
NICANOR P. PALOMARES,	*	
	*	
Complainant,	*	
	*	
v.	*	CFTC Docket No. 99-R015
	*	
JAMES W. BRADSHAW, d/b/a	*	
NEURAL-TECH CAPITAL MANAGEMENT,	*	
and LFG, LLC,	*	
	*	
Respondents.	*	

INITIAL DECISION

Appearances: Nicanor P. Palomares, pro se
 195 Eileen Drive
 Cedar Grove, New Jersey 07009
 Complainant

James W. Bradshaw, pro se
 8 Grigg Street
 Greenwich, Connecticut 06830
 Respondent

James B. Koch, Esq.
 Gardiner Koch & Hines
 53 West Jackson Boulevard
 Suite 1550
 Chicago, Illinois 60604
 Attorney for Respondent LFG, LLC

Before: Bruce C. Levine, Administrative Law Judge

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Overview

Nicanor P. Palomares ("Palomares") is an experienced commodities speculator, who chose to roll the dice with the help of "Recurrence" -- one of those computerized day-trading systems advertised in the likes of Futures magazine. The advertisement that he read said that the system had "Turned \$10,000 Into \$565,750!" after six years of trading foreign currencies. Palomares could live with returns like that!

Convinced Recurrence trading would produce a windfall, Palomares hired James W. Bradshaw d/b/a Neural-Tech Capital Management ("Bradshaw"), a commodity trading advisor ("CTA"), to trade the system for him, and opened an account with LFG, LLC ("LFG"), a Futures Commission Merchant ("FCM"), for purposes of executing the trades.

Following the automated recommendations of Recurrence, Palomares' account steadily dwindled from \$33,031 to a mere \$330, over the course of a year and a half. All the while, Palomares actively stood on the sidelines, continually monitoring the progress of his account and consulting with Bradshaw. Once it was clear that a reversal of fortunes was not in the cards, Palomares closed his account. He then eventually filed a reparation complaint, seeking to have Bradshaw and LFG shoulder the account's losses.

The simple reality is that no technical trading system can help the retail speculator to beat the market. Recurrence is no exception. A trader would do just as well to consult a tarot card reader. Like tarot cards, any belief in the predictive power of technical analysis lies in the realm of faith, not science. With remarkable unanimity, researchers have concluded that there is no useful information to be gleaned in examining sequences of past changes in futures prices.

The issue of whether Palomares was wronged by the makers of Recurrence is unfortunately not before this Court. In the case before us, however, Palomares has simply failed to establish that Bradshaw defrauded him. After all, the record shows that Palomares wanted to trade according to Recurrence, and that Bradshaw gave him exactly what he wanted. Moreover, LFG -- the instrumentality, that merely executed the trades -- has no liability, vicarious or otherwise, for Palomares' losses. Accordingly, for the reasons set out below, the Court **FINDS** that Palomares is not entitled to recovery in reparations, and **DISMISSES** his complaint.

Procedural Background

On October 20, 1998, Nicanor P. Palomares, appearing pro se, (although, as we shall see later, assisted by counsel) initiated this reparations case against respondents James W.

Bradshaw, d/b/a Neural-Tech Capital Management, and LFG, LLC.¹ Although styled as a five-count complaint, the Complaint asserts only four legitimate causes of action.² Palomares claims that Bradshaw caused his trading losses by making fraudulent misrepresentations and by churning his account.³ In addition, Palomares claims that LFG is liable for Bradshaw's violations due to LFG's purported failure to supervise Bradshaw's handling of the Palomares account,⁴ and under the theory that Bradshaw was

¹ See Statement of Facts ("Complaint"), filed October 20, 1998.

² Among Palomares' allegations, he asserts that Bradshaw should be found liable for breach of contract and breach of fiduciary duty. Id. at 3-4, ¶¶19-20, 25-26. See also Reparations Complaint Form, attached to Complaint. These claims, however, are not cognizable in the reparations forum, since neither claim, by itself, constitutes a violation of the Commodity Exchange Act ("Act") or the Commission's regulations promulgated thereunder. See Commodity Exchange Act §14(a), 7 U.S.C. §18(a). See also Tysdal v. Jack Carl/312 Futures, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,242 at 38,712 (CFTC Feb. 27, 1992); Krueger v. The Sage Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,566 at 36,431 (CFTC Dec. 14, 1989); Toub v. Apache Trading Corp., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,975 at 31,856 (CFTC Mar. 6, 1986); Wills v. First Fin. Corp. of Am., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,605 at 30,596-97 (CFTC May 31, 1985). The actions that Palomares seeks to condemn with his non-cognizable claims, however, are completely encompassed by his remaining claims against Bradshaw.

³ See Complaint at 4, ¶¶21-24. See also Reparations Complaint Form, attached to Complaint.

⁴ See Complaint at 5, ¶¶27-28.

LFG's agent.⁵ Palomares seeks to recover from the respondents \$25,794.99 for his churning claim alone,⁶ and \$32,699.79 in total (his actual out-of-pocket losses) for all of his claims.⁷

⁵ Although Palomares does not explicitly allege that LFG should be held vicariously liable under a theory of agency for Bradshaw's alleged violations, Palomares' failure to supervise claim implicitly gives rise to such a cause of action.

⁶ In his original Complaint, Palomares claimed that Bradshaw generated fees and commissions "in excess of \$50,000." Complaint at 3, ¶18. Soon thereafter, Palomares was instructed to supplement his claim for churning damages with "a calculation of the exact amount you are claiming in commissions". See Letter from R. Britt Lenz, Director of the Office of Proceedings, to Nicanor P. Palomares, dated November 9, 1998, at 1 ("Lenz Letter I"). Upon reviewing the account statements, Palomares trimmed his estimate of total commissions charged by almost half, to \$25,794.99. See Letter from Nicanor P. Palomares to R. Britt Lenz, Director of the Office of Proceedings, dated November 18, 1998, at 1 ("Palomares Letter").

⁷ In his original Complaint, Palomares claimed that his actual trading losses were \$34,399.12. See Complaint at 5. This number, however, was wrong as well. Instead, it reflects the amount of money withdrawn from Palomares' IRA for purposes of opening an account with LFG. *Id.* at 2, ¶9. To remedy Palomares' mistaken damages calculation, the Office of Proceedings instructed Palomares as to how he should go about amending his claimed damages. See Lenz Letter I at 1. Along those lines, Palomares subtracted his closing balance (\$330.15) from the original value of his LFG account (\$33,030.94), arriving at a figure of \$32,699.79 for his out-of-pocket losses. See Palomares Letter at 1. Palomares' math was off by a dollar, with the correct measure of out-of-pocket losses being \$32,700.79.

Palomares' claimed damages also included a request for "\$39,961 in the opportunity cost of the investments which were liquidated to fund the trading." See Complaint at 5. This claim was denied prior to the case being forwarded to the Court, for failure to allege facts specific enough to show proximate causation between Bradshaw's actions and the foregone
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LFG, through counsel, filed its answer to the Complaint on December 17, 1998,⁸ and Bradshaw, appearing pro se, did the same soon thereafter.⁹ Following the conclusion of discovery, all parties filed notices with the Court indicating their intent to participate in the oral hearing.¹⁰ On July 9, 1999, the Court

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opportunities. See Lenz Letter I at 1. Similarly, the Director of the Office of Proceedings denied Palomares' claim for punitive damages, see Complaint at 5, for failure to allege facts necessary to support such a remedy. See Lenz Letter I at 2. See also Letter from R. Britt Lenz, Director of the Office of Proceedings, to Nicanor P. Palomares, dated November 24, 1998 (denying Palomares' second request for punitive damages).

⁸ See Answer of LFG, LLC, dated December 17, 1998.

On the same day that LFG filed its answer, it also submitted a motion requesting that the Director of the Office of Proceedings reconsider his decision to forward the Complaint as it pertains to respondent LFG. See Motion for Reconsideration of Determination to Forward the Complaint, dated December 17, 1998 ("Motion for Reconsideration"); 17 C.F.R. §12.18(b). See also Fed. R. Civ. Pro. 12(c) (motion for judgment on the pleadings). This motion was intended to provide LFG with an expeditious exit, thereby saving litigation costs, given its view that the case against LFG was a sure loser. See Motion for Reconsideration ("LFG is named in Count V for failure to supervise a CTA for whom it has no such duty To require LFG to proceed with discovery would cause an expense that is likely not recoverable."). The Director of the Office of Proceedings summarily denied the motion. See Letter from R. Britt Lenz, Director of the Office of Proceedings, to James B. Koch, Esq., dated December 23, 1998.

⁹ See Answer of James W. Bradshaw, dated December 30, 1998 ("Bradshaw's Answer").

¹⁰ See Response to Order Setting Time and Place of Oral Hearing and Pre-Hearing Memorandum, dated April 22, 1999 (LGF); Letter
(continued..)

conducted a hearing at the United States District Court for the Southern District of New York in New York, New York.¹¹ At the hearing, the Court heard testimony from Palomares and from James E. Green ("Green"), Divisional Counsel of LFG. Bradshaw chose not attend the hearing, and therefore, was deemed in default.¹²

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from James W. Bradshaw, to the Office of Proceedings, dated May 17, 1999; Response to Order Setting Time and Place of Oral Hearing and Pre-Hearing Memorandum and Motion for Reconsideration of Order Dated May 27, 1999, dated June 1, 1999 (Palomares).

¹¹ See Transcript of Proceedings, dated July 9, 1999 ("Tr."). At the hearing, all documents and materials contained in the public file, including materials attached to the pleadings and all documents produced during discovery, were received into evidence, without objection. Id. at 17. See also Order Setting Time and Place of Oral Hearing, dated March 29, 1999, at 1. The Court completed the evidentiary record by receiving additional documents and hearing the oral testimony of two witnesses. See generally, Tr.

¹² See Tr. at 4. Being already subject to a Commission order directing him to pay nearly a million dollars in penalties and restitution, see In re Bradshaw, [1998-1999 Transfer Binder] (CCH) ¶27,647 at 48,084 (CFTC May 27, 1999), Bradshaw apparently felt had had nothing more to lose by skipping the hearing. See Tr. at 4 (James B. Koch) ("I spoke with Mr. Bradshaw to see what his testimony was going to be this morning, and he informed me that he did not intend to appear [at the hearing].").

Bradshaw's default, however, does not render Palomares an automatic winner. After all, "a default is not treated as an absolute confession by the defendant of his liability and of the plaintiff's right to recover." Nishimatsu Constr. Co. v. Houston Nat'l Bank, 515 F.2d 1200, 1206 (5th Cir. 1975). See also Cochran v. Amadio, [Current Transfer Binder] (CCH) ¶27,962 at 49,076 n.5 & 49,079 n.26 (CFTC Jan. 4, 2000); 17 C.F.R. §12.312(b)(2) (effect of failure to appear at the hearing). Nor

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are default procedures intended to function as a "blunt instrument of punishment." Novofastovsky v. Osadchy, [Current Transfer Binder] (CCH) ¶28,060 at 49,557 (CFTC Mar. 27, 2000). Rather, they are a measured set of tools designed to account for a party's absence or non-cooperation in the litigation process, without compromising the primary goal of adjudication: a just resolution of the merits of competing claims. See id. As such, Bradshaw's "default does not in itself warrant the court in entering a default judgment. There must be a sufficient basis in the pleadings for the judgment [to be] entered." Nishimatsu, 515 F.2d at 1206. See also In re Global Link Miami Corp., [1996-1998 Transfer Binder] (CCH) ¶27,391 at 46,784 n.80 (CFTC June 26, 1998).

As a consequence for defaulting, Bradshaw loses his standing in this case, meaning, he is precluded from further participating in this adjudication, which includes, not being able to introduce evidence or cross examine witnesses. See Tr. at 4, 7. See also Novofastovsky, ¶28,060 at 49,557 (quoting Frow v. De La Vega, 82 U.S. 552, 554 (1872)). In addition, Bradshaw is deemed to admit all "well-plead allegations of fact." Whether an allegation is well-pled, however, cannot be determined without regard to formulation. See In re Dixon, [Current Transfer Binder] (CCH) ¶28,111 at 49,773 n.5 (CFTC Apr. 12, 2000). "Allegations are not well-pled merely because they are intelligible." Id. They must also mesh with the record as a whole. Examples of allegations that are not well-pled include: (1) allegations made indefinite by other allegations in the same complaint; (2) allegations that are made erroneous by the same complaint; (3) allegations that are contrary to facts of which the Court will take judicial notice; (4) alleged facts that are not susceptible of proof by legitimate evidence; and (5) alleged facts that are contrary to the uncontroverted material in the file of the case. Id. (citing Trans World Airlines, Inc. v. Hughes, 449 F.2d 51, 63 (2d Cir. 1971)). Moreover, the defaulted party is not deemed to have admitted to ultimate conclusions of law; the Court draws its own legal conclusions. See Global Link Miami, ¶27,391 at 46,783-85; In re Global Link Miami Corp., [1998-1999 Transfer Binder] (CCH) ¶27,669 at 48,164 (CFTC June 21, 1999).

