



U.S. COMMODITY FUTURES TRADING COMMISSION

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In the Matter of *
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R&W TECHNICAL SERVICES, LTD., *
GREGORY M. REAGAN, and * CFTC Docket No. 96-3
DOROTHY MOBLEY WORSHAM, as *
Executrix of the Estate of *
Marshall L. Worsham, *
*
Respondents. *
*

INITIAL DECISION

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Before: Bruce C. Levine, Administrative Law Judge

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Overview

This is a story of high-tech charlatanism: the sale of computerized futures trading systems to retail speculators. Gregory M. Reagan and Marshall L. Worsham formed R&W Technical Services, Ltd. ("R&W"), a Texas limited liability company, in 1993 to sell these systems. R&W continues to advertise regularly in Futures magazine.

Reagan claims to have developed mathematical formulae that are reflected in the computer software sold by R&W. A former golf professional with a high school education, he is a self-proclaimed technical guru. In examining past futures price movements, he has discovered "patterns" which predict the future. R&W sells these secrets to the public. (Not surprisingly, at the hearing, respondents failed to submit any evidence to corroborate Reagan's testimony about himself or R&W's products.)

R&W's advertising and promotional brochures reflect Reagan's message. With the assistance of R&W's computer programs, "[f]utures are, in actuality, less risky than equities," and a speculator will "begin earning triple-digit returns almost immediately." The advertisements claim that these results are supported by seven years of actual trading, and that respondents are selling the programs to "increase our own trading capital." These are falsehoods.

In fact, neither R&W nor Reagan have ever opened a futures trading account, and the late Marshall L. Worsham's brief

encounter with futures trading post-dates the 1987-1993 period in which the advertised trading was alleged to have occurred.

"[W]e wanted to give people the impression that we were actually trading so that they could see why [we] would sell something that was so good. One of the toughest reasons to make this sale, no matter how great the product is and [whether] it works or not, is the too good to be true syndrome. So we tried any attempt we could to get people away from the too good to be true [syndrome], why would you sell it if it was so good?"¹

That's a good question, one for which respondents did not have an honest answer.

In short, respondents engaged in systematic fraud in connection with the trading of futures contracts, warranting the severe sanctions ordered herein.

Accordingly, the Court enters a **CEASE AND DESIST ORDER** precluding respondents R&W Technical Services, Inc., and Gregory M. Reagan from repeating their numerous violations of the Commodity Exchange Act and the Commission's implementing regulations. Additionally, respondents R&W Technical Services, Inc., and Gregory M. Reagan are **PERMANENTLY PROHIBITED** from **TRADING** on any contract market. Furthermore, respondents R&W Technical Services, Inc., and Gregory M. Reagan are **ORDERED** to **PAY** a civil monetary penalty of **\$7,125,000**. The Division's request, however, for an order of restitution is **DENIED**. Therefore, the Complaint, as to all matters concerning Dorothy

¹ Division Exhibit 20, Deposition of Gregory M. Reagan, dated October 7, 1994 at 123 (emphasis added).

Mobley Worsham, as executrix of the estate of Marshall L. Worsham, is **DISMISSED**.

Procedural Background

On March 19, 1996, the Commodity Futures Trading Commission filed a Complaint against respondents R&W Technical Services, Ltd. ("R&W"), Gregory M. Reagan, and Marshall L. Worsham.² In the four count Complaint, the Division of Enforcement alleges that, from at least April 1993 to the filing of the Complaint, respondents violated various fraud, registration, and recordkeeping provisions of the Commodity Exchange Act ("Act") and the Commission's implementing regulations in the course of engaging in the business of selling computerized trading systems. By the Complaint, the Commission instituted this proceeding to consider whether the Division's allegations are true, and if so, whether respondents should be sanctioned by the entering of cease-and-desist orders, trading bans, civil monetary penalties and/or orders of restitution.³

On April 25, 1996, respondents, through counsel, filed a joint Answer generally denying the Division's allegations of wrongdoing.⁴

² Complaint And Notice Of Hearing Pursuant To Sections 6(c), 6(d), 8a(3) And 8a(4) Of The Commodity Exchange Act, As Amended, dated March 19, 1996.

³ Id. at Parts III-IV.

⁴ Respondents' Answer To The Complaint, dated April 25, 1996.

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After completion of discovery, the Court conducted an oral hearing in this matter on August 13, 1997 at the United States Tax Court in Chicago, Illinois. All parties have submitted post-hearing initial briefs,⁵ and reply briefs.⁶ Accordingly, this case is now ripe for decision.

The Respondents, Their Product And Marketing Activities

The R&W Partnership

Worsham and Reagan formed R&W, a Texas limited liability company, in early 1993. Neither individual nor the company has ever been registered with the Commission in any capacity.⁷ From

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Several months after the filing of the joint Answer, Marshall L. Worsham died. On motion of the Division, and over her objection, the Court substituted Mr. Worsham's surviving spouse, Dorothy Mobley Worsham, as a respondent in this case. In re R&W Technical Services, Ltd., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,030 (CFTC April 10, 1997). Mrs. Worsham's substitution is limited in two respects. It is confined to her capacity as executrix of Mr. Worsham's estate. Id. at 44,893-44,894. It is also restricted to this proceeding's consideration of an order of restitution, since all other aspects of the Commission's action against Mr. Worsham abated upon his death. Id. at 44,892-44,893.

For purposes of discussion, however, this opinion continues to refer to Mr. Worsham as one of the respondents.

⁵ Division of Enforcement's Post-Hearing Brief ("Division's Brief"), dated September 23, 1997; Respondents' Post-Hearing Memorandum ("Respondents' Brief"), dated September 19, 1997.

⁶ Division of Enforcement's Reply Brief, dated October 9, 1997; Respondents' Reply Memorandum, ("Respondents' Reply Brief"), dated October 8, 1997.

⁷ Complaint at ¶¶1-3; Answer at ¶¶1-3. After the death of Worsham in September 1996, Reagan acquired sole ownership of R&W.
(continued..)

its inception, R&W has engaged in the development and sale of computer programs designed to generate trade signals for the purchase and sale of various commodity futures contracts.

Worsham, as the managing partner, provided the start-up capital for R&W, and managed its day-to-day operations. Reagan, as the technical partner, created the trading model for each commodity contract, developed the requisite software packages necessary to run the R&W programs, marketed the R&W products to prospective customers, and trained others to successfully market the R&W products.⁸

Aided by a staff of three clerical assistants, a customer support technician and two salesmen,⁹ respondents have marketed their products to investors primarily through monthly advertisements in Futures magazine.¹⁰ During the period covered by the Complaint, both Worsham and Reagan inspected and approved the monthly advertisements placed in Futures magazine by R&W, as

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Transcript of August 13, 1997 Oral Hearing ("Tr.") at 99 (Testimony of Gregory M. Reagan).

⁸ Division Exhibit 20, Deposition of Gregory M. Reagan ("Reagan Deposition"), dated October 7, 1994 at 29-30 and 42; Tr. at 139 (Testimony of Gregory M. Reagan).

⁹ Reagan Deposition at 30, 45, 47 and 70.

¹⁰ Id. at 42 and 70. See Division Exhibits 1-5 and 9-11. R&W also occasionally placed advertisements in other magazines, in a country club publication and in medical journals. Tr. at 121 (Testimony of Gregory M. Reagan); Reagan Deposition at 88.

well as any promotional materials distributed to prospective customers.¹¹

When an investor responded to an advertisement, R&W sent the investor an informational package which described the R&W trading systems, identified Reagan as the developer of the systems, represented past trading profits generated by the various trading systems and listed satisfied clients.¹² If the investor did not reply to the informational package, either Reagan, Worsham or another R&W employee placed a follow up phone call to discuss the merits of the R&W trading systems, and to ultimately solicit a sale of R&W's products.¹³

If an investor purchased any of the R&W trading systems,¹⁴ R&W would send the customer a package of software materials along with a warranty certificate and a license agreement. The software package consisted of three separate programs: (1) the particular R&W trading system purchased by the customer, (2) Supercharts by Omega Research, and (3) Quiktrieve by CSI. The Supercharts program served as the operating system on which the

¹¹ Reagan Deposition at 65-70 and 90-91; Tr. at 148-149 (Testimony of Gregory M. Reagan).

¹² Reagan Deposition at 42. See Division Exhibit 18.

¹³ Reagan Deposition at 42-43 and 70-71; Tr. at 122 (Testimony of Gregory M. Reagan).

¹⁴ R&W marketed computer trading systems for 26 commodities. For example, CurrencyMaster executed algorithms for four currency futures contracts: the Deutschemark, the Pound, the Yen and the Swiss Franc. Master Suite, the latest R&W product, generated trade signals for the four currency contracts, as well as the S&P 500, Treasury Bond, and Eurodollar contracts. Tr. at 101 (Testimony of Gregory M. Reagan).

R&W trading systems executed. Quiktrieve provided the investor with the computer interface necessary to download daily futures price data that the user would purchase from an independent data vendor.¹⁵

The R&W Trading Systems

The R&W trading systems consist of mathematical models, or algorithms,¹⁶ developed by Reagan that analyze current futures prices against historical price trends. The algorithms attempt to isolate price trends that historically have forecast significant reversals in futures prices, and as a result, indicate advantageous times for the investor to enter and exit the market. Reagan believes that futures prices systematically fluctuate in reoccurring seven-year cycles.¹⁷ He specifically designed the algorithms to ignore market-specific information and activity, known as "fundamentals," in favor of abstract mathematical trends.¹⁸

¹⁵ Reagan Deposition at 51-54; Tr. at 107-108 (Testimony of Gregory M. Reagan).

¹⁶ An algorithm is a mathematical rule or procedure for solving a problem. Webster's II New Riverside University Dictionary (1984).

¹⁷ Tr. at 131-132.

¹⁸

The Court: "So it's your belief....no amount of studying of fundamentals and market event[s] out there which may or may not move a price of a commodity...is going to be helpful in terms of outguessing the market?"

Mr. Reagan: "On a consistent basis, that's correct."

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The Court: "But it's your belief that the discernment of abstract mathematical trends which are divorced from fundamentals do have utility as a means for consistently outperforming the market?"

Mr. Reagan: "Absolutely, sir."

Tr. at 132-133.

Technical analysts (as Reagan purports to be) and fundamental analysts share a common goal: to profit in financial markets through calculated trading. In pursuit of profits, each trading strategy attempts to predict price changes in the market before they occur and to buy or sell before the market reacts. Both believe that the time lag in which the markets adjust to events is so significant that the properly-informed retail speculator can exploit this failing. At this point, the two trading strategies diverge.

While fundamental analysts believe that the market fails to react quickly to the ongoing stream of price-related information, technical analysts believe that the market more simply fails to react at all to past transaction data in the form of price trends.

Fundamental analysts believe that price-related information drives the market. As a result, fundamental analysts attempt to discover all information relevant to a particular financial market (such as interest rates, inflation, and factors of supply and demand), and then gauge the impact of that information on the expected future price for a given asset. Fundamental analysis thus requires the investor to develop empirical formulas which somehow quantify information and identify the proper time to enter and exit a market. With an empirical formula, the fundamental analyst forms an expectation as to the price that will clear the market in light of the newly acquired information, and then takes a position that should prove profitable should the expectation become realized. See infra note 75 and authorities cited therein.

Technical analysis eschews this approach. Like fundamental analysts, technical analysts acknowledge that information drives the market. However, technical analysts believe that to quantify all the factors that influence supply and demand for a given asset and then determine their combined effect on price is a nearly impossible task. As a result, the technical analyst seeks to identify and exploit nonrandom price patterns. To maximize profits, the technical analyst must enter the market as close to
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When the algorithm identifies a significant expected price movement, the trading system generates a signal to either buy or sell a particular contract, or place a stop-loss order¹⁹ on an existing contract. Except for the stop-loss orders, the trading system does not specify the price at which the contract should be executed -- the trading system merely instructs the investor to buy or sell "at the open," i.e. at whatever price level the market commences trading. Although Reagan acknowledges that prices "at the open" are not static,²⁰ and in fact, may be dramatically affected due to overnight trading in other markets or as a result of early-morning industry announcements, he rationalizes that the algorithms incorporate the average quantity and quality of past fundamental information available to the

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the beginning of the price trend as possible and exit before prices reverse. Marshall, Futures and Option Contracting, (1989) at 420-421.

