³³ A registrant seeking to counter a prima facie case by showing rehabilitation must produce evidence that directly relates to the wrongful conduct at issue and shows that conduct of that nature will not be repeated.¹³⁴

Kelly's conduct stands as wholly unmitigated. Kelly's own evidence reveals that Kelly failed to produce his records because he perceived that his private interests would be ill-served by being drawn into the AVCO investigation.¹³⁵ There is nothing in the record to show that Kelly would not again exalt his private interests over his public obligations, if faced with such a conflict in the future.

Similarly, Kelly has made no showing of rehabilitation. True, Kelly did eventually produce at least some of the records in question. However, he did so only after the Complaint was issued. The timing of this act robs it of probative value. As the Commission has explained:

¹³² Horn, ¶24,836 at 36,940 n.16.

¹³³ Walter, ¶24,215 at 35,013 (quoting Tipton, ¶20,673 at 22,752).

¹³⁴ Akar, ¶22,927 at 31,709-10.

¹³⁵ See Kelly Affidavit at ¶¶ 4-5, 11; Kelly Affidavit, Exhibit B, Memorandum from Brett Little, Esq. to Files.

"It is in the interest of one who is the subject of an outstanding administrative complaint to make every effort to insure that his conduct conforms to the spirit as well as the letter of the law, at least during the period of adjudication, in order to avoid additional charges and also to reduce the likelihood of receiving a severe sanction."¹³⁶

In short, the pendency of this proceeding "create[d] a unique incentive for [Kelly's] good conduct."¹³⁷ In Kelly's own words, "I just read through [the Complaint] real quick and seeing that they could fine me all kinds of money and stuff, that's when I decided I'd better do something. I didn't want to be fined."¹³⁸ Thus, Kelly's ultimate cooperation is insignificant as evidence that under other circumstances his conduct would not be repeated.

Accordingly, the Court finds that the Division is entitled to the revocation of Kelly's CTA registration as a matter of law. In addition, the Court finds the record sufficiently complete so as to preclude the need for subsequent proceedings.

Now, the Court proceeds to the issue of whether the record supports the imposition of a civil monetary penalty.

¹³⁶ In re Vercillo, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,071 at 45,116 n.23 (CFTC May 30, 1997) (quoting In re Silverman, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,410 at 21,643 (CFTC Mar. 14, 1977)).

¹³⁷ Vercillo, ¶27,071 at 45,116 n.23.

¹³⁸ Kelly Deposition at 67.

Kelly's Violation Warrants a Civil Monetary Penalty

In addition to the sanctions discussed above, the Division seeks a civil monetary penalty of \$25,000.¹³⁹ The Division bases this amount on the seriousness of Kelly's violation and his state of mind.¹⁴⁰

Civil monetary penalties serve the goal of deterrence, and they do so in two ways. First, these penalties serve to deter respondents from engaging in further violations of the Act or Commission regulations. The term for this goal is "specific deterrence." Second, civil monetary penalties serve an exemplary goal so as to deter other persons subject to the Act from engaging in illegal conduct. This is called "general deterrence." As the Commission has explained,

"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. To effect this exemplary purpose, that cost must not be too low or potential violators may be encouraged to engage in illegal conduct.

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

¹³⁹ Division's Memorandum in Support at 13.

¹⁴⁰ Id. at 10-12.

they know they are unlikely to profit from it. Thus, in any individual case, our focus turns initially to the gain realized by the particular wrongdoers from their conduct."¹⁴¹

Thus civil monetary penalties are particularly appropriate where fraud or intentional wrongdoing is present, and are best calculated under a deterrence model that focuses on the gains to the wrongdoer, or alternatively, the injury resulting from the violation.¹⁴²

Although Kelly's willful violation does not go to the core of Act's regulatory scheme,¹⁴³ it is nonetheless serious and warrants

¹⁴¹ GNP ¶25,360 at 39,222.

¹⁴² See, e.g., In re Grossfeld, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,468 (CFTC Dec. 10, 1996) ("[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 respondent's wrongdoing must be based on the record as a whole, the financial benefit that accrued to the respondent and/or the loss suffered by customers as a result of the wrongdoing are especially pertinent factors to be considered." (citations omitted)).

To optimize deterrence, the penalty normally should be set at a level that is higher than the respondent's ill-gotten benefits or the injury that he has caused. This premium takes account of the those violations of the Act that go unpunished. GNP, ¶25,360 at 39,223; see also In re Grossfeld, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,975 at 41,120 n.25 (CFTC Feb. 9, 1994) (providing list of generally-recognized sources of economics literature on deterrence theory).

¹⁴³ See In re CBOT's Settlement of Disciplinary Charges, CFTC Docket Nos. 97-E-1, 97-E-2, 97-E-3, 97-E-4, 97-E-5, 97-E-6, 1997 WL 690460 at *13 (CFTC Nov. 6, 1997) (characterizing trade practice violations as a violations of the "core provisions" of the Act); Grossfeld, ¶26,921 at 44,468 ("[O]ur precedent identifies customer fraud as a violation going to the core provisions of the Act.").