Both Palomares and LFG have filed their post-hearing briefs,¹³ making this matter ripe for decision.

The Court's discussion below contains its factual findings and sets forth its reasons for concluding that Palomares has failed to make even a prima facie showing that either Bradshaw or LFG is liable to him for any violation of the Act or Commission regulations.

Discussion

The Recurrence Trading System

Around the beginning of 1996, Palomares, a semi-retired architecture consultant¹⁴ and experienced commodities speculator,¹⁵ received a mailed advertisement from Avco Financial

¹³ See Palomares' Posthearing Brief, dated August 15, 1999 ("Palomares' Brief"); Proposed Findings of Fact and Conclusions of Law, dated September 10, 1999 (LFG).

¹⁴ See Tr. at 44-45. See also Complainant Palomares' Answer to Respondent LFG LLC's Interrogatories and Request for Production of Documents, dated March 6, 1999 ("Palomares' Answer to Interrogatories"), at 1.

¹⁵ Palomares refused to provide discovery documenting his past experience in commodity trading. See id.; Respondent LFG LLC's Interrogatories and Request for Production of Documents Directed to Complainant Palomares, dated January, 26 1999, at 7-8. Likewise, at the hearing, he was evasive when questioned about his trading history, and failed to provide candid testimony on the subject. See Tr. at 38-42, 55-58. Nonetheless, the record clearly reflects that, prior to trading with Bradshaw, Palomares had substantial experience directing his own speculative futures
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Corporation ("Avco") that captured his interest.¹⁶ The advertisement touted the purportedly proven ability of the Recurrence IV ("Recurrence") trading system to systematically beat the market and earn substantial trading profits for its customers over an extended period of time.¹⁷

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accounts with other FCMS. Id. In addition, Palomares had directed his own securities trading. Id. at 44.

¹⁶ See Complaint at 2, ¶6. See also Enclosure 5, attached to the Complaint ("Avco Advertisement") (a photocopy of an Avco promotional piece appearing in a 1996 edition of Futures Sourcebook). At the time that he contacted Avco, Palomares was 63 years of age. See Complaint at 2, ¶6.

¹⁷ The Avco Advertisement graphically and verbally describes Recurrence as having an exceptionally impressive performance history:

**"What Investment Program Allows You To Start
With As Little As \$2,500 And Achieve Over
800% Annual Returns?**

.

Recurrence has made a profit on more than 75% of its trades - with no overnight exposure and minimal drawdowns. From Jan. 1, 1989 to Sept. 30, 1995, trading only Swiss Franc futures, the system made more than \$555,750 on a starting equity of \$10,000 - a return of more than 800%!

.

Those traders with the vision, foresight and lack of ego necessary to let Recurrence tell them when to trade will begin taking profits immediately."

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Recurrence is a computer software program that generates trading recommendations based on observed patterns in the price movement of exchange-traded futures contracts on foreign currencies.¹⁸ More specifically, Recurrence searches for developing patterns in the movement of futures prices that match reoccurring historical trends.¹⁹ Working on the assumption that

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Id. (emphasis in original). See also CFTC v. Avco Fin. Corp., [1996-1998 Transfer Binder] (CCH) ¶27,173 at 45,580-81 (S.D.N.Y. Sept. 29, 1997) (providing numerous examples of other Avco advertisements that tout the performance of the Recurrence trading system in a similar fashion).

¹⁸ As explained by the Avco Advertisement:

"Recurrence works automatically. At the beginning of each trading day, Recurrence loads the last 9 days of price history into your computer. As trading begins, it tracks every price from your real-time data feed. When Recurrence isolates a profitable pattern, an alarm sounds and a pop-up window appears with easy-to-read Buy/Sell/Stop instructions to give to your broker."

Id. See also Avco, ¶27,173 at 45,580 (describing the mechanics of how Recurrence operates).

¹⁹ See Avco Advertisement (generally describing how Recurrence operates and how it incorporates pattern recognition principles into its trading methodology). See also Avco, ¶27,173 at 45,580 (same); In re R&W Technical Serv., Ltd., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 at 47,738 n.39 (CFTC Mar. 16, 1999) (describing Recurrence); In re R&W Technical Serv., Ltd., [1996-1998 Transfer Binder] (CCH) ¶27,193 at 45,718-20 (Dec. 1, 1997) (describing in detail the mechanics underlying a technical futures trading system similar to Recurrence).

current movements in futures prices are non-random and will continue to parallel past trends, Recurrence generates a series of trading recommendations designed to profit from such anticipated future price movements.²⁰ Thus, much like a crystal ball, Recurrence can purportedly predict profitable trades, without having to analyze new information (e.g., interest rates, inflation, factors affecting supply and demand) or even

²⁰ The developers of Recurrence claim to have discovered 14 non-random reoccurring trends in the movement of currency prices. See Avco Advertisement. See also Avco, ¶27,173 at 45,580. If these trends are valid, then the users of Recurrence stand in a position to predict the direction and magnitude of future prices, assuming of course, Recurrence can identify the emerging trends in sufficient time to place trades ahead of the predicted movements.

The process by which Recurrence operates is relatively simple. Recurrence sorts through real-time price data, examining price movements for a pattern that mirrors one of the 14 established trends. See Avco Advertisement. At each pricing iteration, Recurrence assesses the probability that the current pricing pattern constitutes the reemergence of an established trend. See Avco, ¶27,173 at 45,580. The system assesses probabilities in terms of expected profit or loss, meaning, the system continually calculates the expected likelihood that a trade order -- which is based on the assumption that an established trend has developed and will continue -- will yield a specified profit objective that is over and above the cost of commissions. Id. at 45,581 (referring to "net profit"). Once Recurrence determines that the probabilities are in the traders' favor, it issues the appropriate buy/sell/stop order. Id. at 45,580. Thus, in theory, a trader should follow each and every trade recommendation issued by Recurrence, irrespective of concerns over cumulating transaction costs. After all, commissions and risk are already factored into Recurrence's assessment of expected value.

generally understand the motivating forces underlying anticipated price changes.²¹

Palomares' Trading

Impressed by the Avco advertisement, Palomares contacted a sales representative at Avco to inquire about the Recurrence trading system.²² Upon learning that he lacked the technical skills necessary to administer the program and taken aback by the substantial licensing fee, Palomares passed on purchasing the system.²³ But much to Palomares' liking, a cheaper and simpler alternative was suggested to him. The salesperson referred Palomares to a CTA named James W. Bradshaw who could trade Palomares' account according to the Recurrence system.²⁴

Convinced this was the best way to go, Palomares called Bradshaw for purposes of opening a discretionary commodity

²¹ See Avco Advertisement; Avco, ¶27,173 at 45,580-81; See also R&W, ¶27,193 at 45,719 n.18 (describing and distinguishing the methods of commodity valuation employed by fundamental analysts, who believe that only price-related information drives the market, and technical analysts, who believe non-random price patterns can be identified and exploited).

²² See Tr. at 38, 60 (Palomares); Complaint at 2, ¶6; Tr. Exhibit CX-7 at 2, ¶2 ("Prepared Statement").

²³ See Prepared Statement at 2, ¶2, ("I called Avco Financial and was told that the system required technical expertise and costs over \$6,000 I told Avco that I didn't have the expertise or the time to use this system.").

²⁴ See Complaint at 2, ¶6; Prepared Statement at 2-3, ¶¶2-3.

trading account that Bradshaw would trade on Palomares' behalf using the Recurrence trading system.²⁵ The conversation addressed the logistics of setting up the account so that Palomares could get started.²⁶ To this end, Bradshaw sent Palomares a CTA Disclosure Document and an Advisory Agreement.²⁷ On January 3, 1996, Palomares executed these forms and the account opening forms provided to him by LFG,²⁸ and granted a power of attorney to trade the LFG account to Bradshaw.²⁹

Bradshaw commenced trading Palomares' LFG account in March of 1996, funded with a starting balance of \$33,031.³⁰ The account traded heavily for three months. Palomares' daily account statements show that, on the first day of trading, Bradshaw traded 7 contracts for a profit of \$1,312 before subtracting Bradshaw's and LFG's respective fees and commissions

²⁵ See Complaint at 2, ¶¶6-8; Prepared Statement at 3, ¶¶3-4. See also Tr. at 60 (Palomares) ("I told [Avco] I'm not familiar with the Recurrence system, if they could provide me with some broker who could trade this account [following the Recurrence system], I would be willing to just work with the person who is able to do this.").

²⁶ See Prepared Statement at 3, ¶¶4-6.

²⁷ See Complaint at 2, ¶8; Prepared Statement at 3, ¶6.

²⁸ See *infra* notes 119-20 & accompanying text.

²⁹ See Complaint at 2, ¶10; Prepared Statement at 3, ¶8.

³⁰ See Prepared Statement at 3, ¶¶6.

totaling \$245.³¹ The next day of trading also proved profitable, with Bradshaw's trading 8 contracts for a gross profit of \$1,300, with \$280 in advisory fees and FCM commissions.³² However, the third day of trading proved less kind, with 8 contracts being traded for a loss of \$1,400, before subtracting another \$280 in fees and commissions.³³ After the first week of trading, Palomares' account balance had increased \$319, which amounts to a 1% increase in value from the initial balance of \$33,030.

Subsequent weeks in March, however, were not profitable for Palomares, although Bradshaw still earned substantial advisory fees. Palomares' account decreased to \$30,707 by the end of the second week, and plummeted to \$23,729 by the end of the third week.³⁴ In April, Bradshaw managed to increase Palomares' account value to \$30,354 by trading up to 48 contracts in a single day.³⁵ During that month, Palomares' account piled up

³¹ See Enclosure 11, attached to the Complaint (containing copies of Palomares' daily account statements) ("Daily Account Statements"), for March 11, 1996. Palomares states that he received the LFG account statements approximately 4-5 days after the trades had been executed. See Tr. at 59 (Palomares).

³² See Daily Account Statements for March 13, 1996.

³³ Id. for March 15, 1996.

³⁴ Id. for March 29, 1996.

³⁵ Id. for April 4, 1996.

\$9,345 in fees and commissions.³⁶ In May, however, Palomares' account fell on hard times, dropping to a measly \$8,009.28, with Bradshaw and LFG receiving a total of \$3,290 in fees and commissions.³⁷

Although the account remained opened until September of 1997, when Palomares closed it with a balance of \$330.15,³⁸ trading after May of 1996 was light and sporadic. Thirteen months after finally closing the account, Palomares initiated this reparations case.

During the account's active period of heavy trade volume and volatile account balances, Palomares had numerous, albeit brief, discussions with Bradshaw. Although Bradshaw rarely returned missed phone calls, Palomares admits that he was able to get in touch with Bradshaw to express his concerns over the depleting account balance.³⁹ On each occasion that he did so, Bradshaw was curt and dismissive. According to Palomares,

³⁶ See Enclosure 11, attached to the Complaint (containing copies of Palomares' monthly account statements) ("Monthly Account Statements"), for April 1996. Although Bradshaw only once traded 48 contracts in a single day, he had days in April in which he traded 20, 35 and 40 contracts. Id. See also Daily Account Statements for April 12, 1996, April 23, 1996, and April 16, 1996.

³⁷ See Monthly Account Statement for May 1996.

³⁸ Id. for September 1997.

³⁹ See Prepared Statement at 3-4, ¶¶11-13; Complaint at 2, ¶13.

Bradshaw would typically respond by telling him that they have encountered a spell of "bad luck," so "don't worry, we'll build it up" . . . "I'm gonna make it up to you", or other "words to that effect."⁴⁰ Palomares required no further explanation, and allowed Bradshaw to continue trading the account in the same manner as before. This choice would prove imprudent, as Palomares' account sustained further losses.⁴¹

Palomares claims that Bradshaw caused his trading losses by fraudulently misrepresenting certain facts material to his trading, and by churning Palomares' account.⁴² The Court considers Palomares' misrepresentation claim first.

**Palomares Did Not Establish That He Was Defrauded By
Bradshaw's Representations**

Palomares alleges that Bradshaw violated the antifraud provisions of the Commodity Exchange Act by making

⁴⁰ Id.

⁴¹ The fact that Palomares sustained substantial trading losses as a consequence of relying on Recurrence's recommendations, should come as no surprise. See R&W, ¶27,193 at 45,727 n.75 (explaining that programmed trading based on technical analysis is unprincipled and fails to comport with any accepted academic theory pertaining to sound investment strategies).

⁴² See Complaint at 4, ¶¶21-24. See also Reparations Complaint Form, attached to Complaint.

misrepresentations that led to his trading losses.⁴³ In order to recover on his misrepresentation claim, Palomares must establish that Bradshaw knowingly or recklessly made material, false statements that Palomares reasonably relied upon and that proximately caused his damages.⁴⁴ Thus, the first step in

⁴³ Section 4b(a), the general antifraud provision of the Act for futures contracts, provides, in relevant part:

- "(a) It shall be unlawful . . .
- (i) to cheat or defraud or attempt to cheat or defraud . . . ;
 - (ii) willfully to make or cause to be made . . . any false report or statement thereof, or willfully to enter or cause to be entered . . . any false record thereof;
 - (iii) willfully to deceive or attempt to deceive . . . by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract"

7 U.S.C. §6b(a). Cf. 17 C.F.R. §33.10 (Commission's antifraud provision for exchange-traded commodity options transactions).