¹⁹ A "stop-loss order" is an order to buy or sell a futures contract in the trading ring or pit "when a particular price level is reached." CFTC Glossary 38 (1997).

²⁰ Reagan recognizes that the opening consists of a range of prices, not one price.

"You'll have an opening range, but if you take the [average] of that opening, sometimes you get....a lousy fill, but....sometimes you get a good fill. But if you take the [average] open [price], you can go to the bank on that by the rule of numbers."

Tr. at 118.

market on a daily basis.²¹

Reagan professes to have developed the algorithms himself, even though he has a limited education in mathematics and little experience in financial markets.²² As an "equity raiser" (i.e., salesperson)²³ at Dean Witter Reynolds in the cash market for sugar, Reagan claims to have begun to track prices in various

²¹ Reagan explains

"[I]t's totally irrelevant to me what's going to happen once that number is after [the prior] day's close....[The algorithm has] already taken into consideration all the past ...fundamental information that would come at 7:30[a.m.] So it's extremely imperative that you market to the open because after the open there are no certainties anymore."

Tr. at 117.

²² Reagan has never studied mathematics beyond high school, never trained with computers and, except for a three month sales position with First Commodity Corp. of Boston in 1973, never held a job in the futures industry. See Tr. at 103-106, Reagan Deposition at 39-40. In his own words, Reagan says

"[W]hat my background is, I'm a golf professional...."

Reagan Deposition at 31.

"I aced my high school mathematics. I've always been gifted in mathematics. I believe I'm as good as the next person. In fact, better than the next person."

Tr. at 103.

"Now I am self educated[,] self taught. And the way I taught myself, I used to read the Wall Street Journal every day cover to cover, Baron's cover to cover. Because I played golf and I loved the financial world."

Reagan Deposition at 40.

²³ Tr. at 140-141.

commodity futures markets in his spare time.²⁴ Driven solely by his strong intuition regarding market trends, Reagan began to chart market data on his own, identify past market trends and develop a mathematical equation to generate signals to buy and sell futures contracts in the historical market.²⁵ At some

²⁴ Reagan describes this conversion from salesman to analyst.

"I was the principal equity raiser for this firm, so I didn't have much to do during the day for trading. I used to spend most of my time in Dean Witter's offices in London at One World Trade Center looking at the way their technical analysis people came up with decisions to buy and sell.

And basically they had a wall full of charts and they had one to two gentlemen that would go in there with rulers and they would come up with a determination to sell a market or buy a market. I would look at those charts and I would ask them, 'what are you recommending tomorrow?' And, for instance, they'd say, 'This market's going down.' And I would say, 'No, it's not. On what basis do you make that [decision]?' And they had no good reason.

And I found that very interesting and I started looking and seeing patterns and I started making some of my own calculations in my head. And on a day-to-day basis I realized I was projecting or forecasting the direction of the market on a much more accurate basis than they were, so I therefore decided that this is something I would like to look into."

Tr. at 104-105.

²⁵ Reagan's studies resulted in a forecasting system predicated on three axioms.

"I would study [the] data and I would look for historical price patterns and I would look at reasons why markets moved, either made sharp movements up or made sharp movements down, I came up with formulas.

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point, Reagan converted his handwritten analyses into computer programs.²⁶ For a short time prior to his R&W partnership with Worsham, Reagan found an investor to back the development and

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I built this system on three predicat[e]s, the three constants and the only constants that a market has, and that is that there's an open, that there's a close, and that history repeats itself. Those are the only three variables or constants that a market has."

Tr. at 105.

²⁶ At this point, Reagan found a collaborator to do the programming.

Mr. Schoeman: "So how did it come about that these -- that this system was turned into a form of a program?"

Mr. Reagan: "Well, my wife suggested -- we go to church and there's a gentleman there, Dr. Steve Corley, who everyone in church knew was very brilliant. I didn't know exactly what he did, we just knew he was a very brilliant person."

Mr. Schoeman: "What was his name?"

Mr. Reagan: "Dr. Steve Corley. She suggested I ask him for help. He knows computers. So I was hesitant to do so, but I did. I asked him for help and he said 'sure.' And I said, 'what would you like in return?' He said, 'if you do my laundry and feed me, I'll help you.' So I was ecstatic and he did."

Mr. Schoeman: "And did he do the programming?"

Mr. Reagan: "He was the one who actually took my mathematical formulas and translated them into programs."

Tr. at 106.

application of his trading systems.²⁷ However, the investor withdrew because "the pocket book was not deep enough."²⁸

Reagan attempts to distinguish his trading systems as a forecasting tool from those marketed by other technical analysts on the grounds that his systems are not "curve-fitted."²⁹ Although Reagan readily concedes that he adjusted his algorithms to produce trade signals which followed a successful trading

²⁷ Reagan Deposition at 37.

²⁸ Id.

²⁹ Tr. at 125.

Technical analysts typically sift through vast quantities of historic data in search of repeating price patterns. Employing computer programming to highlight specific market activity, the analyst can simulate trading by assuming short or long positions in the market immediately after the highlighted activity. By this post hoc approach, the technical analyst can test numerous trading strategies against several years of price data in various financial markets. Ultimately, the technical analyst will develop a trading model that triggers signals to buy or sell upon the occurrence of a predetermined market event. This involves parametric optimization or "curve fitting." Marshall (1989) at 416-420.

In short, to "curve-fit" a trading system means to look retrospectively at past market movements and to develop a trading program that generates trade signals which would replicate a successful trading strategy for the time period observed. Reagan describes curve-fitting as "taking the original algorithm and changing it or making it, let's say [the algorithm] missed a trade, changing the algorithm or the parameters so it picks the trade up." Reagan Deposition at 125. He recognizes the approach as a pure exercise in hindsight, having no predictive power. Tr. at 129; see also Reagan Deposition at 157 ("And there are people ripping people off and hurting people, you know, go after those guys, would you please.")

For discussion of other generally recognized deficiencies in technical modeling, see Division Exhibit 22, Declaration of Daniel Driscoll ("Driscoll Declaration"), dated April 10, 1997 at 6-7; Marshall (1980) at 420-422.

strategy during his test periods,³⁰ he claims not to have done any further tinkering to achieve the results for the years indicated in the R&W advertisements.³¹ This is because "history repeats itself" in seven year cycles, and once Reagan had properly curve fitted one cycle, there was no need to make any further adjustments to the next cycle of historical trading.

³⁰ Reagan made the following comments:

"[I]f [the algorithm has] said to me [that] I'm flat [i.e., no existing contract position] but [the deutsche]mark is going long [i.e., investor should have invested in a long position], then I said to myself, okay, what is in the movement that I haven't taken into consideration? And one of the things might have been the stop[-loss order] was too tight and it was kicking me out [i.e., improperly recommending an exit signal], so I had to broaden my stop."

Tr. at 127.

"I would write my algorithm to the first contract period....I would write the algorithm and I would [] see...what signal I would have going into the second quarter[.] If I was correct, I knew that I was going in the right direction."

Tr. at 126.

"So if my development was from 1970, at 1977 I would work to...make my algorithms as accurate as I can, then I would test for 1978 on those methods, feeding in 1978, not having 1978 going on, it worked for there, not working good here, so I'm going to curve-fit it again, see."

Tr. at 128.

³¹ Tr. at 133.

Thus, he argues that his advertised results -- falling into a second historical cycle -- were successfully blind-tested.³²

The Court finds Reagan's self-serving testimony and trite explanations concerning the efficacy of his trading systems to be incredible, and gives them no weight. In putting on their case, respondents elected to allow Reagan's testimony to stand alone. Significantly, respondents proffered not a single corroborative witness or even one page of material to document Reagan's past efforts of trend analysis or to identify the alleged seven-year price cycles. Nor did they provide any underlying data or protocols in support of their purported testing of R&W's trading systems.³³

³² Tr. at 124-130 and 133.

Reagan fails to explain how his methodology in fitting the first seven year period of historical data differed from that of other technicians so as to uniquely accomplish this phenomenon. And even assuming that it did, Reagan's approach remained entirely retrospective. That is, any algorithm that was unsuccessful over the second seven year test period necessarily would have been discarded or refitted. Thus, Reagan's professed approach remains a reiteration of the past, not a test of the present or future. In short, he identified price patterns in part of the historical market, wrote an algorithm to track a successful trading strategy in that market, and reported these results ex post.

³³ Although they offered no customer witnesses of their own, respondents suggest that the testimony of one of the Division's two broker witnesses supports the efficacy of their systems. Respondents' Brief at 6. Thomas Otten, a broker with Prudential Securities, testified that in one test of R&W's systems, he generated a \$60,000 profit, and that he generally likes the product. Tr. at 26 and 40. Nonetheless, he also stated that he could not replicate the higher profits advertised by R&W, Tr. at 26, nor did he believe its claims to be true.

"[T]hey're in the business of selling software so they're making the percentages very good. I'm in the business of trading,
(continued..)

As discussed below, R&W, Worsham and Reagan undertook an advertising and promotional campaign characterized by fantastic claims of profitability and blatant falsehoods concerning their trading experience. On the strength of his word alone, Reagan would have the Court find that a former golf professional with no formal training beyond high school, and little in the way of admitted assets,³⁴ has uncovered the deepest secrets of the

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you know, in the real world, so I think it takes more money than they claim it takes to do it comfortably, and so naturally the percentages would be less on a larger amount of money."

Tr. at 19.

Moreover, like the evidence of customer losses in the record, Otten's testimony regarding profits is "mere[ly] anecdotal" in the "absence of documentary evidence of the accounts." Respondents' Brief at 7. Additionally, any favorable, but limited, results that Otten may have had trading R&W programs could easily have been the result of chance. Thus, like the evidence of losses, the evidence of profits is "gossamer" and of "no weight." Id.

John Nolan Cullen, a broker with J.C. Bradford, also testified as a Division witness. Although Cullen is listed as a reference in R&W promotional material, Exhibit 18 at 15, he was critical of the system, and would use it only in a modified form. Tr. at 92-97.

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Mr. Terrell: "Do you own your own home?"

Mr. Reagan: "No."

Mr. Terrell: "Do you rent?"

Mr. Reagan: "Yes."

Mr. Terrell: "Do you have any securities accounts?"

Mr. Reagan: "No."

(continued..)

futures markets heretofore unavailable to others. For the Court to make such a preposterous finding, might be something even more than an abuse of discretion.

The R&W Advertisements And Promotional Material

The Claims

"Futures are, in actuality, less risky than equities. They produce much less volatility in one's capital than equal amounts invested in stock. One can be wrong 50-60 percent of the time and still make a fortune."

Division Exhibit 18 (R&W promotional brochure entitled "Money...Money...Money... Commodity Futures Trading -- A Disciplined, Challenging Way To Achieve High Profits!," by Greg M. Reagan).

(..continued)

Mr. Terrell: "Do you know what the value is of your bank accounts?"

Mr. Reagan: "Last week when I got home it was \$1,847 when I made a deposit."

Mr. Terrell: "Do you own any real estate property anywhere[]?"

Mr. Reagan: "No sir. I wish I did."

Mr. Terrell: "Do you own an automobile?"

Mr. Reagan: "No."

Tr. at 200-01. Compare Reagan Deposition at 149 ("I have a wrap around [mortgage] on my house.").

R&W solicited prospective customers solely through magazine advertisements.³⁵ Over time, the advertisements evolved from plain sentences in ordinary type to colorful graphics surrounded by artwork. The underlying message, however, remains the same. They promise the customer fantastic profits at virtually no risk. And respondents backed these messages with reports of fortunes that have been consistently made trading R&W's systems.

The monthly advertisements generally consisted of statements claiming extraordinary annual returns (always over 100% for an extended time), a compilation of year-by-year trading profits generated by the R&W trading systems for the years 1987 through 1993, and a money-back guarantee.³⁶

³⁵ The past tense is used, since the Complaint covers the period from April 1993 through March 1996. The record, however, indicates that R&W continues to advertise and promote its trading systems in substantially the same manner as described herein. Since 1993, R&W has advertised in every issue of Futures magazine. Tr. at 145 (Testimony of Gregory M. Reagan).