The Court rejects the Division's contention that Kelly's intentional noncompliance with a production request constitutes a
(continued...)

an appropriate civil monetary penalty.¹⁴⁴ Kelly's violation undermines the integrity of the Commission's inspection authority. Refusals to cooperate with inspection-related requests impede the Commission's investigative, oversight and enforcement responsibilities. As a result, the Commission is less able to detect violations of the Act and regulations, impose sanctions, and, thereby, deter future violations.

But what amount of penalty? The Commission in GNP recognized that "[c]ivil monetary penalties cannot be calculated with precision;"¹⁴⁵ and certainly in the instant case there is little in the way of objective criteria for determining what specific penalty best promotes the purposes of the Act. While the consequences of Kelly's violation are real and substantial, they are not easily quantified. Although Kelly perceived his private interests to be best advanced by refusing the Division's request, the benefit he sought to derive from his violation is difficult to calculate. Nor is the cost that resulted from Kelly's wrongdoing easily measured. Although Kelly's record production violation plainly injured the regulatory scheme, it did no direct harm to any customer.

(...continued)

"violation of a core provision of the Act." Division's Memorandum in Support at 12-13. The Division's zeal notwithstanding, not every breach of the Act is equally serious. If infractions of the Commission's record retention, inspection and production requirements stood at the Act's "core," the statute would have no perimeters. This is a geometric impossibility.

¹⁴⁴ CFTC Interpretive Letter No. 77-4, ¶20,405 at 21,632.

¹⁴⁵ GNP, ¶25,360 at 39,222.

The Division suggests a penalty of \$25,000. Since the Court doubts that it could better justify a different figure,¹⁴⁶ it adopts the Division's proposed penalty.¹⁴⁷

Order

The Court concludes: (1) that Sean G. Kelly intentionally failed to produce certain required records and documents upon request of the Division of Enforcement; and (2) that there is no genuine issue of material fact, no necessity that further facts be

¹⁴⁶ But see New York Currency Research Corp., slip op. at 11-12 (imposing \$110,000 penalty for single act in violation of Section 4n(3)(A) and Commission Rule 1.31, while leaving undisturbed the Administrative Law Judge's findings that the Division had failed to establish that respondent had engaged in activities requiring registration, and that respondent had resisted a Division production demand under color of law).

¹⁴⁷ Given the willful nature of Kelly's infraction, the Division's recommended penalty appears "rationally devised in accordance with the purposes [the Commission] has outlined." GNP, ¶25,360 at 39,222. Notably, to promote general deterrence, the Commission has imposed significant civil monetary penalties for recordkeeping and reporting violations, even when those violations had been inadvertent or without harmful intent. In re Nugent, CFTC Docket No. 90-23, 1994 WL 3468 at *4-5 (CFTC Jan 5, 1994) (\$5,000 for 7 violations of Section 4f of the Act, 7 U.S.C. §6f, and Commission Regulation 3.31, 17 C.F.R. §3.31), final order, CFTC Docket No. 90-23, 1994 WL 107589 (CFTC Mar. 31, 1994); In re Angelo, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,943 (CFTC Oct. 19, 1990) (\$5,000 for violating Section 4g of the Act, 7 U.S.C. §6g, and Commission Regulation 1.31 and 1.35(a), 17 C.F.R. §§1.31 and 1.35(a)), summarily affirmed, CFTC Docket No. 89-5, 1993 WL 86042 (CFTC Mar. 24, 1993). Obviously, the penalties need be higher to deter intentional conduct. See Buckwalter, ¶24,995 at 37,687 ("The level of sanction necessary to deter future record-keeping violations is obviously lower for respondents that are already making a good faith effort to comply with the applicable standard than for respondents that intentionally shirk their regulatory responsibility.").

developed, and the Division of Enforcement is entitled to a decision as a matter of law.

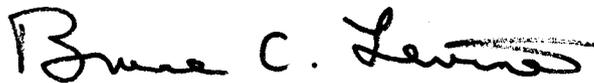
For these reasons, the Court **GRANTS** the Division of Enforcement's motion for summary disposition of its claims that Kelly violated Section 4n(3)(A) and Rule 1.31, 7 U.S.C. §6n(3)(A); 17 C.F.R. §1.31, and **DENIES** Sean G. Kelly's cross-motion for summary disposition and dismissal of the Complaint.

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

1. Respondent Sean G. Kelly's registration as a commodity trading advisor is **REVOKED**; and,
2. Respondent Sean G. Kelly **PAY** a civil monetary penalty of **\$25,000** within 30 days of the effective date of this Order.

IT IS SO ORDERED.¹⁴⁸

On this 24th day of February, 1998



Bruce C. Levine
Administrative Law Judge

¹⁴⁸ Under 17 C.F.R. §§10.12, 10.91(f), 10.102, and 10.105, any party may appeal this Initial Decision to the Commission by serving upon all parties and filing with the Proceedings Clerk a notice of appeal within 15 days of the date of the Initial Decision. If the party does not properly perfect an appeal -- and the Commission does not place the case on its own docket for review -- the Initial Decision shall become the final decision of the Commission, without further order by the Commission, within 30 days after service of the Initial Decision.