⁴⁴ See Harris v. Connelly, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,919 at 41,010 n.6 (CFTC Jan. 3, 1994) (collecting cases).

In an earlier Commission enforcement proceeding, Bradshaw was found to have made fraudulent representations to his clients and to have churned their accounts at both Delong, Fried & Sukenok and LFG during a period that coincides with that of Palomares' trading. See Bradshaw, ¶27,647 at 48,083. The Commission's findings of Bradshaw's systematic abuse, however, do not ease Palomares' burden in this particular litigation.

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As with the closely related doctrine of res judicata, collateral estoppel precludes relitigation of an issue that has been previously litigated involving a party to the first case. See Harter v. Iowa Grain Co., [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,644 at 48,075-76 (CFTC May 20, 1999); Allen v. McCurry, 449 U.S. 90, 94 (1980). It precludes such relitigation in a subsequent proceeding when: "(1) the precise issue has been raised and litigated in a prior proceeding; (2) determination of the issue was necessary to the outcome of the prior proceeding; (3) the prior proceeding resulted in a final judgment on the merits; and (4) the party against whom estoppel is sought has had a full and fair opportunity to litigate the issue in the prior proceeding." Harter, ¶27,644 at 48,076. See Hess v. Mount, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,039 at 37,885 n.14 (CFTC Apr. 17, 1991) (citing Moore v. City of Paducah, 890 F.2d 831, 832 n.4 (6th Cir. 1989)). The burden of proving these factors rests with the party asserting preclusion. See In re Clark, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,032 at 44,930 n.28 (CFTC Apr. 22, 1997) ("The party seeking preclusion bears the burden of showing with clarity and certainty what was determined by the prior judgment.") (citation omitted). "It is not enough that the party introduce the decision of the prior court: rather, the party must introduce a sufficient record of the prior proceeding to enable the trial court to pinpoint the exact issues previously litigated." Id. (quoting United States v. Lasky, 600 F.2d 765, 769 (9th Cir. 1979)).

In the instant case, Palomares has not sought to demonstrate that the requirements of collateral estoppel are satisfied. Moreover, it appears evident that, even if he had tried to do so, he could not have met his burden. The factual issues determined in the enforcement proceeding are not the same as those before this Court. The prior enforcement case against Bradshaw focused exclusively on systematic violations of the Act and its regulations. The Commission's findings of fact do not address Palomares' unique allegations of fraudulent misrepresentation, and do not speak of any misconduct by Bradshaw in the handling of Palomares' specific account. See Bradshaw, ¶27,647. Moreover, in the enforcement proceeding (unlike a reparations proceeding), it was unnecessary to determine the extent, if at all, that Bradshaw's conduct injured anyone, much less if it injured Palomares specifically. See JCC.
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assessing Palomares' claim is to identify the set of Bradshaw's alleged misstatements of which Palomares complains. This is not an easy task, despite the fact that the "pro se" Palomares has been assisted by an attorney -- a "ghost attorney," that is -- throughout this proceeding.⁴⁵

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Inc. v. CFTC, 63 F.3d 1557, 1565 n.23 (11th Cir. 1995) (In enforcement cases involving fraud, proof of actual injury is not required. The Division of Enforcement ("Division") need not show that customers actually relied to their financial detriment on sales agents' misrepresentations.); In re GNP Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,218 (CFTC Aug. 11, 1992). Cf. Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 325 n.2 (1979).

Lastly, the scantily reported Bradshaw enforcement case tells us little about "a variety of fairness-related factors" relating to the respondent's incentives and opportunities to vigorously litigate in the proceeding -- factors that are to be considered in assessing whether collateral estoppel should apply. Clark, ¶27,032 at 44,930. In the enforcement action, judgment was entered against Bradshaw on the express ground that he had failed to respond to the Division's motion for summary disposition, and therefore, was deemed to have "consented to the relief sought by the [Division]." Bradshaw, ¶27,647 at 48,082. Accordingly, findings of fact were entered against Bradshaw without any reference to or discussion of the factual record before the Administrative Law Judge. Since the summary disposition inquiry normally "focuses on whether, on the existing record, the movant is entitled to summary disposition, not whether the opponent has filed a response," In re Bentley, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,620 at 30,651 (CFTC May 22, 1985) ("[W]e decline to engraft a 'deemed consent' provision into the specifics of summary disposition procedure."), the procedures employed and the resulting judgment in Bradshaw both appear unusual.

⁴⁵ There is a specter haunting American courts today, the specter of ghost attorneys. Ghost attorneys are those attorneys who
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prepare, in whole or in part, documents and other work product for otherwise pro se litigants. In the last several years, courts have become more alert to the problems that ghost representation may cause. See Ricotta v. California, 4 F. Supp.2d 961, 985-88 (S.D. Cal. 1998). First, because many courts (as well as the Commission, see Gray v. LFG, LLC, 2000 WL 1280864 at *3 n.7 (CFTC Sept. 12, 2000); Hall v. Diversified Trading Sys., Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,131 at 41,751 (CFTC July 7, 1994); Motzek v. Monex Int'l Ltd., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,095 at 41,625 (CFTC June 1, 1994)) construe complaints by pro se litigants liberally and afford them greater latitude as a matter of judicial discretion, undisclosed ghost attorneys can abuse this practice to the prejudice of an opposing party. See Johnson v. Board of County Comm'rs, 868 F. Supp. 1226, 1231 (D. Colo. 1994). Second, ghost representation is a deliberate evasion of the responsibilities imposed on counsel by Fed. R. Civ. Pro. 11, as well as applicable professional codes. Id. at 1231-32. By not signing documents prepared for the Court, attorneys escape their duties to the Court. See 17 C.F.R. §12.12(b). Third, such behavior involves an attorney in his client's fraud. See Johnson, 868 F. at 1232. Fourth, ghost attorneys avoid ethical rules designed to protect the attorney/client relationship. See Laremont-Lopez v. Southeast Tidewater Opportunity Center, 968 F. Supp. 1075, 1079 (E.D. Va. 1997). For example, all jurisdictions have regulations on when and how an attorney can withdraw, but a ghost attorney could avoid such regulations by never disclosing his or her existence to the Court. Id. Fifth, ghost attorneys may frustrate the "efficient administration of justice" by contracting with the litigant for limited service such as drafting the pleadings only. Id. Such piecemeal representation may confuse the litigant, the Court and other attorneys as to how and when the litigant is "represented."

Despite all their commentary, courts have found it difficult to bust ghost attorneys. See generally Ricotta, 4 F. Supp.2d at 987. The lack of clearly defined rules prohibiting such ghoulish practices makes sanctions inappropriate. Id.; Laremont-Lopez, 968 F. Supp. at 1080; Johnson, 868 F. Supp. at 1232; Ellis v. Maine, 448 F.2d 1325, 1328 (1st Cir. 1971). Courts are left with attorneys whose conduct they find

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The first visible "assistance" that the ghost attorney provided was to draft Palomares' Complaint -- a complaint that is brief, general and, correspondingly, short on specifics.⁴⁶

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contemptuous, but without any statute or ethical rule upon which to impose contempt.

A general test has developed to examine the level of involvement that constitutes ghost representation. See Ricotta, 4 F. Supp.2d at 987 ("virtually every attorney would be eligible for contempt proceedings" if all assistance an attorney gives to friends violated ethics rules). The developing test examines the attorney's contributions to see if they arise to more than "informal advice." Id. See also Ellis, 448 F.2d at 1332 ("substantial part" test). One ethics opinion published by the American Bar Association laid down the rule, "an undisclosed counsel who renders extensive assistance to a pro se litigant is involved in that litigant's misrepresentation" to the Court "in violation of ABA DR 1-102(a)(4) [which states] 'a lawyer shall not . . . (4) Engage in conduct involving dishonesty fraud deceit or misrepresentation.'" See ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1414 (1978). See also Cohen, Afraid of Ghosts: Lawyers May Face Real Trouble When They 'Sort of' Represent Someone, 80 ABA Journal (Dec. 1997). Because the courts that created these tests have not yet used them to sanction a ghost attorney, these tests are best seen as guidelines for the ABA ethics committee. Id.

⁴⁶ This also was Palomares' and the ghost's first abuse of the reparations forum. Compare Alexander v. First Sierra Commodity Corp., [1992-94 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,058 at 41,397-401 (CFTC Apr. 19, 1994) (discussing the specific requirements, set forth in Rule 12.13 of the Commission's Rules Relating to Reparation Proceedings, 17 C.F.R. §12.13, that any person "complaining of a violation of any provision of the Act or a rule, regulation or order of the Commission thereunder" do so with particularity), with Hall, ¶26,131 at 41,751 (holding the particularity requirement of Rule 12.13 inapplicable to a pro se complainant).

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The Complaint makes a sweeping and general claim that Bradshaw's "oral statements" and provisions in Bradshaw's disclosure documents, "gross[ly] misrepresent[ed] . . . all aspects of the trading implemented" in Palomares' account.⁴⁷ Identifying, however, the allegedly offending "oral statements" ultimately proved an elusive task, since Palomares' submissions leave it to the Court to guess precisely what those statements are. Indeed, at the hearing, Palomares' only concrete testimony exclusively focused on the alleged written falsehoods that he found in

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Palomares' second abuse was the fraud on the Court that he perpetrated in trying to hide the ghost. See Johnson, 868 F. Supp. 1226 at 1232. At the hearing, with coaching from his daughter, Palomares claimed that he, not an attorney, drafted the Complaint. See Tr. at 65-66. The Court finds Palomares' representation to be incredible. The clearest indication of Palomares' deception was his own (albeit improper) exercise of the attorney-client privilege when asked if he was being advised by an attorney. Id. at 64-65. See also Palomares' Answer to Interrogatories at 2. Also, after some equivocation, Palomares conceded that he "had some help" in the preparation of his Prepared Statement. Tr. at 22. Lastly, the language, format and tenor of Palomares' Complaint and subsequent filings convinces the Court that they were prepared by an attorney.

Other abuses engaged in by Palomares and the ghost attorney include: (1) the filing of vexatious and repetitious discovery motions and subpoena requests, see Tr. at 4-11; Order, dated June 3, 1999; (2) the filing of sham written testimony, which Palomares repudiated upon questioning, see infra notes 97-98 & accompanying text; and (3) the manufacturing of other evidence, see infra note 98.

⁴⁷ Complaint at 4, ¶24.

Bradshaw's CTA disclosure document,⁴⁸ a topic to which we now turn our attention.

Generally speaking, Palomares alleges that Bradshaw implemented the Recurrence trading system without regard to the account parameters and trading limitations set forth in the documents. Thus, Palomares does not suggest that Bradshaw deviated from the Recurrence system, he merely alleges that Bradshaw followed the system too closely. Palomares points to two specific sections of the Disclosure Document to support this claim of fraudulent misrepresentation, asserting that they

⁴⁸ See Enclosure 10, attached to the Complaint (Disclosure Document, James William Bradshaw, Commodity Trading Advisor, dated August 22, 1995) ("Disclosure Document").

In his attorney-prepared submissions, Palomares does recite, that in his initial conversations with Bradshaw, Bradshaw had "boasted about his trading track record and the high returns from the 'Recurrence' system." Prepared Statement at 3, ¶3. See also Complaint at 2, ¶7. At the hearing, however, the Court's multiple efforts to encourage Palomares to elaborate on any claimed oral misrepresentations met with no success. See Tr. at 21, 60, 68-76. Later in his prepared closing remarks, Palomares also made boilerplate claims that Bradshaw "misrepresent[ed] the probability, magnitude of profits, risk of loss associated with the trading futures using the computer trading program" *Id.* at 117. But aside from offering these canned legal conclusions, Palomares would not specify the manner in which Bradshaw made such misrepresentations.

Indeed, at one point in the hearing, Palomares readily admitted that all of Bradshaw's alleged misrepresentations pertaining to Recurrence were made through the Disclosure Document. *Id.* at 60-61.

falsely stated: (1) that the amount of margin of trades would be set at \$4,000 per contract;⁴⁹ and (2) that Bradshaw would limit trading volume to an average of six contracts per week.⁵⁰ He also contends that the Disclosure Document makes a third false claim: that LFG has not been the subject of any administrative actions or civil or criminal litigation in the last five years.⁵¹ The Disclosure Document, however, does not make any of these claims.

To establish that Bradshaw's trading was to be subject to a fixed \$4,000 margin per contract, Palomares resorts to a plain misreading of the Disclosure Document.

"The money management principles which the advisor will employ include: (1) On all accounts limiting the assets committed as margin for futures to generally be \$4000.00 per contract or a rate approximately 80% to 100% more than the exchange set minimum margin for that particular contract. In other words, the net asset value of the account to be divisible by \$4000.00 or approximately 80% to 100% more than the exchange set minimum margin to determine the number of contracts to be traded for a client. When extreme market conditions exist and trading ranges are

⁴⁹ Id. at 47 (Palomares) ("[The Disclosure Document] said [Bradshaw is] going to trade the minimum margin of \$4,000."). See generally id. at 47-50.