³⁶ See Division Exhibits 1-5 and 9-11.

R&W provided a money-back guarantee. The guarantee provided that if, after one year, the R&W trading system did not generate profits (either real or hypothetical), then R&W would refund the customer's purchase price plus 10 percent in exchange for the return of all materials sent to the customer. Division Exhibit 16. To this date, Reagan claims that approximately 11 customers have received the 110 percent refund under the guarantee. Tr. at 119. Apparently, the refunds have all occurred since Reagan first was questioned about this matter in October 1994. See Reagan Deposition at 84 ("We have never made a refund based on the guarantee.").

It suffices to note that the record contains no evidence to reliably determine the practicality of the guarantee's conditions and the ease with which the guarantee was honored. For example, the guarantee required the investor to execute trades exactly according to the signals generated by the unaltered trading system in either an existing commodity trading account or through fictitious paper trades. Moreover, a customer could readily
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All of the advertisements refer, in one form or another, to the profitability of each trading system in terms of trades actually executed in the market. For example, certain advertisements allege that one of the trading systems "made us", i.e., R&W, substantial trading profits.³⁷ Another advertisement states that one trading system "turned a \$26,650 trading account into a \$610,000 fortune in just 7 years!"³⁸

R&W also distributed a package of promotional materials to investors who responded to the magazine advertisements.³⁹ The promotional package included several documents, including more detailed descriptions of R&W's Master Suite and CurrencyMaster,

(..continued)

alter the variables within the trading systems by changing the underlying algorithm. Among other things, the investor could vary the degree of the stop-loss orders generated by the system, the number of days in which the system "looks back" to compare contract prices, and the number of days a price movement has to occur in order to generate a positive trade signal (the "whip saw filter"). Tr. at 29-33 (Testimony of Thomas Otten). This too would invalidate the guarantee. The customer also could ignore or modify any trading signals at his discretion. Tr. at 92-98 (Testimony of John Nolan Cullen).

³⁷ Division Exhibit 1 ("a 284% average net profit").

"This proven trading system will return a profit when traded for 1 year."

Id. (emphasis added).

³⁸ Division Exhibit 10.

"You can begin earning triple-digit returns almost immediately with the R&W Master Suite."

Id.

³⁹ See Division Exhibits 6-8, 18.

year-to-year profits of each trading system from 1987 to 1993, a list of "a few of our many satisfied customers," an article on technical analysis written by Reagan, an "Executive Summary,"⁴⁰ and a set of "Questions and Answers".⁴¹ Like the magazine advertisements, the promotional package generally describes extraordinary trading profits generated by R&W trading systems.⁴²

These promotional materials seek to bolster the credibility of the respondents' trading systems and disarm any remaining customer skepticism by making several other supporting representations. For example, one undated promotional sheet contains the following question and answer:

⁴⁰ The Executive Summary purports to describe respondents' business backgrounds, and past and present business affiliations. Division Exhibit 18 at 16 ("The principals of R&W Technical Services, Ltd. [Worsham and Reagan] have a combined business experience of 72 years in the International Financial Markets.").

⁴¹ Division Exhibit 18 at 18; see also Division Exhibit 7.

⁴² In addition, the promotional package highlights the systems' ability to generate substantial profits with the commitment of only limited capital. See e.g. Division Exhibit 18 at 4-11 and 17. More specifically, several of the promotional documents stress the absence, or limited number, of margin calls required to trade each system. For example, one of the materials states that "A certified trading record of [CurrencyMaster's] 6-year performance reveals that the largest drawdown equaled only 28% of the profits it had already made; the original equity in the account has never been touched." Id. at 17. Armed with a supporting chart, another piece concludes that the S&P Master Trading System "[yields a] 235% annual return with minimal margin calls." Id. at 4.

Of course, all of this is simply intended as further support for respondents' overriding claim that its system "maximizes profits and minimizes risk." Id. (emphasis in original).

**"IF CURRENCYMASTER IS SUCH A GREAT SYSTEM WHY ARE YOU
MARKETING IT?"**

We are selling this to increase our own trading capital! We have the bulk of our money in these 4 currencies, as well as 22 other commodities which we have also developed systems for and have been trading since 1987...."

Division Exhibit 7.

In another promotional piece written by Reagan, entitled "Money...Money...Money. Commodity Futures Trading -- A Disciplined, Challenging Way To Achieve High Profits!," Reagan describes himself as a "well-seasoned commodities trader with an excellent profits track record."⁴³ And prospective customers just don't have to take Reagan's word on the success of R&W's systems because the advertised trading results are "certified."⁴⁴

Their Falsity

In fact, R&W's promises that any customer would "make a fortune" by using its trading systems are "too good to be true."⁴⁵ And R&W's claims of certified actual trading backing the efficacy of its systems are lies as well.

⁴³ Division Exhibit 18.

⁴⁴ For example, on advertisement invites the reader to request a "certified track record" for the trading system advertised. Division Exhibit 2. And another advertisement states that the "[c]hart shows *certified* trades for the period January 1, 1987-December 31, 1992." Division Exhibit 5 (emphasis in original).

⁴⁵ Reagan Deposition at 123.

Simply put, it is undisputed that neither R&W nor Reagan have ever opened a futures trading account, and Worsham's brief encounter with futures trading post-dates the 1987-1993 period in which the advertised trading was alleged to have occurred.⁴⁶ Indeed, Reagan as much as admits that respondents' promotional references to "increas[ing] our own trading capital" and "hav[ing]" the bulk of our money in these 4 currencies, as well as 22 other commodities" were intended to be deceptive.⁴⁷ When

⁴⁶ Reagan Deposition at 14; Tr. at 141-142; see also Driscoll Declaration at 3.

The Court: "[N]either you nor any other principal at R&W, or R&W, experienced any real balance sheet reportable to IRS profits as a result of any futures trading using this or any other system, is that correct?"

Mr. Reagan: "That's correct."

Tr. at 154-155.

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Mr. Terrell: "That says you are going to -- you're raising it for your own -- you're raising -- you're selling the system to increase your own trading capital."

Mr. Reagan: "That was an attempt [by] us to answer why would we sell something that was so good. So we wanted to give people the impression that we were actually trading so that they could see why we would sell something that was so good. One of the toughest reasons to make this sale, no matter how great the product is and [whether] it works or not, is the too good to be true syndrome. So we tried, any attempt we could to get people away from the too good to be true [syndrome], why would you sell it if it was so good? I later modified it because it wasn't so."

(continued..)

asked to explain the promotional claims of past profitability, Reagan at best could only claim to have mimicked real trades by making simulated trades on a computer.⁴⁸ Thus, respondents' very explicit claims to having made real trades and real profits with little risk⁴⁹ in fact reduce to little more than their

(..continued)

Reagan Deposition at 123 (emphasis added); see also Tr. at 175 and 177.

At the oral hearing, Reagan attempted to explain away the these specific misrepresentations as innocent oversights. Tr. at 175 ("once I did discover it, I removed it"); see also Tr. at 176-179. Reagan's claim of "oversight" however is inconsistent with his admission that he intentionally inserted the false statements in the promotional copy "to give people the impression that we were actually trading...."

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The Court: "'For six years this trading system has made us a 284 percent average net profit for trading D mark, B pound, S franc and J yen.' Could you elaborate on what you meant by that statement? And specifically, what do you mean when you talk about a trading system for six years in this context having made us the stated rate of return?"

Mr. Reagan: "Yes, sir. After six years of taking the actual open, low, close, putting it into my system through my formulas on a day-to-day basis without fail and keeping account of it, at the end of six years the average return to us, R&W Technical Services, that's the us, R&W Technical Services, because that's where the computer was being held at the time when the ad was written, was 284 percent."

Tr. at 153-154.

⁴⁹ Reagan conceded that in making R&W's claims concerning margin requirements, his approach was entirely gerrymandered. Reagan Deposition at 105-106. ("[W]ith \$9,000 as a starting account in January...you would have very few margin calls. Then we discovered if you had put \$20,000 in [the account] you would have no margin calls, if you had followed these algorithms....").

(continued..)

unsubstantiated (and unbelievable) claim that they successfully blind-tested their algorithms through hypothetical trading over a seven year period.⁵⁰

(..continued)

Moreover, although the promotional materials fail to make the distinction, Reagan admitted that the initial margin requirements varied depending on the time the speculator entered the market. Reagan Deposition at 106 ("I could never and would never say [the initial margin requirement] from July to July because I could show you on my own [records] where you would have [needed] 28 or 29 grand [] but not for January through December.").

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Mr. Terrell: "You had no bank account with a balance from trading the trading systems, did you?"

Mr. Reagan : "No, sir, but if you did, this is what the results would have been. Now, you can go to the bank on that Mr. Terrell."

Tr. at 158.

It follows that R&W's "certification" claims are a sham as well. When asked to explain how he certified the trading results, Reagan responded, "I certify it....There is a stamp that says certified and I put GMR there. This means certified." Reagan Deposition at 91.

Reagan's certification claim was just another effort to falsely bolster the trading systems' credibility.

The Court: "What are you adding when you use the word 'certified' to qualify or bolster a representation that you would otherwise make in these ads, [since you are] presumably asserting that its true in any event?"

Mr. Reagan: "Thank you for asking that question."

By this time I had clients that were openly sending me letters and making available, would you like to see my, you know account statements? So I had actual account statements, so what I tried to get across here was this was certifiable at this point. You know, I certify this, I think it is

(continued..)

In a nutshell, respondents promoted their trading systems as the key to riches without risk, representing that their efficacy had been proven by extensive, systematic actual trading. But at best, the trades occurred in cyberspace, and at worse, were nothing more than a product of respondents' imagination. In doing so, they defrauded their customers.

(..continued)

certifiable. I'll send you a brokerage statement from a client of mine. That's what I was trying to enter into now, because, I mean at this point the clients that have been trading this have received -- the people that stuck with it, tremendous results, above average annual returns, 80, 90, 100 percent returns, and they were sending in referral letters and they were sending in offers to take brokerage statements to send to clients, anything just really highly acclaiming it.

So I tried to step up, you know, see, the credibility is the whole thing here because most people never have a system work for them ever. And this is what I had to defend and I had to support was that not only does this system work, but it's certifiable that it works."

The Court: "So you're using the word 'certify' to just --"

Mr. Reagan: "Lend credibility."

The Court: "To just be more emphatic."

Mr. Reagan: "Yes, sir."

Tr. at 161-163 (emphasis added).

The Court notes that the record is devoid of any customer brokerage statements.

R&W, Reagan And Worsham Violated The Antifraud Provisions Of The
Commodity Exchange Act

"[T]he credibility is the whole thing here because most people never have a system work for them ever."

Tr. at 162 (Testimony of Gregory M. Reagan).

Section 4b

The Complaint charges that respondents violated Section 4b(a)(i) and (iii) of the Act, 7 U.S.C. §6b(a)(1) and (iii).⁵¹

⁵¹ It does this in three ways. First, the Complaint charges all three respondents as primary violators of Section 4b. Complaint at ¶20. Next, it charges Reagan and Worsham with secondary liability for R&W's primary violations as controlling persons under Section 13(b) of the Act, 7 U.S.C. §13c(b). Id. at ¶21. Lastly, it again charges Reagan and Worsham with the same secondary liability as aiders and abettors under Section 13(a) of the Act, 7 U.S.C. §13c(a)). Id. at ¶22. But see In re Interstate Securities Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,954-38,955 (CFTC June 1, 1992) ("[I]n determining sanctions our focus is on the overall nature of the wrongful conduct rather than the number of legal theories the Division can successfully plead and prove.").

To establish controlling person liability under Section 13(b), the Division must prove that the alleged violator: (1) controlled the person or persons liable for a violation of the Act, and (2) did not act in good faith or knowingly induced the violation. Wide-ranging dominance over the operations of an entity at which the violative acts occurred will suffice to establish "control." In re Spiegel, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,103 at 34,765 n.4 (CFTC Jan. 12, 1988); In re GNP Commodities [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,216 (August 11, 1992) aff'd in part and modified sub nom., Monieson v. CFTC, 996 F.2d 852 (7th Cir. 1993); In re Apache Trading Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,251 at 38,794 (CFTC Mar. 11, 1992); Hickle v. Commodity Fluctuations Systems, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,956 at 31,784 (CFTC Feb. 28, 1986). A controlling person knowingly induces a violation if the person had "actual or constructive knowledge of the core activities that constitute the violation at issue and allowed [the activities] to continue." In re Spiegel, ¶24,103 at 34,767.

(continued..)

Section 4b is the Act's general antifraud provision for futures contracts and provides in relevant part:

"(a) It shall be unlawful... (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made or to be made, for or on behalf of any other person...

(..continued)

To establish aider and abettor liability under Section 13(a), the Division must prove that: (1) a primary violation of the Act occurred, (2) the alleged aider and abettor knew of the primary violation, and (3) the alleged aider and abettor intentionally assisted in the wrongdoing. In re Buckwalter, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,686 (CFTC Jan. 25, 1991); In re Western Financial Management, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC Nov. 14, 1985); In re Lincolnwood, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,254-28,255 (CFTC Jan. 31, 1984). In other words, in order to be an aider and abettor, a person must "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed." In re Richardson, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,644 n.10 (CFTC Jan. 27, 1981) (quoting United States v. Peoni, 100 F.2d 401, 402 (2nd Cir. 1938) (Hand, J.)).

The Court's findings, as set forth herein, that all three respondents engaged in primary violations of Section 4(b) likewise establish the secondary liability of Worsham and Reagan for R&W's violations. Respondents stipulated that Worsham and Reagan "controlled" R&W under Section 13(b). Stipulation (on control), presented to the Court at the oral hearing on August 13, 1997. Moreover, all of R&W's fraudulent conduct was undertaken directly and intentionally by Worsham and Reagan as its partners and agents. This, in turn, satisfies both the "knowing participation" standard under aiding and abetting liability, and the "bad faith" or "knowing inducement" tests for controlling person liability. While Worsham and Reagan seek to shield themselves from secondary liability by pleading ignorance of the law, Respondents' Brief at 34, it is of course knowledge of the conduct -- not its lawfulness -- that is material. In re Lincolnwood, ¶21,986 at 28,255 (aiding and abetting liability); In re Spiegel, ¶24,103 at 34,767 (controlling person liability).

(i) to cheat or defraud or attempt to cheat or defraud such other person; [or]

....

(iii) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract...." (emphasis added).

By its express terms, the prohibitions of Section 4b to apply to registrants and nonregistrants alike.

In order to establish a violation of Section 4b of the Act in an enforcement proceeding, the law requires the Division to prove, by a preponderance of the evidence, that respondents' advertising and promotional materials or other sales solicitations were "in connection" with futures transactions, and contain representations that were: (1) misleading to reasonable customers, (2) made with scienter, and (3) material.⁵² The Court turns to this assessment.

"In Connection With" Futures Transactions

Section 4b was amended in 1968 to extend its coverage from "members of the contract market" to "any person" who engages in fraudulent or deceptive conduct "in connection with" futures transactions.⁵³ The federal courts have recognized that the "in

⁵² For an extensive discussion of the elements of commodity sales fraud, and the policies that underlie them, see In re Staryk, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,923-43,928 (CFTC June 5, 1996).

⁵³ Saxe v. E.F. Hutton & Co., Inc., 789 F.2d 105, 111 (2d Cir. 1986) ("The amendment was prompted in part by congressional concern that potential investors had been solicited to trade in the commodities markets through fraudulent representations made
(continued..)

or in connection with" language in Section 4b encompasses conduct beyond the solicitation of a purchase or sale of commodity futures contracts, or actual trading.⁵⁴

Respondents seek to avoid the broad sweep of the "in connection with" language by distinguishing the instant case from those cases in which Section 4b has been applied to misrepresentations expressly intended to induce customers to open futures accounts.⁵⁵ They argue:

"In a discretionary trading account case, when the respondents fraudulently induce the opening of an account, the fraud is not complete until there is some actual trading controlled by the respondents. That is, there is no profit to the defrauder or loss to the customer until contracts are made....Our case is different. R&W did not solicit anyone to open a trading account with R&W, let alone a discretionary trading account. R&W's purported fraud, if there was one, would have been complete whether or not any trading occurred. Indeed, the fraud would have been complete whether or not any purchaser of any R&W systems ever opened a trading account, discretionary or otherwise."

Respondents' Reply Brief at 3.

(..continued)

by unregulated persons....[and the legislative history] illustrates that Congress recognized that fraudulent conduct may occur during the solicitation of potential customers, and intended the CEA to protect investors in this regard.").

⁵⁴ Id. at 110-111. See also Hirk v. Agri-Research Council, Inc., 561 F.2d 96 (7th Cir. 1977).

⁵⁵ Respondents' Brief at 20-29.

Respondents' argument fails for several reasons. At the outset, their contention that the "in connection with" language requires that the Section 4b fraud be completed by trading finds no support in the legislative history or case law.⁵⁶ Additionally, respondents' argument also fails as a matter of pure formalism, since in an enforcement context, any solicitation fraud is consummated without a showing of actual trading or injury.⁵⁷ Moreover, Section 4(b) condemns attempted frauds as well as completed ones.

Perhaps most importantly, however, respondents' argument fails as a matter of economic reality. Respondents' denials notwithstanding, the connection between respondents' solicitations and transactions in futures is "very close and substantial."⁵⁸ Although the Court recognizes that respondents did not directly solicit customers to open commodities accounts, and that the purchaser of any of the R&W trading systems was not obligated to engage in any actual trading,⁵⁹ the systems were not

⁵⁶ Hirk, 561 F.2d at 104 ("Clearly Congress has recognized through the years that fraudulent and deceptive conduct in connection with futures transactions can and does occur prior to the actual opening of a trading account and has intended to regulate it by including the 'in connection with' language in Section 4b.") (emphasis added).

⁵⁷ JCC, Inc. v. CFTC, 63 F.3d 1557, 1565 n.23 (11 Cir. 1995); In re GNP Commodities, Inc., ¶25,360 at 39,218. Contra CFTC v. American Metals Exchange Corp., 775 F. Supp. 767, 775 (D.N.J. 1991), aff'd. in part, rev'd. in part, and remanded on other grounds, 991 F.2d 71 (3d Cir. 1993) (requiring proof of reliance in an enforcement action under Section 4b(A) of the Act).

⁵⁸ Respondents' Brief at 22 n.6.

⁵⁹ See Id. at 2.

marketed as mere computer games, but as a vehicle for making one's fortune in futures speculation. Respondents well understood that the marketing success of their 3,000 dollar computer programs was inextricably tied to demand for futures trading, and their advertising materials in fact promote both. Indeed, R&W maintained customer referral and revenue-sharing arrangements with futures brokers.⁶⁰

Under these circumstances, respondents' solicitations quite comfortably fit within the "in connection with" framework of Section 4b.⁶¹

Misleading Representations

As already discussed at length, R&W advertised that the fantastic results that it claimed for its trading systems were backed by extensive, systematic actual trading. These representations were more than misleading, they were blatantly false.

⁶⁰ Tr. at 14-17 (Testimony of Thomas Otten); Tr. at 87-91 (Testimony of John Nolan Cullen).

⁶¹ See Saxe at 109 ("anti-fraud provisions should be broadly read to prohibit 'novel or atypical' fraudulent schemes) (citing and quoting A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2d Cir. 1967); Davis v. Coopers & Lybrand, 787 F.Supp. 787, 796 (N.D. Ill. 1992) ("What matters for purposes of [the Act] is the purpose for which investment is made -- that of commodities trading -- and not the form that the investment takes."); CFTC v. AVCO Financial Corp., No. 97 Civ. 3119 slip op. at 13 (S.D.N.Y. Sept. 1997) ("in connection with" requirement of Section 4b met where subscribers used a computerized system to trade their own accounts).

Scienter

The second element the Division must prove in order to establish a violation of Section 4b is that the misleading statements were made with scienter. As the Commission has stated, misleading statements are made with scienter when they are "committed intentionally or with reckless disregard [of a statutory duty] under the Act."⁶²

Given the nature of R&W's promotional claims and respondents' active involvement, the Court "ha[s] no difficulty inferring that [respondents'] false statements were intentional."⁶³ Reagan and

⁶² Hammond v. Smith, Barney, Harris Upham & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,659 (CFTC Mar. 1, 1990), aff'd sub nom., JCC, Inc. v. CFTC, 63 F. 3d 1557 (11th Cir. 1995). Statements are "reckless" if made with so little care that it is "very difficult to believe the [actor] was not aware of what he was doing." Do v. Lind-Waldock & Co., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,516 at 43,321 (CFTC Sept. 27, 1995) (quoting Drexel Burnham Lambert, Inc. v. CFTC, 850 F.2d 742, 748 (D.C. Cir. 1988)). "Mere negligence, mistake, or inadvertence" fail to meet the scienter requirement. See CFTC v. Noble Metals International, Inc., 67 F.3d 766, 774 (9th Cir. 1995) and cases cited therein.

A finding of intentional wrongdoing may be supported by inferences from circumstantial evidence. Thus, in considering scienter, the trier of fact is not called upon to read the respondent's mind, or to accept self-serving, but implausible, denials of culpable knowledge. In re JCC, Inc., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,579 (CFTC May 12, 1994) and cases cited therein. see also In re Kolter, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,262 at 42,198 (CFTC Nov. 8, 1994) (An unsupported denial of fraudulent intent is insufficient to defeat motion for summary disposition as "[circumstantial] facts establish scienter, and [respondent] has submitted no controverting evidence.").

⁶³ In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914 (CFTC June 16, 1995) ("[Respondent] guaranteed profits and promised wildly exaggerated returns. He compared the risk of trading options to investments such as savings accounts and mutual funds. Given the nature of these representations, we have no difficulty inferring that
(continued..)

Worsham directly controlled R&W⁶⁴ and readily admitted to being responsible for reviewing its advertisements and promotional materials and for soliciting customers.⁶⁵ In addition, Reagan wrote some of the copy, "verified" the claims, and provided all the data contained in R&W's promotional materials.⁶⁶

Here, however, any inference of willfulness simply is unnecessary, since Reagan openly admits to respondents' intent.

"[W]e wanted to give people the impression that we were actually trading so that they could see why [we] would sell something that was so good."

Reagan Deposition at 123.⁶⁷

(..continued)

[respondent's] false statements were intentional rather than reckless.").

⁶⁴ Stipulation (on control).

⁶⁵ Complaint at ¶¶2-3 and 5; Answer at ¶¶2-3 and 5

⁶⁶ Complaint at ¶3; Reagan Deposition at 66-70; Tr. 145-148.

⁶⁷ In their post-hearing brief, respondents continue to press the purported efficacy of their trading systems in opposition to (or alternatively, in mitigation of) a finding of fraud. See Respondents' Brief at p.5 n.2 (record supports finding that "leveraged trading could readily produce the claimed results"); Id. at 6 ("The R&W systems were excellent products and persons who used the system[s] to trade found [them] highly profitable."); Id. at 30 ("[I]t was [not] shown that the results would have been intrinsically different if R&W had made actual trades in the market."); Id. at 35 ("It is true that customers paid a substantial amount to acquire the systems. But even if there was a misrepresentation, the customers got fair value in exchange: trading systems that worked....").

But simply saying it does not make it so. As explained earlier, the record contains absolutely no reliable evidence to support the proposition that the R&W trading systems provided traders with any market advantage whatsoever. Moreover, even if respondents actually believed that their systems worked (another
(continued..)

Materiality

The final element the Division must prove in order to establish violations of Section 4b is that the misrepresentation is material. Whether a statement is material or not depends on an objective standard: whether "it is substantially likely that a reasonable investor would consider the matter important in making an investment decision."⁶⁸ Respondents' false claims that their systems' performance was tested by actual trading plainly satisfy this test.