⁵⁰ Id. at 62-63 .

⁵¹ Id. at 55 (Palomares) ("I've seen a lot of [LFG] violations that was given to me by [the National Futures Association ('NFA')].").

increased, the margin requirements will be proportionally increased."⁵²

Clearly, this passage does not represent that the margin would be invariably set at \$4,000 per contract. A reading of the plain language of this provision reveals that the assets committed as margin shall either be \$4,000 or "a rate approximately 80% to 100% more than the exchange set minimum margin for that particular contract."⁵³ The disjunctive indicates that on trades where margin is required, the margin may never reach, or may in fact exceed \$4,000, depending on the circumstances. More importantly, however, Palomares brought no evidence to establish (and the accounts statements do not show) that Bradshaw violated either margin standard set forth in the paragraph.⁵⁴

Palomares alleges that Bradshaw's disclosure agreement made a second representation, this one limiting the average number of contracts traded to six per week.⁵⁵ Palomares relies on the following language for this representation:

⁵² Disclosure Document at 7.

⁵³ Id.

⁵⁴ See Tr. at 87-92.

⁵⁵ Id. at 62-63.

"The commission amount of \$10.00 plus \$4.74 for NFA and exchange fees, in total \$14.74, will be deducted per round turn contract by the FCM. (see page 12 paragraph two). Our trading program trades almost every trading day, trading an average of 6 times a week which is \$88.44 a week per contract in commissions. Please note that NFA and exchange fees may vary slightly."⁵⁶

This passages does not represent that Bradshaw would trade an average of 6 contracts a week -- only that the contracts that he traded were to be turned around about once a day.⁵⁷ This passage says that Bradshaw trades contracts on average 6 times a week at \$14.74 per round turn in LFG commissions and NFA and exchange fees.⁵⁸ Because Bradshaw is a day trader who rarely leaves contracts overnight, he will complete a round turn on a contract each day he trades for commissions and fees of \$14.74. Ergo, because Bradshaw trades an average of 6 times a week and completes a round turn on each contract at \$14.74, the result is \$88.44 for each contract he trades each week. Nothing in this passage suggests a limitation on the number of contracts Bradshaw would trade. Therefore, Bradshaw did not represent such a limitation in violation of Section 4b(a).

⁵⁶ Disclosure Document at 8.

⁵⁷ A review of the account statements shows that the provision, properly read, was not violated.

⁵⁸ Bradshaw's advisory fee is plainly disclosed elsewhere in the document. See id. at 9, 17.

Palomares' third alleged misrepresentation rests on yet another erroneous reading of the Disclosure Document. Palomares would have the Court believe that he relied, to his detriment, on the following statement for the conclusion that LFG had not, within the last five years, been the subject of any administrative actions or civil or criminal litigation:

"The required Futures Commission Merchant ("FCM") for the Managed Account Program is LFG, LLC. d.b.a. Lincco Futures Group, a Chicago corporation which is registered as a clearing Futures Commission Merchant with the CFTC and is a member of the NFA. The FCM's main office is located at 233 S. Wacker Drive, Suite 2400, Chicago, IL 60606. There has neither been any material, administrative, civil, or criminal actions pending, concluded, or on appeal against LFG or its principals with the last five years."⁵⁹

Once again, Palomares gets it wrong. The key adjective here is "material." Under Rule 4.34(k),⁶⁰ a CTA must disclose all material legal actions against FCMS that do not result in a favorable judgment. Rule 4.34(k)(2) limits "material" actions for FCMS to the following:

"(2) With respect to a futures commission merchant or an introducing broker, an action will be considered material if:

⁵⁹ Disclosure Document at 12 (emphasis added).

⁶⁰ 17 C.F.R. §4.34(k).

(i) The action would be required to be disclosed in the notes to the futures commission merchant's or introducing broker's financial statement prepared pursuant to generally accepted accounting principles;

(ii) The action was brought by the Commission; *Provided, however,* that a concluded action that did not result in civil monetary penalties exceeding \$50,000 need not be disclosed unless it involved allegations of fraud or other willful misconduct; or

(iii) The action was brought by any other federal or state regulatory agency, a non-United States regulatory agency or self-regulatory organization and involved allegations of fraud or other willful misconduct."⁶¹

At the hearing, Palomares testified that he had found a "lot of violations" for which LFG had gone through litigation, but mentioned no one violation specifically.⁶² The Court's independent review of the NFA database, however, found no violations that would constitute a material action under Rule 4.34(k)(2). None of the relevant actions would be required to be disclosed under accepted accounting principles, none exceeded \$50,000 and none involved accusations of fraud.⁶³ Furthermore, James E. Green, LFG's Divisional Counsel, testified that LFG had

⁶¹ 17 C.F.R. §4.34(k)(2) (*italics in original*).

⁶² Tr. at 55.

⁶³ LFG did settle one case for \$50,000, but because this does not exceed \$50,000 and did not involve intentional violations or fraud, it does not constitute a material action under Rule 4.34(k)(2).

no material violations during the relevant reporting period.⁶⁴ In short, the record contains no reason to doubt the truthfulness of the statement that "[t]here has neither been any material, administrative, civil, or criminal actions pending, concluded, or on appeal against LFG or its principals with the last five years."

In fact, all of Palomares' misrepresentation claims relating to the Disclosure Document are utterly frivolous. At one point in his testimony, Palomares slipped into confessing that, during the period of trading, he had not even read the document.⁶⁵ Thus, Palomares did not rely on the Disclosure

⁶⁴ Tr. at 78, 111-12.

⁶⁵ See id. at 62-63.

Palomares:: "'The Commission amount of \$10 plus 7.74 for NFA and Exchange fees, in total, \$14, will be deducted by return contract by FCM, page 12. Our trading program trades almost every trading day, trading an average of six times a week, which is \$84.44 a week per contract in commission.'"

The Court: "And he traded more than six times a week, is that correct?"

Palomares: "Yes, he did."

The Court: "When did he start trading more than six times a week?"

Palomares: "From the day he started."

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The Court: "So you knew he was trading more than six times a week?"

Palomares: "I don't know what was going on in there."

The Court: "Well, you knew he was trading more than six times a week, right?"

Palomares: "At the time I didn't know what was in the disclosure document at the time."

Id. See also Prepared Statement at 4, ¶19.

Most of the time, of course, Palomares made an unconvincing attempt to keep to the self-serving script that his ghost attorney helped him to prepare. For example, the passage quoted above continues:

The Court: "So you weren't relying on this disclosure document--"

Palomares: "I was relying entirely on this disclosure document that he's going to follow it in a more religious way."

The Court: "You just told me from the outset you knew he was trading more than six times a week, didn't you?"

Palomares: "Yes, he did."

Tr. at 63-64; See also id. at 73-76. The Court, of course, credits Palomares' admission against interest regarding his inattention to the Disclosure Document, over his unreasonable (given his contemporaneous knowledge of the actual trading in his account), evasive, equivocating, and simply inconsistent testimony to the contrary. The Court's findings in this regard are additionally buttressed by its unfavorable assessment of Palomares' demeanor in testifying. See In re Staryk, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 at 45,811 (CFTC Dec. 18, 1997).

Document (whatever its truths or falsehoods) in his trading with Bradshaw.⁶⁶ Rather than using the Disclosure Document for the

⁶⁶ As stated earlier, under the Commission's antifraud provisions, recovery depends on more than proof that a respondent made a misrepresentation involving a material fact. Recovery, among other things, additionally depends on a complainant establishing that the material misrepresentation was reasonably relied upon and the proximate cause of his trading losses.

Proximate causation and reliance are both concerned with the connection between the misrepresentations and the loss. "The concept of proximate causation restricts tort liability to those whose conduct, beyond falling within the infinite causal web leading to an injury, is a legally significant cause." Rodriguez-Cirilo v. Gracia, 115 F.3d 50, 52 (1st Cir. 1997)). See Id. at 54 (Campbell, J., concurring) ("Causation in tort law is generally divided into two concepts: causation in fact, or actual causation, and proximate causation or legal causation."); Fedorczyk v. Caribbean Cruise Lines, Ltd., 82 F.3d 69, 73 (3rd Cir. 1996) ("Causation includes cause in fact and legal causation, which is often referred to as proximate cause. Courts have often conflated cause in fact and legal causation into 'proximate cause,' but the two are distinct."). In determining the existence of proximate causation, the Commission looks to whether the respondent's violative conduct was a substantial factor in bringing about complainant's loss and also to whether the loss was a reasonably probable consequence of the respondent's conduct. See Sansom Refining Co. v. Drexel Burnham Lambert, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,596 at 36,562 (CFTC Feb. 16, 1990).

Moreover, in order to succeed, a complainant must prove that he actually relied on the alleged misrepresentations and that the reliance was justified. See Steen v. Monex Int'l. Ltd., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,245 at 38,726 (CFTC Mar. 3, 1992) (Gramm, Chairman, concurring) ("However, in order to prevail in a case involving deception or misrepresentation, the customer must . . . prove that he relied on any misrepresentation to his detriment, and that such reliance was justified.") (italics in original) (citing Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1025 (5th Cir. 1990) and Royal Am. Managers, Inc. v. IRC Holding (continued..)

purpose for which it was intended (reliance in trading), Palomares and his ghost lawyer simply combed the unread document after-the-fact, looking for flaws (using it only for reliance in

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Corp., 885 F.2d 1011, 1016 (2d Cir. 1989)); Minasian v. Standard Chartered Bank, PLC, 109 F.3d 1212, 1215 (7th Cir. 1997) ("In New Jersey, as in most other states, a person claiming to be the victim of commercial fraud must show that he justifiably relied on the other party's false statement."); Indosuez Carr Futures Inc. v. CFTC, 27 F.3d 1260, 1264-65 (7th Cir. 1994); Brown v. E.F. Hutton Group, Inc., 991 F.2d 1020, 1032 (2d Cir. 1993); Atari Corp. v. Ernst & Whinney, 970 F.2d 641, 645-46 (9th Cir. 1992). "Justifiable reliance is not a theory of contributory negligence; rather it is a limitation on a[n] . . . action which insures there is a causal connection between the misrepresentation and the plaintiff's harm. Only when the plaintiff's conduct rises to . . . [reckless] conduct . . . will reliance be unjustifiable." Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1516 (10th Cir. 1983) (citations omitted). A finding of non-reliance suggests the customer would have acted no differently had he known the truth. See Schreider v. Rouse Woodstock, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,196 at 32,514 (CFTC July 31, 1986); Jakobsen v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,812 at 31,392 (CFTC Nov. 21, 1985); Vetrone v. Manglapus, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,702 at 30,984-985 (CFTC Aug. 6, 1985).

The Court does not assume that, because misrepresentations preceded a transaction, the misrepresentation induced the transaction. Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 7, 1992) ("It is self-evident that every customer loss does not result from injurious conduct It is also evident . . . that not all violations of the Act cause harm to customers. Even when a statutory violation and customer losses are present in the same set of circumstances, a cause-and-effect relationship is not automatically assumed."). But, needless to say, where (as here) the alleged misrepresentation was not effectively communicated until after the trades, the temporal disconnect precludes a finding of reliance.

litigation). This obviously is not what the Commission had in mind in requiring the document under Rule 4.34(k), nor is it a proper use of the document in a reparations proceeding.

Having concluded that Palomares has failed to show that Bradshaw misled Palomares through his Disclosure Document or in their discussions,⁶⁷ the Court now considers Palomares' churning claim.

⁶⁷ Palomares' submissions make brief mention of conversations that he had with Bradshaw after the losses in the account began to mount. Palomares initiated all of these talks, with Bradshaw being an unwilling participant. See Prepared Statement at 3, ¶11 ("Bradshaw never initiated any telephone calls to discuss my account. Many of my phone calls were never returned. Bradshaw was extremely abrupt and whenever I asked about the losses he said: 'I'm gonna make them up to you . . . Don't worry . . . we'll build it up'" (ellipses in original)). See also Complaint at 2, ¶13. At the hearing, Palomares also complained about Bradshaw's reluctance to talk to him, see Tr. at 71, and the empty reassurances that he got when they did converse. See *id.* at 73 ("He said he promising that he's going to build it up, and he's going to make it up.").