As explained by the Commission, "[t]he function of the materiality requirement is to weed out actions based on trivial or

(..continued)

proposition unsupported by the record), such "a good faith belief [would not be] inconsistent with a finding of scienter." Hammond, ¶24,617 at 36,659 (Specific intent to deceive, as an element of mail fraud and securities violations, could be found from material misstatement of fact made with reckless disregard, and "no amount of honest belief that the enterprise would ultimately make money [could] justify baseless, false or reckless misrepresentations or promises.") (citing United States v. Boyer, 694 F.2d 58, 60 (3d Cir. 1982); accord Haltimer v. CFTC, 554 F.2d 556, 562 (2d Cir. 1977) (intent to injure customer not required); Do v. Lind-Waldock & Co., ¶26,516 at 43,322 ("[T]he absence of a specific intent to injure" does not excuse the broker's failure to fulfill a customer's cancellation instruction.).

Finally, as explained infra note 75, the very notion that a speculator could significantly benefit from R&W's systems is highly implausible, since it is inconsistent with widely accepted notions of how markets work.

⁶⁸ Sudol v. Shearson Loeb Rhoades Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,748, at 31,119 (CFTC Sept. 30, 1985) (citing TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)); accord Lehoczký v. Gerald, Inc., [1994-1996 Transfer Binder Comm. Fut. L. Rep. (CCH) ¶26,441, at 42,923 n.23 (CFTC June 12, 1995).

tangentially related representations."⁶⁹ In essence, a finding of materiality is a finding that the misrepresentation, deceptive sales practice or marketing technique is likely to cause economic injury to customers. This is true because economic injury occurs whenever customers would have chosen differently but for the deception. But for the material misrepresentation, customers would be willing to pay less for the product or service offered and/or would have used their money for alternative products or investments which they would have valued more highly.⁷⁰

The issue of materiality is "a mixed question of law and fact and the trier of fact is uniquely competent to make the materiality determination, requiring as it does 'delicate assessments of inferences a reasonable [investor] would draw from a given set of facts and the significance of those inferences to him.'"⁷¹ Some assessments, however, are less delicate than others. Since futures speculation is little more than a pure exercise in financial risk-

⁶⁹ Sudol, ¶22,748 at 31,118.

⁷⁰ In re Staryk, ¶26,701 at 43,928 n.84. In enforcement cases involving fraud, however, proof of actual injury is not required. The Division need not show that customers actually relied to their financial detriment on respondents' misrepresentations. See supra note 57.

⁷¹ Sudol, ¶22,748 at 31,119 (quoting TSC Industries, Inc., 426 U.S. at 450).

The Commission has borrowed from federal securities laws in holding that "[w]hether or not the misrepresented or omitted fact is important, such that the reasonable investor would attach significance to the fact as part of his decision, turns on whether a reasonable investor would regard the fact as significantly altering the total mix of information available." Id.

taking -- "a zero sum game...produc[ing] both winners and losers"⁷² -- it is not surprising that the Commission has held that representations concerning the risk involved in trading and the likelihood of profits are material as a matter of law.⁷³

Similarly, it follows as a matter of simple logic that claims intended to substantiate representations of increased profit and reduced risk are material as well. This certainly includes representations that a program or system has been tested by actual trading (when in fact the claimed tests results are theoretical, hypothetical, simulated, or just plain ginned-up).⁷⁴

In sum, with the necessary elements of the offense plainly established, there is no doubt that respondents engaged in systematic fraud in soliciting purchasers of their trading systems, and that the fraud occurred "in connection" with the trading of futures contracts. Respondents' false claims of proven success in actual trading accomplished what they were intended to do: they bolstered the purported efficacy of a product that is indeed

⁷² In re JCC, Inc., ¶26,080 at 41,576 n.23.

⁷³ Sudol, ¶22,748 at 31,119; Gordon v. Shearson Hayden Stone, Inc., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,016 at 23,981-23,982 (CFTC Apr. 10, 1980); In re JCC, Inc., ¶26,080 at 41,575.

⁷⁴ Levine v. Refco, Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 at 36,115 (CFTC July 11, 1989) ("[I]n determining whether to rely on a trading program to guide his decisions to enter and exit the futures market, a reasonable customer would think it material that the trading program at issue had never been tested through actual trading."); Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,225 at 38,650 (CFTC Jan. 17, 1992) (representation that trading approach had been tested by actual trading over a 30-month period and had proven successful held material).

"too good to be true."⁷⁵ In so doing, they repeatedly violated Section 4b(a)(i) and (iii) of the Act.

⁷⁵ Respondents' seek to trivialize their infractions as "incidental" and "highly technical," resulting in no customer injury. Respondents' Brief at 34. The Court disagrees. Their misrepresentations served to flagrantly deceive customers as to the value of R&W's systems, and as to the likelihood of profit and the magnitude of risk inherent in futures trading.

There is good reason for regarding respondents' false claims that the success of their systems had been verified by methodical, forward-looking, actual trading as fraud of the egregious sort. If these claims were in fact true, customers might in fact have reason to believe that Reagan had discovered trading's Elysian fields. But generally-accepted principles of economics, as well as common sense, instruct us that such a happy discovery is not to be.

In contradistinction to the hucksters of retail trading programs, respected scholars are virtually unified in their recognition that even the most legitimate technical systems (with their hypothetical and retroactive foundations) are incapable of providing the trader with any significant market advantage. Since "[i]n recommending a particular transaction or offering a professional opinion, a commodity professional makes an implied representation that there is a reasonable basis for the recommendation or opinion," Syndicate Systems, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,289 at 32,788 (CFTC Sept. 30, 1986) (citations omitted), this further suggests that any marketer's claim of increased profitability or reduced risk through the use of these systems is likely to be fraudulent.

The efficient market capital model emphatically contests the notion that financial markets are so inefficient that speculators can exploit these markets' inability to adjust to all types of information. Although the limits of the efficient capital market model, and its implications for regulatory policy, are a dependable source for endless debate, few dispute the model's general predictive powers. In fact many important regulatory policies are predicated on the model's accuracy. See, e.g., Basic, Inc. v. Levinson, 485 U.S. 224 (1988) ("fraud on the market" action for a violation of Securities Exchange Commission Rule 10b-5); In re LTV Securities Litigation, 88 F.R.D. 134 (N.D. Texas 1980).

The economic literature generally speaks of three possible states of efficiency: weak, semi-strong and strong. The "weak" view states that the market only incorporates all past transaction data, the "semi-strong" view states that the market incorporates all publicly available information, and the "strong" view states that the market incorporates all information,
(continued..)

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including non-public information. See Fama, Efficient Capital Markets: A Review of Theory and Empirical Work, 25 J.Fin. 383 (1970). What debate there is centers on whether the efficiency of competitive markets is "strong" or merely "semi-strong." Virtually the entire economic community is in agreement, however, that the efficiency of the market is sufficiently strong so that all publicly available information is rapidly disseminated and is then almost instantaneously reflected in the price for any widely traded investment contract. As a consequence, investor analysis of specific investment contracts will not lead to superior gains, since it will require an analyst to predict value better than the market as a whole. Thus, while some traders will profit while others will lose, the outcome of speculative investment is unlikely to significantly outperform chance. 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 (1970).

In the context of futures markets, the efficient market model therefore posits that the futures price always provides the best unbiased estimate of the subsequent spot price for a future date. In other words, "the price level of a commodity market incorporates all the available information in a way that no single individual could possibly hope to do." The McGraw-Hill Handbook of Commodities and Futures at 38-6 (Martin J. Pring ed. 1985).

Fundamental analysts dispute the limits of the efficient market model. They believe that financial markets exist only in a weak form (i.e., late-breaking public information and existing non-public information can be exploited to generate speculative profits).

Technical analysts, however, reject the notion of functioning markets altogether. Instead, they first make a deterministic (one might say spiritual) leap of faith that non-random price patterns exist. They then illogically posit that these patterns, once revealed to the few (or indeed -- through marketing -- to the many), may be successfully exploited in trading. To accomplish this, of course, the "pattern" must remain undetected by others (otherwise the increased market activity defeats the "pattern" by driving the price to a point where speculation is no longer profitable). See Marshall (1989) at 263-264.

(continued..)

Section 4o

The Act also specifically regulates the conduct of commodity trading advisors (CTAs).⁷⁶ Therefore, in addition to its charges under general provisions of Section 4b, the Complaint charges respondents with primary violations of the antifraud provisions of the Act, Section 4o(1), 7 U.S.C. §6o(1), which specifically governs CTA conduct.⁷⁷ In language similar to Section 4b, Section 4o(1) makes it unlawful for a CTA (or, as not here relevant, any "associated person of a [CTA], commodity pool

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Public policy presumes that markets are not so witless. "The presumption is [] supported by common sense and probability [as] [r]ecent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information...." Basic, 485 U.S. at 246.

⁷⁶ Subject to certain exclusions, Section 1a(5)(A) of the Act, 7 U.S.C. §1(a)(5)(A) defines "commodity trading advisor" to include any person who:

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

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

...."

Respondents dispute their classification as CTAs both on statutory and constitutional grounds. Respondents' Brief at 8-13. As discussed in the next section of this opinion, these challenges are unavailing in this forum.

⁷⁷ Complaint at ¶28.

operator, or associated person of a commodity pool operator") to directly or indirectly:

"(A) employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or

(B) engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant."⁷⁸

⁷⁸ Although respondents' scienter is plainly established in the present case, there is one oddity in the current state of law on Section 4o that merits comment. Under current Commission case law, scienter is a element necessary to establish fraud under Section 4b and under Section 4o(1)(A), but not under Section 4o(1)(B). In re Kolter, ¶26,262 at 42,198-42,199 ("[a]lthough scienter must be proved to establish a violation of section 4b and section 4o(1)(A), it is not necessary to establish a violation of section 4o(1)(B)."). Why? Good question!

As support for its holding, the Commission in Kolter relied on the Eleventh Circuit's opinion in Messer v. E.F. Hutton & Co., 847 F.2d 673, 677-679 (11th Cir. 1988). In Messer, the court in turn relied on Aaron v. SEC, 446 U.S. 680 (1980), in which the Supreme Court held that Section 17(a)(1) of the Securities Act of 1933 imposed a scienter requirement, while Section 17(a)(3) of that statute did not. Aaron, 446 U.S. at 697 ("Although the parties have urged the Court to adopt a uniform culpability requirement for the [two] subparagraphs of §17(a), the language of the section is simply not amenable to such an interpretation.") (majority opinion, Stewart, J.); Id. at 703 (Burger, C.J., concurring) ("If, as intimated, the result is 'bad' public policy, that is the concern of Congress where changes can be made.") The Messer court reasoned that the distinction between Section 4o(1)(A) and Section 4o(1)(B) is analogous to the distinction between Section 17(a)(1) and Section 17(a)(3), and therefore warrants parallel treatment under Aaron. Messer, 847 F.2d at 677.

Whether or not Kolter, Messer or Aaron were correctly decided, the Commission itself has suggested that the results do indeed reflect 'bad' public policy. The Commission has repeatedly stressed the need for a "consistent and uniform approach" when addressing whether to impose a scienter requirement in its rules implementing the various antifraud provisions of the Act. See In re Staryk, ¶26,701 at 43,926-43,927 n.74; Adoption of Antifraud Rules, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,049 at 20,645 (CFTC June 17, (continued..)

Of course, a fraud is a fraud is a fraud. Having found that respondents' conduct violated Section 4b, it follows that respondents' conduct violated Section 4o(1) as well.⁷⁹

(..continued)

1975); Regulation of Commodity Option Transactions: Notice of Proposed Rulemaking, [1975-1977 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,284 (CFTC Apr. 5, 1977); In re ContiCommodity Services, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,038, at 37,880 (CFTC Apr. 17, 1991). There is nothing to suggest that the any material distinction exists between the types of fraud described in Section 4o(1)(A) and Section 4o(1)(B) to justify differing treatment with regard to scienter. Indeed, the very thought that the necessity to prove scienter in a case of CTA fraud should turn on the subtle determination that a CTA "employ[ed] any device, scheme, or artifice to defraud" (Section 4o(1)(A)) , but did not "engage in any transaction, practice, or course of business which operates as a fraud or deceit" (Section 4o(1)(B)), seems (in three words) just plain silly.