Palomares could not have reasonably relied on Bradshaw's dismissive reassurances. Indeed, Bradshaw's unresponsiveness appeared, quite reasonably, to have alarmed, rather than calmed, Palomares. In any event, such expected expressions of optimism as those given by Bradshaw cannot support a claim of fraud. See Howard v. Haddad, 962 F.2d 328, 331 (4th Cir. 1992) (Powell, Jst., sitting by designation) (finding that statements such as "the stock was a good investment" and "the stock was a good opportunity" are puffery and are not actionable under the securities laws); accord San Leandro Emergency Med. Plan v. Philip Morris Co., 75 F.3d 801, 811 (2nd Cir. 1996) (finding statements such as Philip Morris is "'optimistic' about its earnings" and Philip Morris "'expected' Marlboro to perform well" are "puffery [which could not have] misled a reasonable investor" and are not actionable as fraudulent misrepresentations); Indemnified Capital Invs. S.A. v. R.J.
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O'Brien & Assocs., Inc., 12 F.3d 1406, 1413 (7th Cir. 1993) ("[T]he representation of the O'Briens' 'highly successful trading ability,' made in the context of soliciting a customer, can be construed as nothing but an opinion and not a false statement of material fact. If actions for fraud could be successfully maintained every time someone optimistically represents his or her trading abilities, then our courts would be hopelessly deluged with fraud suits."); Raab v. General Physics Corp., 4 F.3d 286, 289-290 (4th Cir. 1993) (finding that statements such as "the DOE Service Group is poised to carry the growth and success of 1991 well into the future" is simply a "mere expression of optimism from company spokesmen" and is a statement which lacks materiality); LaScola v. US Sprint Communications, 946 F.2d 559, 568 (7th Cir. 1991) (ruling that statements such as: "the company has a lucrative compensation plan;" "the executives are 'straight shooters;'" and "US Sprint is ethical and committed to conducting business in accordance with the law" are not actionable as fraudulent misrepresentations).

Nor was Palomares "lulled" by his unsettling contacts with Bradshaw. Lulling involves a broker or advisor who causes an investor to continue trading despite losses by reinforcing an earlier misrepresentation. See Modlin v. American Futures Group, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,059 at 49,550 (CFTC Mar. 15, 2000). As the Commission has explained:

"When a customer has been misled into opening an account by misrepresentation or omission of material fact, he may be prevented from learning the truth -- and thus discovering the fraud -- by conduct that, standing alone, is neither false nor misleading. Because such 'lulling' conduct perpetuates the effect of the initial wrongdoing, however, it may be legally significant even if it is not independently unlawful. In the absence of preexisting fraudulent activity, however, the labelling of conduct as 'lulling' does not lessen a complainant's burden to establish that the conduct at issue rises to the level of an

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Palomares Did Not Establish That Bradshaw Churned His Account

Palomares claims that Bradshaw "churned" his account.⁶⁸ Churning applies to the activity that brokers or advisors undertake when they execute trades with an excessive volume and frequency, with the intent of generating commissions or fees at the expense of advancing the investor's interests.⁶⁹ Churning is

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independent violation of the Act or Commission regulations."

Secrest v. Madda Trading Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,627 at 36,698 n. 13 (CFTC Sept. 14, 1989) (citation omitted). Palomares has not established an earlier misrepresentation or fraud and therefore cannot show lulling.

⁶⁸ See Complaint at 4, ¶¶21-22.

⁶⁹ See Booth v. Peavy Co. Commodity Servs., 430 F.2d 132, 133-34 (8th Cir. 1970). Although sharing the same name, a finding of churning in commodities accounts requires a different factual analysis than a finding of churning in securities accounts. As Professor Markham has explained,

"[C]ommodity prices are often volatile, resulting in rapid price fluctuations. This results in many short-term trading strategies that are not used in trading securities, where more stable prices prevail. Further, futures contracts are heavily leveraged, as a result of their relatively low margin requirements, and traders often move quickly in and out of commodity futures positions in order to limit their losses. These factors, coupled with the short-term existence of futures contracts, result in a frequency of trading

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conceptually related to fraudulent misrepresentation because, in essence, the investor claims that the broker misrepresented how he would trade the investor's money. That is, the investor claims he and the broker agreed on how the account would be traded and the broker traded in excess of that agreement. Similarly, churning can also be viewed as a type of unauthorized trading, because the investor claims that the broker traded the account beyond limits to which the investor agreed.⁷⁰ Viewed as either misrepresentation or unauthorized trading, churning claims have been included as an implied right of action for fraud.⁷¹

(..continued)

much higher than is commonly found in the securities industry."

Markham, Commodities Regulation: Fraud, Manipulation & Other Claims, 13A Comm. Reg. §11.03 (1995). See generally Lowe, Churning in the Commodity Futures Accounts, 5 Corp. L. Rev. 322, 338 (1982) (suggesting quantitative tests for churning are meaningless in the commodities trading context).

⁷⁰ See Evanston Bank v. Conticommodity Services Inc., 623 F. Supp. 1014, 1024 (N.D. Ill. 1985).

⁷¹ See Johnson v. Arthur Espey, Shearson, Hammill & Co., 341 F. Supp. 764, 766 (S.D.N.Y. 1972) (collecting cases).

Churning may be found even where the account showed a gain. Thus, for example, the fact that Palomares' account profited in April, would not necessarily preclude a finding of churning for that month. See Piskur v. Int'l Precious Metals Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,493 at 30,188 (CFTC Jan. 2, 1985).

To establish a claim for churning, an investor must demonstrate three elements by a preponderance of the evidence: (1) that the broker or advisor controlled the level and frequency of trading in the account; (2) that the overall volume of the broker's trading was excessive in light of the investor's trading objective; and (3) that the broker acted with the intent to defraud or in reckless disregard of the investor's interests.⁷² The first element, control, focuses on whether, in the context of the investor-broker relationship, the broker possessed "actual and as well as legal control" over the level of trading in the account.⁷³ It follows that a control inquiry may be more searching when the investor maintained a non-discretionary account. However, a control inquiry is appropriate for discretionary accounts as well, since the Commission recognizes that a particular investor may keep such a tight reign on a discretionary account that the broker may in

⁷² See Hinch v. Commonwealth Financial Group, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,056 at 45,020 (CFTC May 13, 1997).

⁷³ Lehman v. Madda Trading Co., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,417 at 29,866 (CFTC Nov. 13, 1984). See also Morris v. Stotler & Co., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,080 at 38,047 (CFTC June 27, 1991).

actuality exercise less control than the investor.⁷⁴

The second churning element addresses the "excessiveness" of the trading. While the Commission has yet to reduce the "excessiveness" inquiry to a precise rule or formula, it has provided a structure.⁷⁵ An excessiveness inquiry first focuses on determining the investor's trading objective to which the broker or advisor agreed.⁷⁶ As "excessive" is a relative term, the Court first seeks to determine this objective in order to establish the baseline against which an excessiveness claim can be measured.⁷⁷ The complainant then must show that his broker

⁷⁴ When an account is discretionary, however, the Commission presumes that the broker controlled the account, unless evidence exists that suggests the investor actually told the broker how to trade his account. See Secrest, ¶24,627 at 36,700 (while an agreement vesting plenary trading authority in a broker is prima facie evidence that the broker controlled the level of trading in the customer's account, the prima facie case may be rebutted by other relevant evidence). See also Schmidt v. Murlas Commodities, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH), ¶23,195 at 32,512 n.2 (CFTC July 29, 1986).

⁷⁵ See Fields v. Cayman Associates, Ltd., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,688 at 30,928 (CFTC Jan. 2, 1985). See also In re Paragon Futures Assoc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,266 at 38,847 (CFTC Apr. 1, 1992).

⁷⁶ See Gilbert v. Refco, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,081 at 38,059 (CFTC June 27, 1991)

⁷⁷ Id. See also, Craighead v. E. F. Hutton & Co., 899 F.2d 485, 491 (6th Cir. 1990) ("Plaintiffs' arguments reveal a misunderstanding of the obligations upon a plaintiff who brings a churning claim. Such a plaintiff need not necessarily plead an exhaustive list of transactions. But to allege something is (continued..)

traded his account in a manner exceeding some norm agreed upon by he and the broker.⁷⁸ Evidence of the parties' trading

(..continued)

'excessive' is, at its heart, to allege a comparison, and to plead a comparison with the specificity required by Rule 9(b), plaintiffs must indicate *what is being compared, and how.*" (italics in original).

⁷⁸ See Gilbert, ¶25,081 at 38,059 ("Indeed, the starting point of the excessiveness analysis should be: 'delineation of the customers investment goals, for those objectives significantly illuminate the context in which the trading took place and, indeed, form standards against which the allegations of excessiveness may be measured.'" (quoting Costello v. Oppenheimer & Co., 711 F.2d 1361, 1368 (7th Cir. 1983))).

It should be noted, however, the evidence of the customer's trading objective is not invariably required to prove churning. Some speculators may simply have no easy to articulate trading objective or strategy (beyond simply hoping to hit winning trades). The investor's lack of a concrete goal or plan, however, does not necessary bless his broker's trades. See In re Murlas, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,485 at 43,157 (CFTC Sept. 1, 1995) ("Customer silence in these circumstances cannot be reasonably construed as a license for [a broker] to disregard a customer's financial interests in selecting trades. Such silence, at most, might suggest that the [broker's] customer is open to a range of trading strategies or techniques. Moreover, even when a customer endorses aggressive trading techniques, evidence may still establish that the [broker] turned his back on his customer's financial interests by trading simply to generate commissions.") (citing Halterman v. Eastern Capital Corp., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,222 at 35,036 (CFTC Apr. 15, 1988)). When an investor cannot give evidence of a clear trading objective, the Commission still scrutinizes the broker's trading for a pattern reasonably indicative of a strategy designed to generate commissions. Fields, ¶22,688 at 30,929 ("As we stated in Lehman, we will readily infer neither that a pattern of trading which is reasonably indicative of a strategy designed to generate commissions has a legitimate, but unexplained, basis, nor that such a pattern is consistent with the customer's

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objectives generally comes from written or oral agreements, as well as the investor's acquiescence to the trading patterns in the account.⁷⁹

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trading objectives.") (citing Lehman, ¶22,417 at 29,868 n.3.). This test examines the broker's trades for patterns that reveal trading strategies to which only the most self-destructive speculator could assent, such as trading with a monthly commission-to-equity ratio of over 100%. See Lehman, ¶22,417 at 29,867 (finding churning based on a monthly commission to equity ratio of 139%). When the trading pattern indicates such an extreme strategy, the burden of proof shifts to the broker to establish that it was desired by the investor. See Fields, ¶22,688 at 30,929 ("Thus, when a respondent is confronted with prima facie evidence that he traded excessively, he must be prepared to articulate a reasonable justification for his trading.").

⁷⁹ When a investor does not object to specific trades, the Commission, in some cases, considers such "acquiescence [as] a factor . . . in determining complainant's trading objectives." DeAngelis v. Shearson/American Express, Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,753 at 31,139 (CFTC Sept. 30, 1985). See Paragon, ¶25,266 at 38,848-49 (holding that the trading at issue cannot be deemed excessive when the investors were "informed that the computer trading strategy [being employed] involved day trading" and that the investors were "generally aware that the . . . [respondents' were using the] day trading strategy and [the investors] did not disapprove of it"). In these cases, investor silence in the face of the broker's trades is interpreted not as a ratification of the broker's actions, but as evidence that the broker's trades comply with the investor's objectives. See; Gilbert, ¶25,081 at 38,059-60; Gatens v. Int'l Precious Metals Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,636 at 30,710 (CFTC June 18, 1985); Piskur, ¶22,493 at 30,188.

In other cases, however, a complainant's acquiescence to a broker's trading may have little probative weight. See Murlas, ¶26,485 at 43,156-57 (Since the investors did not have the "experience and sophistication" to understand the intricacies of
(continued..)

Once the complainant's trading objectives are established, the Court then determines how much weight to give to various objective factors that may indicate excessive trading in relationship to those trading objectives. In this undertaking, the Court generally looks at five factors: (1) high commission-to-equity ratio; (2) a high percentage of day trades; (3) the broker's departure from an agreed-upon trading strategy; (4) trading in the account while it was undermargined; and (5) in-and-out trading.⁸⁰ This, however, is not a mechanical or

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the account executives' trading, the Commission could not conclude that the investors' "failure to protest" constituted reliable evidence that the account executives traded in a manner consistent with their customers' trading objectives.).

⁸⁰ See Paragon, ¶25,266 at 38,847; See also Faber v. Paine Webber, Jackson & Curtis, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,909 at 34,220 (CFTC Sept. 9, 1987). The Commission has emphasized, however, that this list is not exclusive, and that churning may be found even if not all of the factors have been developed. See Gilbert, ¶25,081 at 38,059. Moreover "the relationship among the factors may be as important as the independent existence of each factor." Id. See also Halterman, ¶24,222 at 30,036.

formulaic exercise.⁸¹ Depending on the discovered objective, it may be appropriate to give more or less weight to a given element. For example, "if profiting from short-term market trends is an acknowledged element of a customer's trading objective, evidence of frequent day trading in the customer's account could have limited significance to a proper analysis of excessiveness."⁸²

The third churning element examines scienter: the broker's intent to trade, or his recklessness in trading,⁸³ the account for his own benefit, as opposed to that of the investor.⁸⁴ In the churning context, scienter may be inferred from objective

⁸¹ See Gilbert, ¶25,081 at 38,058.

⁸² Id. at 38,059 n.31.

⁸³ Cf. Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1281-86 (11th Cir. 1999) (concluding that most circuits find recklessness or severe recklessness will satisfy scienter requirement for a Section 10(b)(5) action under the Securities Exchange Act).

⁸⁴ Scienter is a required element of all claims under Section 4b(a) of the Act. See Hammond v. Smith Barney, Harris Upham & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,658 (CFTC Mar. 1, 1990) (explaining that the Commission's scienter requirement is consonant with that applied in the securities context). See, e.g. Craighead v. E.F. Hutton & Co., 899 F.2d 485, 489 (6th Cir. 1990); Hotmar v. Lowell H. Listrom & Co., 808 F.2d 1384, 1385 (10th Cir. 1987); Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, 767 F.2d 1498, 1501 (11th Cir. 1985); Tiernan v. Blyth, Eastman, Dillon & Co., 719 F.2d 1, 2 (1st Cir. 1983); Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980). Cf. Staryk, ¶27,206 at 45,810 (holding that scienter is an element of options fraud under Rule 33.10).

indications that the primary benefits of the broker's trading were flowing to himself rather than his customers.⁸⁵

Palomares bases his churning claim on Bradshaw's rapid trading of his account that generated fees for Bradshaw, while eventually exhausting Palomares' investment capital.⁸⁶ Although the record plainly establishes that Bradshaw controlled the trading in Palomares' account,⁸⁷ Palomares has failed to make even a prima facie showing that Bradshaw's trading was excessive in light of Palomares' objective.

As discussed earlier, the Court looks for evidence of an agreed upon trading strategy, in any (1) written agreements or (2) oral understandings between the parties, and in (3) the

⁸⁵ See Murlas, ¶26,485 at 43,157. Some of the factors that may indicate scienter are: (1) a high commission-to-equity ratio; (2) trading accounts that are open for one month or less; and (3) a high percentage of day trades. Id., at 43,158 n. 16.

⁸⁶ See Complaint at 3.

⁸⁷ The goal of the control inquiry is to determine which party was "responsible for the level of trading in the account." Lehman, ¶22,417 at 29,866. Bradshaw admitted in his answer that Palomares opened a discretionary account and executed a power of attorney in Bradshaw's favor, granting Bradshaw legal decision-making authority over the account. See Bradshaw's Answer at 2, ¶10. While the evidence suggests that Palomares monitored Bradshaw's performance, no evidence suggests that Palomares directed Bradshaw's trading or otherwise exercised more actual control over the account than Bradshaw.

investor's acquiescence to the broker's trades.⁸⁸ The record in this case contains all three types of evidence.

Both Palomares and Bradshaw acknowledge that they had an oral agreement to trade the Recurrence system.⁸⁹ From this, it is clear that Palomares' strategy envisioned day trading⁹⁰ with a system that promised that the more you traded, the more you profited.⁹¹

This evidence of Palomares' trading intentions is buttressed by Bradshaw's Disclosure Document. This document sets forth trading parameters plainly intended to provide for Recurrence-type trading.⁹² Moreover, the advisory agreement,

⁸⁸ See Gilbert, ¶25,081 at 38,059; DeAngelis, ¶22,753 at 31,138;.

⁸⁹ See Complaint at 2, ¶7 ("Bradshaw promised that he would use the 'Recurrence' futures trading system"); Prepared Statement at 3, ¶4 ("Bradshaw indicated that I can transfer my Individual Retirement Account . . . at Smith Barney to LFG and he would manage it for me using the 'Recurrence' system."); Tr. at 59 (Palomares) ("I wanted to have [Bradshaw] run my account based on the system that they had provided"); Bradshaw's Answer at 2 ("I traded pursuant to a [R]ecurrence futures trading system.").

⁹⁰ See Avco Advertisement.

⁹¹ See supra note 20.

⁹² The Disclosure Document describes Bradshaw's trading method as the following:

"The trading method used by the Trading Advisor is based upon proprietary technical and computer analysis only. It is not based on the analysis of fundamental supply and

(continued..)

which Palomares signed, provides Bradshaw with wide discretion in determining the volume and frequency of trading, and does not reveal any desired or maximum limitations on volume or frequency of trades agreed upon by these parties.⁹³

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demand factors, general economic factors and anticipated world events. It is exclusively a technical trend related method utilizing acceleration and directional velocity equations. The CTA interprets and executes with discretion (see page 10, paragraph 2), computerized trading signals for both intra-day positions (day trades) and inter-day positions (trades held beyond one day), as generated in real time only by several highly advanced technically based analytic systems programs, utilizing artificial intelligence properties and highly integrated risk avoidance factors. All analytic systems combine to form one trading method. All automated trading systems strategies utilized by the Trading advisor are proprietary and confidential."

Disclosure Document at 6. See also id. at 3 ("THE TRADING PROGRAM EMPLOYED CONSISTS OF DAY TRADING, WHICH TENDS TO GENERATE LARGE COMMISSION EXPENSES FOR THE MANAGED ACCOUNTS. THE HIGH LEVEL OF TRANSACTIONS CREATES A HIGH BREAK-EVEN POINT FOR THE CLIENT AND REDUCES THE PROBABILITY THAT TOTAL PROFITS WILL EXCEED TOTAL LOSSES.") (emphasis in original); id. at 5 (Bradshaw's focus is "utilization of computer trading system programs using advanced technical analysis and neural net design application"); id. at 8 ("Although in day-trading it is never the intention to have a position held overnight and strict stop-loss protection is always adhered to, on very rare and unforeseen occasions world events may cause the market to close inner day which could cause managed accounts to have open positions.").

⁹³ Id. at 13.

The final piece of compelling evidence of Palomares' intended trading strategy comes from his own conduct (both inside and outside the courtroom). Palomares admitted to receiving the daily and monthly account statements from LFG.⁹⁴ These account statements clearly showed a high volume of trading,⁹⁵ yet Palomares acknowledged that he never urged Bradshaw to reduce his level of trading or to otherwise trade more conservatively.⁹⁶ If, in fact, Bradshaw was trading Recurrence with too much vigor for Palomares' taste, why did Palomares fail to speak up?

The inference, of course, that one might draw from Palomares' failure to protest Bradshaw's aggressive trading strategy, is that Palomares approved of it. Knowing that, Palomares sought to conceal the true extent of his understanding of the trading, by filing a sham document with the Court. In his ghost-written Prepared Statement, Palomares proclaimed: "I did not understand the account statements which arrived

⁹⁴ See Tr. at 59.

⁹⁵ At the hearing, Palomares himself navigated the Court through the history of his account statements. See Tr. at 49-50 (pointing out instances where trades of 35 and 48 contracts were day traded).

⁹⁶ Tr. at 75. Palomares' complaints to Bradshaw were limited to grouching about the losses he was taking. See Prepared Statement at 3, ¶11.

approximately a week after the date of the transactions."⁹⁷
However, when pressed by the Court, Palomares' prepared testimony proved to be a lie.

The Court: "Wait a second. You could read the account statements, you knew how to read them."

Palomares: "Yes, I do."

. . . .

Palomares: "I understand the beginning value, number on contracts."

The Court: "The losses, the debits, the credits, how much money you had in the account. You understood all the information on those statements, is that correct?"

Palomares: "Yes, your honor." ⁹⁸

⁹⁷ Prepared Statement at 4, ¶13.

⁹⁸ Tr. at 59-60. Several pages of discussion follow this remark in the testimony in which Palomares attempts to claim that he was unaware of the volume of trading in his account. Id. at 71-74. Such statements can hardly be reconciled with other statements Palomares made. For example, one may wonder how Palomares can claim that he was unaware of the trade volume, when at another point he claims that the Daily Account Statements were difficult to read given the number of executed trades on each statement. See Palomares' Brief at 2, ¶13. Likewise, it is hard to imagine that Palomares was in the dark about his account, given that he repeatedly called Bradshaw, whenever he noticed his account was losing money. See Prepared Statement at 3, ¶11. Back at the hearing, however, Palomares finally admitted to being aware of the trading "early on." See Tr. at 74.

Palomares' sham written statements and inconsistent oral testimony completely destroy his credibility as a witness. But Palomares did more than provide false testimony. He also sought to introduce manufactured evidence into the record. Palomares attempted to introduce a document purportedly printed from the

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In short, Palomares' conduct in monitoring his account and his efforts before this Court to conceal the extent of his knowledge and sophistication,⁹⁹ further support a finding that

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NFA website that lists LFG as an entity that had been "doing business as" Neural-Tech Capital Management ("Neural-Tech"), a name under which Bradshaw also conducted business. Id. at 33 (Palomares) ("This came from NFA documents, I think you're much aware of what NFA does."). Palomares attached this document to his post-hearing brief and referred to it during the testimony and closing argument. See Tr. at 81-82, 117. The Court attaches it as Exhibit 1 to this Initial Decision. If true, this document would go a long way in supporting Palomares' claim that Bradshaw was an agent of LFG, thereby making LFG vicariously liable for any violations found against Bradshaw. The document, however, is an adulteration of the true version of the record found on the NFA website. The Court attaches this true version as Exhibit 2. A ready comparison of Palomares' document with the true version tells all. The NFA website lists all of LFG's "doing business as" names alphabetically. Yet Palomares' fraudulent document lists all of LFG's "doing business as" firms alphabetically except for one -- Neural-Tech. Clearly, Neural-Tech has been added to Palomares' document without observing the NFA's practice of alphabetical organization of names. In fact, by using the "copy" and "paste" functions on a word processor, the Court was able to copy the NFA webpage showing the alphabetical listing, paste it onto a word processor, and type in Neural-Tech in a manner that reproduced Palomares' fake document precisely.

Palomares' frivolous, vexatious and fraudulent conduct pervaded this proceeding. See supra note 46. For this reason, there is little doubt that if LFG had taken the trouble to file a properly supported motion seeking an award of its attorneys fees and costs from Palomares, that the Court would have granted it. See Carr Investments, Inc. v. CFTC, 87 F.3d 9, 14 (1st Cir. 1996).

⁹⁹ See supra notes 15, 97-98 & accompanying text.

what he wanted was winning trades, not necessarily less trades, from Bradshaw.

In the light of Palomares' trading objective, there is no indication that Bradshaw's trading was excessive. In Palomares' account, the monthly commission-to-equity ratios were 18.94%, 37.61%, 16.48%, and 28.33%, before trading trickled off.¹⁰⁰ In the absence of a trading objective that would suggest otherwise, these ratios do not establish excessive trading.¹⁰¹ Furthermore,

¹⁰⁰ For example, the subsequent two months realized commission-to-equity ratios of 4.17% and 3.35%.

While every churning case discusses the commission-to-equity ratio, few explain how the ratio is calculated. Commission-to-equity ratios are determined by dividing the commissions generated during the month by the average daily balance of the account's equity. The average daily balance is computed by adding the beginning account balance for each day a transaction occurs during the month, then dividing that sum by the number of days during that month when a transaction occurs. See In re Lincolnwood Commodities Inc., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,248 (CFTC Jan. 31, 1984). See also Fields, ¶22,688 at 30,929 n.3. In its calculation here, the Court computes the commission-to-equity ratio for each natural month. The Commission has not indicated that a method for calculating the "commission" element of the ratio. In the above calculation, this Court considers the commission to be the sum of Bradshaw's advisory fee and LFG's commission; it does not include any NFA and exchange fees.

¹⁰¹ In Gilbert, the Commission found that in the absence of an unambiguous trading objective to the contrary "monthly commission-to-equity ratios . . . [of] 33.3%, 26.4%, 30.5%, 44.7%, 14.6%, 16.9%, 13.8%, 32.6%" did not establish excessiveness. Gilbert, ¶25,081 at 38,060. See also Levine v. Refco, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 at 36,116 n.10 (CFTC July, 11, 1989) (stating a monthly commission-to-equity ratio in excess of 18% "is not, (continued..)

the evidence tends to show that Palomares understood that Bradshaw's Recurrence trading method anticipated day trading and rapid reversals in position. Although Palomares undoubtedly was oversold on technical trading by Avco,¹⁰² there is simply no

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standing alone, a sufficient basis for finding churning"); Halterman, ¶24,222 at 35,037 (stating monthly commission-to-equity ratios of 19% and 24% found to be "ambiguous when considered in the context of other relevant factors demonstrated on the record").

Cases where the Commission has found churning include: Fields, ¶22,688 at 30,929 (monthly ratios ranging from 15% to 76%); Lehman, ¶22,417 at 29,867 (139% for the fifteen days the account was open); Lincolnwood, ¶21,985 at 28,249 (steadily increasing monthly ratios ranging from 18.8% to 78% and 18% to 61.25%; rates for three months of 48%, 32.7% and 74.4%).

Although the Commission found churning in DeAngleis where the monthly commission-to-equity ratio was 17%, DeAngelis, ¶22,753 at 31,138, it has explained that the frequent depositing of money into the account lowered the monthly ratio relative other cases. Gilbert, ¶25.081 at 38,060 n.35.