In a sense, however, all of this "may be much ado about nothing." Aaron, 446 U.S. at 703 (Burger, C.J., concurring). It would appear unlikely that the Commission would squander its scarce enforcement resources to litigate against respondents "whose past actions have been in good faith," since in almost all instances the act of notification itself would deter future violations. Id. Moreover, even before 1990, when the Commission in Hammond, ¶24,617, adopted a scienter requirement for actions under Section 4b, some showing of bad faith was required. See Wills v. First Financial Corp. of America, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,605 at 30,597-30,598 (CFTC May. 31, 1985) (complainant in reparation action must "show[] that [respondent's] false promise was made without any belief as to its truth, or in reckless disregard of its truth") (citation omitted); accord First National Monetary Corporation v. Weinberger 819 F.2d 1334, 1340 (6th Cir. 1987) ("The requirements for a fraud claim under §4o are basically the same as for a fraud claim under §4b. The elements are derived from the common law action for fraud. [The complainant] has to prove that [the respondent] misrepresented a material fact which was intended to induce reliance....") (emphasis added).

⁷⁹ Having now condemned the exact same conduct of Reagan and Worsham under four different legal theories ((1) primary violations under Section 4b; (2) controlling person violations under Section 4b; (3) aiding and abetting violations under Section 4b; and (4) primary violations under Section 4o(1)), the Complaint goes for six. It charges Reagan and Worsham with secondary liability for R&W's primary violations of Section
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4(o)(1) as controlling persons, Complaint at ¶29, and as aiders and abettors, id. at ¶30. Once again, the evidence that establishes that all three respondents engaged in primary violations of the Act's fraud provisions likewise establishes the secondary liability of Worsham and Reagan for R&W's violations. See supra note 51.

Successfully going for seven, eight and nine, the Division also alleges that all three respondents engaged in primary violations of Commission Regulation 4.41, 17 C.F.R. §4.41, and that Reagan and Worsham are secondarily liable as controlling persons and aiders and abettors of R&W. Complaint at ¶¶28-30.

Regulation 4.41, entitled "Advertising by commodity pool operators, commodity trading advisors, and the principals thereof," requires specific disclosures that are intended to safeguard against the general type of fraud that occurred in this case. It provides, in relevant part, that:

"No person may present the performance of any simulated or hypothetical commodity interest account....unless such performance is accompanied by one of the following:

(i) The following statement: "Hypothetical or simulated performance results have certain inherent limitations. Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown;"

...."

Obviously neither R&W, Reagan or Worsham made the required disclosures. But, once again, see In re Interstate Securities Corp., ¶25,295 at 38,954-38,955 ("[I]n determining sanctions our focus is on the overall nature of the wrongful conduct rather than the number of legal theories the Division can successfully plead and prove.")

R&W, Reagan and Worsham Violated
The Registration And Recordkeeping Provisions
Of The Commodity Exchange Act

Section 4m(1)

The Complaint charges that respondents also engaged in primary violations of Section 4m(1) of the Act, 7 U.S.C. §6m(1).⁸⁰ With exceptions not here applicable, Section 4m(1) effectively requires that CTAs register with the Commission.⁸¹ There is no factual dispute here, only one of law. Respondents have resisted registration, claiming that: (1) they are excluded from the statutory definition of a CTA;⁸² and (2) even if they

⁸⁰ Complaint at ¶24.

⁸¹ In pertinent part, Section 4m(1) provides:

"It shall be unlawful for any commodity trading advisor..., unless registered under this Act, to make use of the mails or any other means or instrumentality of interstate commerce in connection with his business as such commodity trading advisor...."

⁸² Answer at ¶37.

In pertinent part, Section 1a(5) of the Act specifically excludes from the definition of "commodity trading advisor," "the publisher or producer of any print or electronic data of general and regular dissemination, including its employees." Section 1a(5)(B)(iv). It then proceeds, however, to limit the application of this exclusion to situations where "the furnishing of such service by [the publisher or producer] is solely incidental to the conduct of their business or profession." Section 1a(5)(C).

Since respondents' dissemination of trading advice through its computer programs is not merely incidental to their business, but rather composes their entire business, the Division argues that the limiting language of Section 1a(5)(C) excludes respondents from the statutory exclusion. Division's Brief at 16-18. Not so, according to respondents, who rely on Lowe v. SEC, 472 U.S. 181 (1985) (a case in which respondents' (continued..)

are not so excluded, "[t]he Commodity Exchange Act as applied to respondents violates their rights of freedom of speech and freedom of the press under the First Amendment of the United States Constitution."⁸³

(..continued)

distinguished counsel, Michael E. Schoeman, successfully argued the cause and filed briefs for petitioners).

In Lowe, the Supreme Court held that the exclusion from the definition of "investment adviser" under the Investment Advisers Act of 1940 (IAA) (which is similar in language to the general CTA exclusion set forth in Section 1a(5)(B)(iv) of the Commodity Exchange Act) encompassed "any person or organization which was engaged in the business of furnishing investment analysis, opinion, or advice solely through publications...and did not furnish specific advice to any client...." Lowe, 472 U.S. at 191 (citation omitted). In so holding, it relied on the "plain language of the exclusion," Id. at 206, and additionally reasoned that in enacting the IAA, "Congress was primarily interested in regulating the business of rendering personalized investment advice, including publishing activities that are a normal incident thereto", Id. at 204.

Respondents argue that the IAA's definition of "investment adviser" is "obviously the model for the general definition of 'commodity trading advisor' in 7 U.S.C. §1(a)(5)." Respondents' Brief at 9 n.3. While acknowledging that "[i]t is true that subdivision (C) of 7 section 1(a)(5) limits the exclusion in subdivision (B) to situations where the 'furnishing of such services' by the publisher or other excluded person is merely incidental to that person's business or profession" (a provision with no parallel in the IAA), respondents reason that "consistent with Lowe...the activity referred to in (C) must mean personalized advice. Thus,...the publisher of The Wall Street Journal or any other person referred to in (B) is permitted a limited amount of personalized advice, provided that those services are merely incidental to such person's business or profession. The respondents here gave no personalized advice." Respondents' Brief at 11-12 (emphasis in original).

⁸³ Answer at ¶38.

Respondents correctly argue that "[i]n Lowe, the majority opinion indicated that impersonal financial newsletters were protected by the First Amendment, see 472 U.S. 210 n.58, and strongly suggested (but did not explicitly hold) that the Advisers Act's discretionary licensing system would be

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As respondents concede in their prehearing memorandum,⁸⁴ their reading of Section 1(a)(5)'s exclusion has already been rejected by the Commission in favor of the Division's.⁸⁵ Moreover, the Commission has expressly declined to address respondents' constitutional challenge, preferring to leave that issue, in the first instance, to the courts of appeals.⁸⁶ This Court is bound by these determinations (whether correct or not), until they are "reversed or otherwise refined" by the Commission.⁸⁷

Lastly, placing the issues of the statutory exclusion and the section's constitutionality to the side, respondents alternatively argue that their activities simply do not fall within Section 1a(5)(A)'s definition of a CTA.⁸⁸ The Court disagrees.

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unconstitutional as applied to impersonal financial newsletter publishers, id. at 204-205." Respondents' Brief at 10 (note omitted).

⁸⁴ Respondents' Prehearing Memorandum, dated May 12, 1997 at 9-10.

⁸⁵ In re Armstrong, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,657 at 40,149 (CFTC Feb. 8, 1993), remanded on other grounds sub nom., Armstrong v. CFTC, 12 F.3d 401 (3d Cir. 1993); on remand, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,332 (CFTC Mar. 10, 1995), aff'd., 77 F.3d 461 (3rd Cir. 1996) (no opinion), cert. denied, ___ U.S. ___ (1996), 116 S.Ct 2502 (1996).

⁸⁶ Id.

⁸⁷ In re Trillion Japan Company, Ltd., [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,082 at 41,589 (CFTC May 23, 1994).

⁸⁸ Respondents' Reply Brief at 5 ("All R&W did was sell mathematical formulas....").

The language of Section 1a(5) bears repeating. It defines "commodity trading advisor" to include any person who:

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

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

...."

Respondents' sale of computer trading programs meet this definition precisely. The very purpose of these programs was to "advise[] others" "as to the value or advisability of trading in" futures contracts. In the words of respondents, the computerized trading systems contain

"the mathematical formulations of the opinions of R&W, Reagan and Worsham about how commodities markets operate. They, indicate when, in their opinion, market conditions call for a purchase, a sale or a stop order. They are in substance no different from the expression of such an opinion in a newsletter or other print medium. Instead of writing in print that the current market data indicate a 'buy,' for example, R&W has converted its news into algorithms and the algorithms cause a buy (or other signal) to appear on the user's computer screen. In both the newsletter and the electronic formats what is transmitted to the reader (or user) in the author's opinion."

Respondents' Prehearing Memorandum at 2 (emphasis added).

Accordingly, the Court finds that respondents engaged in primary violations of Section 4m(1) of the Act by acting as commodity trading advisors without benefit of registration.⁸⁹

Section 4n(3)(A) And Commission Regulations 1.31 And 4.33

Lastly, the Complaint charges R&W with primary violations of certain recordkeeping and production requirements set forth in Section 4n(3)(A) of the Act, 7 U.S.C. §6n(3)(A), and Commission Regulations 1.31 and 4.33, 17 C.F.R. §§1.31 and 4.33.⁹⁰ Section 4n(3)(A) provides:

"Every commodity trading advisor and commodity pool operator registered under this Act shall maintain books and records and file such reports in such form and manner as may be prescribed by the Commission. All such books and records shall be kept for a period of at least three years, or longer if the Commission so directs, and shall be open to inspection by any representative of the Commission or the Department of Justice. Upon request of the Commission, a registered commodity trading advisor or commodity pool operator shall furnish the name and address of each client, subscriber, or participant, and submit samples or copies of all reports, letters, circulars, memorandums, publications, writings, or other literature or advice distributed to clients, subscribers, or participants, or prospective clients, subscribers or participants."

(Emphasis added.)

⁸⁹ Again, Reagan and Worsham are secondarily liable as controlling persons and aiders and abettors of R&W. Complaint at ¶¶25-26.

⁹⁰ Complaint at ¶33.

Here the Division's case encounters an obstacle: the plain language of the statute.⁹¹ By its express terms, Section 4n(3)(A) applies only to registered CTAs, not unregistered ones such as R&W.⁹² The Court, of course, must presume that Congress meant what it said.⁹³ Thus the Complaint's charge that R&W violated Section 4n(3)(A) is not sustainable.

⁹¹ International Brotherhood of Teamsters, Chauffeurs, Warehousemen & Helpers of America v. Daniel, 439 U.S. 551, 558 (1979) ("The starting point in every case involving the construction of a statute is the language itself.") (quoting Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring)); Reno v. NTSB, 45 F.3d 1375, 1379 (9th Cir. 1995) ("The language of a regulation is the starting point for its interpretation."); T.S. v. Board of Education, 10 F.3d 87, 89 (2nd Cir. 1993) ("Plain meaning is ordinarily our guide to the meaning of a statutory or regulatory term." (citations omitted)); Grandview Holding Corp. v. National Futures Ass'n, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,996 at 44,809 (CFTC Mar. 18, 1997) ("Applying the basic principles of rule construction, our starting point is the plain meaning of NFA's rule." (citations omitted)).

⁹² Similarly, when Congress has intended to extend coverage of the Act to both registered CTAs as well as to those required to be registered, it has employed equally clear language to effectuate its purpose. See Section 4o(1) ("It shall be unlawful for a commodity trading advisor....").

⁹³ See United States v. Wooden, 688 F.2d 941, 950 (4th Cir. 1982) ("[A] judge must presume that Congress chose its words with as much care as the judge himself brings to bear on the task of statutory interpretation." (citation omitted)); Russello v. United States, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion....We refrain from concluding here that the differing language in the two subsections has the same meaning in each." (citations omitted)); Zimmerman v. North American Signal Co., 704 F.2d 347, 353 (7th Cir. 1983) (court should not construe a statute in such a way as to make words or phrases meaningless, redundant or superfluous); United States v. Espinoza-Leon, 873 F.2d 743, 746 (4th Cir. 1989); United States v. Wong Kim Bo, 472 F.2d 720, 722 (5th Cir. 1972); Deberry v. Sherman Hospital Ass'n, 769 F.Supp. 1030, 1033 (N.D.Ill. 1991); Miller v. Carlson, 768 F.Supp 1331, 1335-1336 (N.D.Cal. 1991); Grandview Holding Corp., ¶26,996 at (continued..)