¹⁰² Unfortunately, individual retail speculators, like Palomares, simply do not get it: no amount of technical or fundamental advice can help them to outguess the futures market. See Dennis, Materiality and The Efficient Capital Market Model: A Recipe for the Total Mix, 25 Wm. & Mary L.Rev. 373 (1984); Posner, Economic Analysis of Law, Ch. 15 (4th ed. 1992); Comment, The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry, 29 Stan.L.Rev. 1031 (1977); Fischel, Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities, 38 Bus.Law. 1 (1982); Lorie & Hamilton, The Stock Market: Theories And Evidence (1973); Fama, Efficient Capital Markets: A Review of Theory and Empirical Work, 25 J.Fin. 383 (1970). The efficient market model predicts that any information upon which Bradshaw, or any other broker, might base a predictive model would already be reflected in the contract price. Thus, the
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evidence that Bradshaw's implementation of Recurrence resulted in "any improper trading patterns," to support a claim of excessive trading.¹⁰³ Since Palomares has failed to prove excessive trading, he has failed to demonstrate that Bradshaw churned his account.¹⁰⁴

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outcome of retail speculative investment is unlikely to significantly outperform chance. See R&W, ¶27,193 at 45,727 n.75. Indeed, because retail speculators, like Palomares, pay commissions and fees on each trade, long-term trading is nearly always a losing proposition (except for the advisors and brokers).

¹⁰³ Paragon, ¶25,266 at 38,849. While Palomares sought to establish that on occasion the account was traded while undermargined, he was unable to identify even a single undermargined trade. See Tr. at 87-92. However, even if he had been able to do so, the Commission does not infer churning from trading involving short or occasional lapses below margin. See Murlas, ¶26,485 at 43,157.

¹⁰⁴ Searching for another theory on which to base liability, Palomares stabs in the dark for a registration violation. Specifically, he claims, without explanation, that Bradshaw acted as an Introducing Broker ("IB"), and that Bradshaw failed to register as such, as required by Section 4d(1), 7 U.S.C. §6d(1). See Tr. at 117. See also Palomares' Brief at 13. Here again, Palomares and his ghost attorney simply get it wrong. The definition of "Introducing Broker," set forth in Rule 1.3(mm), specifically provides that the term "shall not include . . . any commodity trading advisor which, acting in its capacity of commodity trading advisor . . . solely manages discretionary accounts pursuant to a power of attorney" 17 C.F.R. §1.3(mm). There is absolutely nothing in the record to suggest that Bradshaw did not meet the terms of this proviso. Moreover, it is difficult to see how such a registration violation would have caused Palomares any injury. See supra note 66. After all, Palomares wanted to trade Recurrence, and Bradshaw gave him what he wanted.

**Under Any Circumstances, LFG Is Not Liable For
Bradshaw's Conduct**

Palomares named LFG as a co-respondent, seeking to establish LFG's joint liability for Palomares' losses under the theories that Bradshaw was the agent of LFG, and that LFG failed to diligently supervise Bradshaw.¹⁰⁵ Having failed to establish Bradshaw's liability, the Court need not address these theories for reaching LFG.¹⁰⁶ Nonetheless, it will do so briefly.

Bradshaw Was Not An Agent Of LFG

Section 2(a)(1)(A)(iii) provides that "the act, omission, or failure of any official, agent, or other person acting for any other individual, . . . corporation, or trust within the scope of his employment or office shall be deemed the act, omission, or failure of such individual, . . . corporation, or trust."¹⁰⁷ Section 2(a) is a variant of the common law principle

¹⁰⁵ See Complaint at 5, ¶¶27-28.

¹⁰⁶ Palomares' post-hearing brief also contains rote recitals that LFG is liable as an aider and abettor, see 7 U.S.C. §13c(a), and as a controlling person, see 7 U.S.C. §13c(b), of Bradshaw. See Palomares' Brief at 12, ¶¶70-71. Having not been raised at any previous stage of this proceeding, the Court declines to discuss these meritless theories for reaching LFG.

¹⁰⁷ 7 U.S.C. §4.

of respondeat superior, a doctrine that imposes secondary liability on a principal for the wrongdoing of its agents.¹⁰⁸

Agency has been defined as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf . . . and consent by the other to act."¹⁰⁹ An agreement to act "on behalf" of another is not merely an agreement to provide some good or service. Rather, it is an agreement under which the principal authorizes the agent to act in a representative capacity and the

¹⁰⁸ See Rosenthal & Co. v. CFTC, 802 F.2d 963, 966 (7th Cir. 1986).

Section 2(a) departs from respondeat superior in two important respects. First, it serves as a quasi-criminal statute in the enforcement context. Id. In addition, it applies to agents who are not necessarily employees. Id.

A respondent's liability under this section depends on proving: (1) that a violation of the Act or Commission regulation actually and proximately caused the complainant's injury; (2) that the person committing the violation was the agent of the respondent; and (3) that the violation occurred within the scope of that agency. Id. at 966-67. As already discussed, Palomares has failed to establish the first necessary condition for LFG's liability under this standard.

¹⁰⁹ Restatement (Second) of Agency §1(1) (1957).

The Restatement includes control by the principal of the agent as an element of an agency agreement. See id. The Commission, however, has rejected the idea that control is essential for vicarious liability under Section 2(a)(1)(A). Wirth v. T & S Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,271 at 38,875 n.29 (CFTC Apr. 6, 1992).

agent accepts that authority.¹¹⁰ In other words, agency is an agreement in which the principal permits the agent to bind the principal to third parties.

Whether an agency exists does not depend upon the alleged principal's and agent's subjective understanding of the relationship. Rather, it depends upon objective manifestations.¹¹¹ These objective manifestations may take the form of an express written agreement or course of conduct from which an actual or apparent agency agreement may be inferred.¹¹²

¹¹⁰ See United Packinghouse Workers v. Maurer-Neuer, Inc., 272 F.2d 647, 648-49 (10th Cir. 1959), cert. denied, 362 U.S. 904 (1960); Columbia Univ. Club v. Higgins, 23 F. Supp. 572, 574 (S.D.N.Y. 1938); S.B. McMaster, Inc. v. Chevrolet Motor Co., 3 F.2d 469, 474 (E.D.S.C. 1925).

¹¹¹ See Restatement (Second) of Agency §1(1) cmt. b.

¹¹² Agency can be established by actual authority or apparent authority. See Reed v. Sage Group, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,943 at 34,300 (CFTC Oct. 14, 1987) ("Congress, the courts and the Commission have consistently recognized that Section 2(a)(1)(A) was intended to cover all forms of principal-agent relationships."). Actual authority refers to the relationship between the alleged agent and principal. Express actual authority is created when the agent acts on behalf of the principal pursuant to a written or oral agreement between the two. See Bancoklahoma Mortgage Corp. v. Capital Title Co., 194 F.3d 1089, 1104-05 (10th Cir. 1999) (citing Shelby v. Slepekis, 687 S.W.2d 231, 234 (Mo.Ct.App. 1985)). Implied actual authority is created when the course of dealing between the agent and principal or the nature of the duties that the alleged agent is assigned by the alleged principal suggests that the agent possesses authority to act in some representative capacity for the principal. Id. Implied authority derives from the actual relationship between the

(continued..)

Palomares bears the burden of proving the existence and scope of an agency relationship by a preponderance of the evidence.¹¹³ He was able to produce no direct evidence of an

(..continued)

principal and the agent, not what third parties may have been told or believe as to the nature of the relationship. Id.

"Apparent agency," like actual agency, may also be inferred from a course of conduct. Unlike actual agency, however, which focuses exclusively on the relationship between the alleged agent and principal, apparent agency examines the relationship between the alleged principal, alleged agent and the third party. See Theodore Kotsikas Foundation v. Drexel-Burnham Lambert, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,398 at 39,360 (CTFC Sept. 30, 1992); Lobb v. J.T. McKerr & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,568 at 36,441 (CFTC Dec. 14, 1989). "Apparent authority results from a manifestation by a person that another is his agent." Restatement (Second) of Agency §8 cmt. a. See also Moriarty v. Glueckert Funeral Home, Ltd., 155 F.3d 859, 866 (7th Cir. 1998). Such a manifestation may take the form of "written or spoken words or any other conduct of the principal which, reasonably interpreted, causes the third party to believe that the principal consents to have the act done on his behalf." Theodore Kotsikas, ¶25,398 at 39,360 (quoting Restatement (Second) of Agency §27 (1958)). See also Restatement (Second) of Agency §8 cmt. c (Not only must there be a manifestation of agency by the principal, but the third party must actually have reason to believe that the agent has authority to act for the principal.); Fennell v. TLB Kent Co., 865 F.2d 498, 502 (2d Cir. 1989).

¹¹³ Berisko v. Eastern Capital Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,772 at 31,223 (CFTC Oct. 1, 1985) ("It is well-settled that agency is not presumed and that the burden of showing the relationship rests upon the party asserting it.") (internal quotation marks omitted).

express agreement making Bradshaw an agent of LFG.¹¹⁴ Therefore, the Court must determine whether Palomares produced circumstantial evidence from which an express, implied or apparent agreement may be inferred. Here too, Palomares comes up short.¹¹⁵

¹¹⁴ Palomares' only proffer in support of an agency relationship was the fake NFA website list identifying LFG with Neural-Tech. See supra note 98. LFG's Divisional Counsel Green testified that LFG had no written or oral agreements to permit Bradshaw to act on LFG's behalf, and that it provided no compensation to Bradshaw. See Tr. at 96-98. Green's testimony on this point stands as unimpeached and unrebutted, and the Court fully credits it.

¹¹⁵ To begin with, Palomares does not specify what kind of agency relationship LFG and Bradshaw possessed, but simply leaves it to the Court to guess. For example, he does not specify that the purpose of the alleged agency relationship was to solicit accounts, trade accounts, or advertise LFG.

Palomares' allegations of agency are extremely vague, scattershot, and thinly supported, therefore making them easy to resolve (against him). Agency, however, is an area of Commission law where the development of more clearly defined rules might reap substantial benefits by reducing legal unpredictability (which increases costs to the regulated industry and its customers -- as well as to the taxpayers who support the increased litigation that such uncertainty spawns). In the past, the Commission has expressly avoided definite formulas and refused to identify dispositive factors that might simplify the agency inquiry. See Wirth, ¶25,271 at 38,875. Thus, in many cases, the Commission's agency inquiry is notably fact intensive and ad hoc in nature, involving few safe harbors or bright line standards, unclear lines of demarcation, an unbounded scope of inquiry, and an express, but not very useful, set of policy imperatives. See this Court's discussion in Webster v. Refco, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,578 at 47,695-702 (CFTC Feb. 1, 1999).

As best the Court can tell, Palomares alleges three facts that he believes constitute evidence of an agency relationship between LFG and Bradshaw. First, Palomares alleges that LFG allowed Bradshaw to provide him with its account opening forms.¹¹⁶ Second, Palomares alleges that both LFG and Bradshaw generally benefited from Palomares' account.¹¹⁷ Finally, Palomares alleges that LFG and Bradshaw shared commissions on his account.¹¹⁸ The Court starts with the forms.

In both his ghost-assisted Complaint and Prepared Statement, Palomares alleges that Bradshaw provided him with LFG's account opening forms.¹¹⁹ LFG's Green disputed this.¹²⁰ The Court credits Green's testimony over Palomares' scripted filings. Even if, however, Palomares had received LFG's forms from Bradshaw, that fact, without substantially more, would not

¹¹⁶ See Complaint at 2 ¶8; Prepared Statement at 3, ¶6.

¹¹⁷ See Tr. at 93.

¹¹⁸ See Tr. at 97. Palomares never uses the term "commission-splitting" but appears to complain of this activity in general terms.

¹¹⁹ See Complaint at 2, ¶8; Prepared Statement at 3, ¶6.

¹²⁰ See Tr. at 114 ("We send out account documents. Mr. Palomares has indicated that he received it from Bradshaw. We don't send out CTA documents for CTA's. CTA's don't send out account documents for us."). See also Tr. at 85.

establish a relationship of actual agency.¹²¹ Moreover, LFG's

¹²¹ Clearly, an FCM's provision of the account-opening documents through the hands of a third party may be a factor in the determination of whether that third party is the FCM's agent. See Knight v. First Commercial Fin. Group, Inc., [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,942 at 44,554 (CFTC Jan. 14, 1997); Ho v. Dohmen-Ramirez, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,221 at 32,605 (CFTC Aug. 19, 1986); Berisko, ¶22,772 at 31,223. But in and of itself, it is not a large factor. Indeed, the Commission has found the use of the FCM's forms, even in combination with other factors, insufficient to establish an agency relationship. In Taylor, the Commission considered whether a commodity pool operator ("CPO") was the agent of the FCM through which the pool traded. At the hearing stage, the Administrative Law Judge found the following: (1) the CPO "gave" its customers the FCM's forms "to sign to open the account;" (2) the CPO represented that he "traded directly through" the FCM; and (3) the FCM financially benefited through its relationship with the CPO. See Taylor v. Vista Futures, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,373 at 35,607 (CFTC Dec. 21, 1988). On that basis, the Administrative Law Judge concluded that the CPO was an agent of the FCM. See Taylor v. Vista Futures, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,165 at 38,429-30 (CFTC Nov. 20, 1991). The Commission, upon review, saw it differently. It held that the CPO's use of the FCM's forms, exclusive dealing and the FCM's financial benefit arising from the relationship did not amount to proof of an agency relationship. Id. Basically, the Commission found these facts to be consistent with a CPO that was autonomous or acting on behalf of its customers.

More recently, in Scheufler, the Commission considered whether a non-guaranteed IB was the agent of an FCM. In that case, the customer called a toll-free number in response to an infomercial. See Scheufler v. Stuart, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,171 at 45,574 (CFTC Sept. 30, 1997). An IB subsequently sent the customer documents that included the IB's information packet and the FCM's account-opening documents. Id. Shortly after the customer received the documents, the IB telephoned the customer and subsequently explained how to complete the account-opening documents. Id. The customer filled out the FCM's account-opening documents and wrote a check for \$20,000. Id. The IB sent a courier to pick

(continued..)

forms in themselves go a long way toward disproving any apparent agency.¹²²

As to Palomares' second allegation, it is undoubtedly true that LFG benefited from its relationship with Bradshaw. But mutual benefit is an presumably omnipresent factor in all freely-entered business relationships. Thus, its presence does little to sort out agency relationships from other commercial relationships between independent business entities by contract or otherwise.¹²³ FCMs and CTAs, IBs, and publishers of

(..continued)

them up (and presumably forwarded them to the FCM) and the FCM eventually set up an account for the customer. Id. Although the FCM did not directly communicate with the customer during the account-opening process and although the IB was a conduit for both the FCM's account-opening documents and the customer's deposit funds, the Commission found there was "no evidence that Trinity [, the IB,] acted as Gerald's[, the FCM,] agent." Id. at 45,577. Thus, just because an FCM's account-opening forms pass through the hands of a third party, even if that third party helps the customer open an account with the FCM, the third party is not necessarily (or probably) the FCM's agent. To establish agency, considerably more is required.

¹²² The power of attorney that Palomares signed for LFG contains a hold harmless clause and numerous other indications that clearly convey that Bradshaw's actions were to be taken on behalf of Palomares, not LFG. See Exhibit 2, Response to Order Setting Time and Place of Oral Hearing and Pre-Hearing Memorandum, dated April 22, 1999.

¹²³ See Webster, ¶27,578 at 47,698; United States v. Marroso, 250 F. Supp. 27, 30 (E.D. Mich. 1966) ("The fact that one assists another or does something for his benefit does not constitute such person an agent for another."); Taylor, ¶25,165 at 38,430 (holding that, in a case where an FCM was alleged to be a
(continued..)

commodities market information or trading methodologies complement each others' activities. Independent CTAs generally depend on their customers to trade and the FCM fills a necessary role in this trading. Likewise, FCMs benefit from the commissions generated by customers that follow an independent CTA's trade recommendations. Both FCMs and CTAs benefit from those who create a general interest in commodities trading by publicizing basic information about the markets or trading methods. However, the resulting mutual benefit does not make these nominally independent entities de facto representatives of the other(s) without proof of other, more probative facts. ¹²⁴

(..continued)

principal, the FCM's benefit arising from a commodity pool is "insufficient" to establish an agency relationship).

¹²⁴ In Reed, for example, the Commission sought to define the nature of a Section 2(a)(1)(A) relationship between two nominally independent firms who did business with each other as FCM and IB. See Reed, ¶23,943. Looking to the legislative history of Section 2a(1)(A), the Commission found that Congress commented on circumstances before the Commission and resolved the question by drawing a distinction between circumstances where an IB and FCM are independent businesses and circumstances where the IB is a "de facto branch office" of the FCM. Id. at 34,302. The Commission took this legislative history to mean that "those factors that have historically been present in almost every relationship" between an FCM and IB "will not be sufficient" to establish agency under Section 2(a)(1)(A). Id. Thus, the Commission examined the factual record to determine whether a nominally independent IB and FCM were "truly independent." Id. at 34,303.

Lastly, Palomares contends that Bradshaw and LFG shared commissions.¹²⁵ The Commission has deemed a commission-splitting agreement to be "strong evidence of a principal-agent relationship."¹²⁶ However, it is important to distinguish the disbursement of fees in Palomares' case from what the Commission considers commission-splitting. Commission-splitting results when the FCM and CTA enter an agreement to share in a commission or fee that one of them charges to the customer.¹²⁷ There is no evidence of such an agreement here.

In Palomares' case, LFG charged to Palomares' account and remitted to Bradshaw certain fees per round turn contract that were determined by Palomares' agreement with Bradshaw, not a commission-splitting agreement between LFG and Bradshaw.¹²⁸ The

¹²⁵ Tr. at 97.

¹²⁶ Ho, ¶23,221 at 32,605; accord Berisko, ¶22,772 at 31,223; Cox v. Eastern Capital Corp., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,756 at 31,153 (CFTC Oct. 1, 1985); Bogard v. Abraham-Rietz & Co., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,273 at 29,394 (July 5, 1984).

¹²⁷ Ho, ¶23,221 at 32,605; Berisko, ¶22,772 at 31,223; Cox, ¶22,756 at 31,153; Bogard, ¶22,273 at 29,394.

¹²⁸ See Disclosure Document at 9 ("There will be no monthly management fee nor any incentive fee (percentage of profits) charged by the Commodity Trading Advisor. A fee of twenty-five dollars (\$25.00) per single round turn contract will be charged and withdrawn as a professional fee for the trading advisor"). See also id. at 17 (entitled "Fee Payment Authorization") ("I [Palomares]. . . authorize [LFG] to withdraw from my account a professional charge of twenty-five dollars (continued..)

fees that LFG charged for its own services were separate from, and were not based on Bradshaw's commissions.¹²⁹ This is not a case in which the CTA acted for the purpose of soliciting accounts on the FCM's behalf, or where the CTA possessed no separate existence from the FCM.¹³⁰

In sum, the Court finds that Palomares failed to prove that Bradshaw and LFG acted as agent and principal, respectively.

(..continued)

(\$25.00) per single round turn contract traded for services rendered by James W. Bradshaw, CTA, and issue to him a monthly payment in total of these trades based on my account's preceding monthly activity.").

As LFG's Green explained,

"Mr. Bradshaw would say this is what I'm to be paid, Mr. Palomares says that's fine and we paid them. We're simply the brokers, we're the people in the middle. We hold it, he tells us to send the monies, we send it. That's all."

Tr. at 97.

¹²⁹ See Disclosure Document at 8-9; Tr. at 95-99 (Green).

¹³⁰ Cf. Reed, ¶23,943 at 34,303-04.

LFG Had No Duty To Supervise Bradshaw

Palomares contends LFG breached its duty to diligently supervise Bradshaw. LFG, however, had no such duty.

Rule 166.3 which states:

"Each Commission registrant . . . must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised, or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant."¹³¹

The Commission has made it clear that, "[t]he basic purpose of [Rule 166.3] is to protect customers by ensuring that their dealings with the employees of Commission registrants will be reviewed by other officials in the firm."¹³² The duty also extends to "agents" who are not employees.¹³³ Because Bradshaw

¹³¹ 17 C.F.R. §166.3.

¹³² Adoption of Customer Protection Rules, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,642 at 22,624 (July 24, 1978). See also Sherman v. Sokoloff, 570 F. Supp. 1266, 1271 (S.D.N.Y. 1983) ("[I]t is altogether clear from the releases accompanying the proposal and later adoption of §166.3 that its purpose is to insure that employees are properly supervised, not to impose a general duty to police the trading in every account carried by the FCM.").

¹³³ See Rules Pertaining to Registration and Regulatory Requirements for Introducing Brokers, and Associated Persons of Introducing Brokers, Commodity Trading Advisors and Commodity
(continued..)

did not act on LFG's behalf as an employee or agent or in any other capacity, LFG possessed no duty to supervise Bradshaw's activities under Rule 166.3.

Order

For the reasons stated above the Court FINDS that the complainant has failed to establish that the respondents are liable to him for violations of the Act or Commission regulations. Accordingly, the Complaint of Nicanor P. Palomares

(..continued)

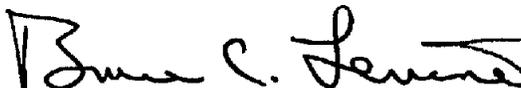
Pool Operators, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,792 at 27,233-34 (Aug. 3, 1983) ("[A]ll . . . Commission registrants except associated persons with no supervisory duties, must diligently supervise the commodity-related activities of persons acting on its behalf.").

The Commission, has refused to extend an FCM's liability under Rule 166.3 to agents acting outside the scope of an their agency. See Taylor, ¶25,165 at 38,430 ("Because the activity at issue was not in furtherance of Cheney's agency with respondents, there is no violation of §166.3."); Lobb, ¶24,568 at 36,445.

against respondents James W. Bradshaw, d/b/a Neural-Tech Capital Management and LFG, LLC is hereby **DISMISSED** with prejudice.

IT IS SO ORDERED.¹³⁴

On this 2nd day of October, 2000



Bruce C. Levine
Administrative Law Judge

¹³⁴ Under 17 C.F.R. §§12.10, 12.314 and 12.401(a), any party may appeal an Initial Decision to the Commission by serving upon all parties and filing with the Proceedings Clerk a notice of appeal within 20 days of the date of the Initial Decision. If a 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.

Exhibit 1

EX. P-③

No Regulatory Actions against NFA ID 0264185	
CFTC Reparations Cases Detail BRADSHAW, JAMES WILLIAM NFA ID 0264185	
<p>Important Information Regarding Reparations: Reparations claims are not enforcement actions. They are attempts by customers to resolve futures-related disputes. The number of reparations claims filed does not necessarily mean that the individual or firm violated any rules. Some of the claims may have been dismissed, settled or withdrawn.</p>	
Case Numbers	
99-R015; 98-R046	
<p>At this time, no further data is available in the system. For more information on reparations, contact the Commodity Futures Trading Commission at (202) 418-5508.</p>	
NFA Arbitration Awards Detail BRADSHAW, JAMES WILLIAM NFA ID 0264185	
<p>Important Information Regarding Arbitrations: Arbitration is a dispute resolution forum. It is not a regulatory action. Arbitration information is available for NFA cases involving disputes between public customers and NFA Members if an award has been rendered. The information provided does not include cases which were closed before January 1, 1990, cases which are still pending or cases which were settled, withdrawn or rejected. However, even when an award is made public, the names of some parties may not be disclosed. Customers can choose to keep their identities confidential. Also, the names of parties who have settled their part in the cases are not disclosed.</p>	
No NFA Arbitration Awards involving NFA ID 0264185	

Details and Status LFG LLC NFA ID 0210312			
Regulatory Actions		Current Status	
Agency	Number	APPROVED FOREIGN FIRM AGENT	
NFA	1	APPROVED NFA MEMBER	
CFTC	1	REGISTERED FUTURES COMMISSION MERCHANT	
Exchanges	27		
NFA Arbitration Awards	12	Name	Doing Business As
CFTC Reparations Cases	85		Formerly Known As
		LFG LLC	NEURAL-TECH CAPITAL MANAGEMENT; ADVANCED RETAIL BROKERAGE GROUP; CUSTOM BROKERAGE & SERVICES; DANIELS TRADING GROUP; ETG/EXCELL TRADING GROUP; FUTURES ONLINE; GLOBAL SERVICES DIVISION; GSD; HAMMER TRADING; INTERMARKET; INTERMARKET TRADING GROUP; KEYSTONE; KEYSTONE INTERMARKET; KEYSTONE MARKETING SERVICES; KMS; LFG; LGU; LINNCO; LINNCO FUTURES GROUP; PROFESSIONAL SERVICES DIVISION; PROFESSIONAL SERVICES GROUP; ZAPFUTURES

16/21

Exhibit 2

NATIONAL FUTURES ASSOCIATION

Background Affiliation Status Information Center

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BASIC Details and Status			
LFG LLC			
NFA ID 0210312			
Show Main Office Address Show Listed Principals Show Membership/Registration History			
Regulatory Actions		Current Status	
Agency	Number	•APPROVED FOREIGN FIRM AGENT	
NFA	1	•REGISTERED FUTURES COMMISSION MERCHANT	
CFTC	1		
Exchanges	34	Name	Doing Business As
NFA Arbitration Awards			Formerly Known As
Role	Number	LFG	LINNCO FUTURES GROUP INC
Claimant	0	LLC	
Respondent	17		
CFTC Reparations Cases			
99		ADVANCED RETAIL BROKERAGE GROUP; CUSTOM BROKERAGE & SERVICES; DANIELS TRADING GROUP; ETG/EXCELL TRADING GROUP; FUTURES ONLINE; GLOBAL SERVICES DIVISION; GSD; HAMMER TRADING; INTERMARKET; INTERMARKET TRADING GROUP; KEYSTONE; KEYSTONE INTERMARKET; KEYSTONE MARKETING SERVICES; KMS; LFG; LGU; LINNCO; LINNCO FUTURES GROUP; PROFESSIONAL SERVICES DIVISION; PROFESSIONAL SERVICES GROUP; ZAPFUTURES	

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