Regulations 1.31 and 4.33, however, are another matter. Regulation 4.33 requires "each commodity trading advisor registered or required to be registered under the Act" (emphasis added) to make and keep certain records at its main business office and in accordance with Regulation 1.31. Regulation 1.31 supplements Regulation 4.33 by setting forth certain retention procedures, and by directing CTAs to make all required records available to any representative of the Commission by open inspection or by the provision of copies.

Having found that R&W was required to be registered as a CTA, there is no factual dispute that R&W violated both regulations.⁹⁴ R&W does not deny that it maintained certain

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44,809 ("Because NFA Rule 3-11 refers both to 'accept[ance]' and 'final acceptance,' the Appeals Committee's conclusion that the concepts are synonymous is contrary to the plain meaning of the rule." (brackets in original)).

⁹⁴ There is, however, a remaining legal dispute. Respondents suggest that since Section 4n(3)(A) requires only that registered CTAs maintain records as prescribed by the Commission, the extension of a record requirement by Regulations 4.33 and 1.31 to CTAs who have failed to register goes beyond statutory authority. Respondents' Brief at 14. Respondents' contention is based on a "flawed premise."

In promulgating Regulation 4.33, the Commission expressly stated that it intended the rule to serve a broader purpose than implementing Section 4n(3)(A) alone. Commodity Pool Operators and Commodity Trading Advisors; Final Rules, 44 Fed. Reg. 1,918, 1,924 (CFTC 1979), reprinted in Adoption of Rules Concerning Commodity Pool Operators and Commodity Trading Advisors, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,725 (CFTC Jan. 8, 1979) ("The rule is intended to implement section 4n(3)(A) of the Act and to assist the Commission in monitoring compliance by CTAs with the Act and regulations.") (emphasis added and note omitted). Indeed the Commission's authority to form the Rule stemmed not only from Section 4n, but also Sections 2(a)(1), 4c(a)-(d), 4(d), 4(f), 4(g), 4(k), 4(m), 8a, 15, and 17, 7 U.S.C. (continued..)

required business records at Reagan's home, rather than at its main business office, and that it refused to produce its records to representatives of the Commission for inspection.⁹⁵

Accordingly, the Court finds that R&W engaged in primary violations of Commission Regulations 1.31 and 4.33 as alleged by the Division.⁹⁶

Sanctions

With the discussion of liability complete, the Court now turns to the issue of sanctions. In its posthearing brief, the Division seeks a cease and desist order, a civil monetary penalty of \$7,125,000 and restitution of \$3,795,250.⁹⁷ The Court adopts the Division's proposed cease and desist order against respondents R&W Technical Services, Ltd. and Gregory M. Reagan,

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§§2, 4, 6c(a)-(d), 6f, 6k, 6m, 12a, 19, and 21. See Batra v. E.F. Hutton & Co., Inc., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,937 at 34,286 n.6 (CFTC Sept. 30, 1987) ("[Amicus curiae] argues that proof of a violation of Rule 1.55 should include evidence of scienter because proof of a violation of Section 4b, in its view, requires proof of scienter. This argument shares the flawed premise of the theory applied by the judge -- it assumes that Section 4b and Rule 1.55 are coextensive. In adopting Rule 1.55, however, the Commission relied upon Sections 4c(b), 4g(1), 4l, 4o, and 8a(5) of the Act, in addition to Section 4b.").

⁹⁵ Stipulation (Testimony of Robert H. Agnew), presented to the Court at the oral hearing on August 13, 1997.

⁹⁶ And, of course, Reagan and Worsham are secondarily liable for violations of these regulations as controlling persons and aiders and abettors. Complaint at ¶¶34-35.

⁹⁷ Division's Brief at 26-33.

and orders them jointly and severally to pay a civil monetary penalty of \$7,125,000, as recommended by the Division. The Court additionally imposes a permanent trading ban on these two respondents.

The Court, however, declines to order restitution in this case. Since restitution is the only sanction available against Mrs. Worsham,⁹⁸ the Complaint as to Dorothy Mobley Worsham, as executrix of Marshall L. Worsham's estate, is hereby **DISMISSED**.

Cease And Desist Order

The Division urges this Court to order respondents to cease and desist from violating the relevant portions of the Act and the Commission's implementing regulations.⁹⁹ Cease and desist orders are appropriate where there is a reasonable likelihood that the wrongful conduct will be repeated.¹⁰⁰ Repetition is viewed as probable where there is a pattern of misconduct -- as opposed to isolated errors or good faith mistakes -- and where there is no indication of rehabilitation.¹⁰¹

Such a situation exists here. Respondents openly refuse to comply with the registration requirements of the Act. More

⁹⁸ See supra note 4; see also Division's Brief at 26 n.9.

⁹⁹ Division's Brief at 26-27.

¹⁰⁰ In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,181 (CFTC Mar. 16, 1993).

¹⁰¹ See In re Fritts, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,255 at 42,132 (CFTC Nov. 2, 1994), and authorities cited therein.

importantly, respondents have continuously marketed their trading systems on a pillar of lies concerning their systems' proven performance and efficacy. They admit no deception and show no remorse. As long as respondents can profit, their wrongdoing almost certainly will continue. Accordingly, a cease and desist order is plainly warranted.

Civil Monetary Penalty

What Is The Law?

In addition to a cease and desist order, the Division also urges the Court to levy a substantial civil monetary penalty on respondents.¹⁰² Relying on the Commission's opinion in In re Grossfeld,¹⁰³ the Division seeks a penalty of triple respondents' monetary gain, or \$7,125,000.¹⁰⁴ Like the present case, Grossfeld involved allegations of systematic retail sales fraud in connection with transactions in Commission-regulated financial instruments.¹⁰⁵

¹⁰² Division's Brief at 27-31.

¹⁰³ [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 (CFTC Dec. 10, 1996).

¹⁰⁴ Division's Brief at 30.

¹⁰⁵ In Grossfeld, the fraudulent scheme involved options on futures, while here the fraud involves transactions in connection with futures themselves. In addressing the issue of sanctions, the distinction is of no significance.

In Grossfeld, the Commission reviewed an Initial Decision of this Court.¹⁰⁶ Grossfeld was assigned to this Court by way of Commission remand. In reviewing two prior Initial Decisions issued by another Administrative Law Judge,¹⁰⁷ the Commission had left that Judge's findings of liability undisturbed, but directed that this Court reconsider the appropriate measure of civil monetary penalties. The Commission's directions were quite clear.

"On remand the ALJ should consider the record as a whole and base the civil money penalties on the financial benefit accrued to [respondents] or the losses suffered by their customers as a result of their wrongdoing. In the alternative, he should specifically explain why such a basis is impractical or inappropriate."

In re Grossfeld, ¶25,726 at 40,367 (citation omitted).¹⁰⁸

¹⁰⁶ In re Grossfeld, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,975 (CFTC Feb. 9, 1994).

¹⁰⁷ The case was first heard and Initial Decisions rendered by Administrative Law Judge William G. Spruill. In re Grossfeld, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,275 (CFTC Apr. 23, 1992) (Initial Decision); [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,351 (CFTC July 27, 1992) (Initial Decision Final Order On Monetary Sanctions). By the time of Commission remand, In re Grossfeld, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,726 (CFTC May 20, 1993), Judge Spruill had retired, and the case was reassigned to the undersigned Administrative Law Judge.

¹⁰⁸ Accord In re Gordon, ¶25,667 at 40,182 (CFTC Mar. 16, 1993) (remanded with same instructions); In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. ¶26,440 (CFTC June 13, 1995) (same).

On remand, this Court observed that the Commission's focus on costs and benefits

"reflects a renewed effort to enforce a policy of effective deterrence in the imposition of civil money penalties. In so doing, the Commission appears to draw from the generally recognized economics literature on deterrence theory in concluding that respondent gain or customer loss should be used as the basis for devising penalties."

In re Grossfeld, ¶25,975 at 41,120.¹⁰⁹

¹⁰⁹ As the Court further explained in Fritts,

"[I]n the past, the Commission has exhorted the Court to weigh a number of aggravating factors in determining penalties. These factors tend to be of two types: (1) those that contribute in a quantitative manner to respondent gain and/or customer loss; and (2) those that are more qualitative in nature. Factors of the first type include: the frequency with which the violation occurred, the duration of the violations, the number of people affected by the violative behavior, and the size of the business conducted by each respondent. Under the Commission's prior approach, these factors tended to be weighed subjectively and on an ad hoc basis, rather than as part of a total assessment of customer losses or respondent gains. More recently, however, the Commission has opted for a more objective approach that does not consider these factors independently but only as they directly contribute to losses and gains.

Aggravating factors that are more qualitative in nature include such things as the mind-set or evil intent of the violators and the nature of the injury inflicted on others. Although they do not lend themselves to explicit measurement, having been deemed by the Commission to be of importance, these factors can be used to adjust the penalty after an assessment of customer losses and gains has been conducted."

(continued..)

Drawing from the literature, the Court then reasoned that a gains-based standard is the preferred regulatory approach. Customer losses, however, when they greatly outweigh respondents' gains, should be considered an aggravating factor warranting a further increase in the penalty.¹¹⁰ Furthermore, the penalty should be set at a level reflecting a premium to ensure that wrongdoing is unprofitable.¹¹¹ Indeed, in 1992, Congress statutorily endorsed in appropriate cases a multiplier of "triple the monetary gain" or more in the calculation of civil monetary penalties.¹¹²

The Court has followed the foregoing economic approach in Grossfeld and in all subsequent cases.¹¹³ Since the Commission

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In re Fritts, ¶26,255 at 42,133 n.12.

¹¹⁰ In re Grossfeld, ¶25,975 at 41,120-41,122.

¹¹¹ Id. at 41,120-41,121.

"Deterrence theory dictates that the penalty include a premium to offset the benefit of engaging in undetected illegal conduct. Penalties are set such that the amount of the penalty multiplied by the perceived probability of detection exceeds the expected gain of the violative act."

In re Fritts, ¶26,255 at 42,133 (citation omitted). See also, Bentham, The Theory of Legislation, (C.K. Ogden ed. 1931) at 325 ("[T]he more deficient in certainty a punishment is the severer it should be.").

¹¹² The 1992 change was meant to "stiffen[] penalties for violations of the Act." Futures Trading Practices Act of 1992, S. Rep. No. 102-22 102nd Cong., 2nd Sess. (1992), reprinted in 1992 U.S.C.C.A.N. 3103, 3115.

¹¹³ In re Staryk, ¶26,701; In re Cantillano-Estrada, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,284 at 42,438 (CFTC (continued..))

in Grossfeld accepted the results of the Court's approach to assessing civil monetary penalties,¹¹⁴ the Court will again employ it in this proceeding.

The Court notes, however, that two Commission decisions that post-date Grossfeld have reinjected considerable confusion into the law of civil monetary penalties. In Commodities International Corp., the Commission assessed an aggregate civil monetary penalty of only \$420,000 against respondents Commodities International Corp., Ellis K. Kahn and Phillip Grabarnick,

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Jan. 9, 1995); In re Fritts, ¶26,255. See also In re Bilello, CFTC Docket No. 93-5, November 20, 1996 Prehearing Conference Transcript.

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"As the ALJ correctly perceived our recent precedent does reflect some refinement to our traditional approach to calculating civil money penalties. In particular, we have emphasized that while the assessment of the gravity of the respondent's wrongdoing must be based on the record as a whole, the financial benefit that accrued to the respondent and/or the loss suffered by customers as a result of the wrongdoing are especially pertinent factors to be considered."

In re Grossfeld, ¶26,921 at 44,467-44,468 (citations omitted).

Based on its gains-based deterrence approach, the Court calculated a \$2,700,000 penalty for respondent Grossfeld, and a \$500,000 penalty for respondent Stein. The Commission affirmed to penalty against Stein, but reduced the penalty against Grossfeld to \$1,800,000. Id. at 44,468-44,470. The Commission's modification of the Court's assessment against Grossfeld, however, did not reflect a quarrel with the Court's general approach, but rather rested on its disagreement with the Court over the strength of the evidence material to quantifying Grossfeld's ill-gotten gains. Id. at 44,470 n.39.

although "[t]he annual management fee collected as part of the fraudulent [allocation] scheme amounted to almost \$3 million, and the respondents were responsible for even greater losses of their customers."¹¹⁵ The Commission's decision leaves this discrepancy between the penalties assessed and the magnitude of the gains to respondents and losses to their customers entirely unexplained.¹¹⁶

Approximately seven months later, in Rouso, the Commission found that four of the most active traders in the NYMEX crude oil pit "created a 'shadow market' using customer orders to their advantage to obtain a better price for their personal trades."¹¹⁷

¹¹⁵ In re Commodities International Corp. [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,566-44,567 (CFTC Jan. 14, 1997).

¹¹⁶ Compare In re Miller, ¶26,440 at 42,913, in which the Commission stated:

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

Id. at 42,913 (emphasis added and notes omitted).

¹¹⁷ In re Rouso, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,310 (CFTC Aug. 20, 1997).

In affirming Administrative Law Judge George H. Painter's imposition of a \$200,000 civil monetary penalty against one of the respondents, \$100,000 respectively against two others, and \$50,000 against the fourth, the Commission limited its "explanation" to just one sentence.¹¹⁸ The Commission's opinion does not analyze the penalties imposed in any fashion to the gains realized by the respondents or the losses imposed upon customers, or address any of the other factors discussed in the Commission's Grossfeld decision.¹¹⁹

¹¹⁸ Id. at 45,311 ("We find that the gravity of these violations was sufficient to justify the penalties imposed by the ALJ and that the specific amounts assessed reflect the gravity of each respondent's violations....").

¹¹⁹ Compare In re Bilello, CFTC Docket No. 93-5, November 20, 1996 Prehearing Conference Transcript at 41-43, in which this Court reasoned:

"[T]he Commission has...established what is essentially an economic test. In cases of retail sales fraud, this Court seeks to promote deterrence by basing civil monetary penalty assessments, whenever possible, on respondent's wrongful gain, while considering customer loss as an aggravating factor. To this calculus the Court adds a multiplier, so that the penalty is set at a level substantially above the wrongful gain. This premium is necessary to promote general deterrence in a world where much wrongdoing necessarily escapes the attention of enforcement authorities.

In trade practice cases, however, the nature of the injury, and therefore the focus of the penalty calculation, is different. In any given case of fraud on the floor of the exchange, the direct benefit to the offending floor broker or trader, and the direct injury to the broker's customers, may be relatively small as well as difficult to establish....Rather, by undermining the integrity of the market, the primary economic

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Although Commodities International Corp. and Rouso appear to offer no coherent alternative to the economic method

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effect of [respondent's] noncompetitive trading was to damage the core market mechanism of exchange traded futures.... Trade practice violations, demonstrating fraud-ridden trading pits and traders, fundamentally poison the public's perception of the market, and, even more so than isolated instances of sales fraud, threaten the orderly operation of the market.

That the integrity of the market is not an easily quantifiable cost, makes it not less real and substantial. Much more than isolated instances of sales fraud, trade practice violations hurt every actual and potential customer of futures by eroding the credibility and thereby reducing the efficiency of exchange trading. It is a social cost that diminishes the wealth of society. See Posner, Economic Analysis of Law (1992 Fourth Ed.) at 7. This should be of paramount consideration in setting a civil monetary penalty for [respondent's] misuse of the exchange.... Civil monetary penalties must not be perceived by floor brokers and traders as a cost of doing business. They must reflect a premium that makes the risk of detection unacceptable to the would-be wrongdoer, thereby deterring others, as well as the respondent, from engaging in such wrongful conduct in the future."

(Citations and internal quotation marks omitted.)

Thus, in a manner similar to retail sales fraud violators, trade practice violators measure up the potential benefits of illicit conduct against the risk of substantial penalties. As a result, trade practice violators can be equally deterred with appropriate civil penalties. Although the imposition of civil monetary penalties in trade practice cases requires a more thorough economic analysis, the proper calculation still requires the factfinder to consider factors which differentiate one award from the next.

traditionally employed by this Court in the penalty determination, their net effect is to raise some doubt on the propriety of this Court's deterrence-based approach to assessing sanctions. Accordingly, this remains an area of the law sorely in need of Commission guidance, in order to avoid the appearance, if not the reality, that the Commission's civil monetary penalty assessments are little more than a throw of the dart.¹²⁰

¹²⁰ See In re Grossfeld, ¶25,726 at 40,367 (civil monetary penalty analysis must "reflect[] a reasoned evaluation"); accord In re Gordon, ¶25,667 at 40,181 ("Our review focuses on whether the ALJ's choice of sanctions reflects a reasoned application of the appropriate factors we have previously identified as relevant to such an assessment.").

As with findings of liability, the "reasoned evaluation" necessary to support the imposition of a sanction requires a careful application of material facts to the law.

"Section 6(b) of the Act contemplates a hearing at which evidence bearing on the issues of liability and sanctions may be presented....[T]he rules themselves do not draw distinctions between liability issues and sanctions issues."

In re Fetchenhier, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,838 at 40,745 (CFTC Aug. 13, 1997); accord In re Scheck, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,834 at 40,733 (CFTC Aug. 13, 1993); In re Vercillo, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,836 at 40,740 (CFTC Aug. 13, 1993); In re Kenney, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,839 at 40,751 (CFTC Aug. 13, 1993); In re Mosky, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,841 at 40,761 (CFTC Aug. 13, 1993); In re Schneider, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,842 at 40,765 (CFTC Aug. 13, 1993).

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

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Grossfeld Applied

The record in this proceeding provides the Court with an easy measure of respondents' wrongful gains and customer losses. Reagan admitted that, as of June 1996, R&W had sold one or more trading systems, each with a minimum price of \$2,500, to 950 customers.¹²¹ The Court employs these two figures to obtain a

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"The requirement that the agency must state the basis for its findings and conclusions means that such findings and conclusions must be sufficiently related to the record as to advise the parties of their record basis....

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

Sen. Rep. 752, 79th Cong. 1st Sess at 24-25 (1945); H.R. Rep. 1980, 79th Cong. 2nd Sess. at 39 (1946); cited in Attorney General's Manual on the Administrative Procedure Act at 152 (1946).

¹²¹ Division Exhibit 21, Declaration of Gregory M. Reagan, dated June 17, 1996 at ¶7; Tr. at 191-193 (Testimony of Gregory M. Reagan).

Reagan's June 1996 declaration was filed in support of respondents' action seeking to enjoin this administrative proceeding. R&W Technical Services, Ltd. et al. v. CFTC, No. H96-1149 (S.D. Texas 1996). In his declaration, Reagan attests to extensive knowledge of the financial affairs of R&W. Yet, at this Court's August 1997 hearing, Reagan (by then the sole owner of R&W) professed to be completely ignorant as to the revenues of his

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estimate of both the relevant gains and losses: multiplying \$2,500 by 950, the Court calculates that respondents received, at a minimum, \$2,375,000 in revenues.¹²² This figure represents customer losses as well, since it is reasonable to assume traders would not have purchased the R&W systems but for the misrepresentations made by respondents.

The Division requests a civil monetary penalty of three times respondents' wrongful gain.¹²³ This computes to \$7,125,000 (\$2,375,000 X 3). Although the Court might be able to conjure up a different number, it would not necessarily be a better one.¹²⁴

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company. Tr. at 186-188. This is but another example of Reagan's absolute incredibility whenever providing self-serving testimony.

¹²² The Court notes that this calculation includes sales for a period of three months beyond the period covered by the Complaint. Moreover, it appears as a gross, not a net, revenue figure, since R&W's modestly scaled enterprise surely incurred some significant operating expenses in the sale of its systems.

Nonetheless, the \$2,375,000 figure is still an extremely conservative estimate of respondents' ill-gotten gains. The record indicates that some customers may have purchased additional systems after their original purchase. Reagan Deposition at Exhibit CFTC 11 (advertising EuroMaster and TreasuryMaster for \$2500 each, or \$4500 together, to "all CurrencyMaster customers"). The record also indicates that the price of the trading systems increased quickly to \$3,495 in April 1993 (near the beginning of the period covered by the Complaint) and then to \$3,995 by March 1996 (the end of the Complaint period). Division Exhibit 1; Tr. at 193 (Testimony of Gregory M. Reagan). The Court's revenue figure does not account for repeat purchasers or this substantial price appreciation.

¹²³ Division's Brief at 30.

¹²⁴ Although, "[c]ivil monetary penalties cannot not be calculated with precision," the Division's recommended penalty is "rationally devised in accordance with the purposes [the Commission] has outlined." In re GNP Commodities, Inc., ¶25,360 at 39,222.

This penalty is specifically assessed for respondents' violations of the relevant antifraud provisions of the Act and the Commission's implementing regulations: Sections 4b and 4o, and Regulation 4.41. It adjusts respondents' ill-gotten gains by a premium to account for the general likelihood of detection and prosecution under the Act. Given the gravity of respondents' fraud, a lesser civil monetary penalty would not adequately serve to generally deter such conduct.

Trading Prohibition

In issuing its Complaint, the Commission directed this Court to consider whether respondents should be subject to an order prohibiting them from trading on contract markets.¹²⁵ Although the Division's post-hearing submissions are surprisingly silent on the issue, imposition of permanent trading bans against R&W and Reagan are plainly warranted under the case law.

Trading prohibitions are appropriate where there exists a nexus between respondents' violations and the integrity of the futures market.¹²⁶ A nexus exists when the respondents' misconduct represents an inherent threat to the market. This threat need not be reflected in the futures and options prices or interfere with normal trading patterns, but is sufficiently present where the conduct erodes "[p]ublic perception, protection, and confidence in

¹²⁵ Complaint at Part III b.

¹²⁶ In re Fritts, ¶26,255 at 42,132.

[the] markets."¹²⁷ Permanent trading prohibitions are warranted when the conduct is both intentional and egregious.¹²⁸

Like associated persons who fraudulently misrepresent the profits and risks involved in trading futures contracts in order to generate commissions, respondents' fraud-ridden campaign to market computer programs as a vehicle to assured wealth "certainly diminishes the integrity of the market in the public eye."¹²⁹ Such sales fraud distorts the true nature, workings and purposes of futures markets, thereby eroding customer confidence and bringing to these markets an undeserved disrepute. Under Commission case law, this pattern of intentional and highly damaging misconduct surely is sufficiently egregious to warrant a permanent trading prohibition.¹³⁰

¹²⁷ In re Miller, ¶26,440 at 42,914.

¹²⁸ Id., (citing In re GNP Commodities, Inc., ¶25,360 at 39,222).

¹²⁹ Id., (citing Monieson, 996 F.2d at 863).

¹³⁰ In re Miller, ¶26,440 at 42,914 (pattern of sales fraud extending over "several years" where "[respondent] guaranteed profits and promised wildly exaggerated returns....[and] compared the risk of trading options to investments such as savings accounts and mutual funds" sufficiently egregious to warrant permanent trading prohibition); In re GNP Commodities, Inc., ¶25,360 (a broker who, after the fact, systematically allocated winning trades to his personal account and losing trades to customer accounts, and who subsequently promoted his account's overwhelming "track record" to prospective investors received a permanent trading prohibition).

Unfortunately, as with its assessment of civil monetary penalties, the Commission's trading ban case law continues to reflect disparate results which do not appear to be bounded by sensible principles. See, e.g., In re Commodities International Corp., ¶26,943 at 44,566-44,567 ("[R]espondents' violations of the Act involved fraud that continued over a period of many months and involved millions of dollars and hundreds of people," thereby warranting one year trading bans); In re Rousso, ¶27,133 (continued..)

Restitution

The Division also seeks restitution of \$3,795,250 to respondents' defrauded customers.¹³¹ As this Court has previously noted, the concept of restitution lacks both Commission direction and conviction.¹³² Approximately five years have passed since the statute authorizing the Commission to award restitution in administrative proceedings, the Futures Trading Practices Act of 1992, was enacted. Yet the Commission has failed to promulgate procedures which would instruct the Court on

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at 45,311 (respondents, whose noncompetitive trading "represent[s] repeated and direct assaults on the integrity of the marketplace," received ten year trading prohibitions); In re Fetchenhier, CFTC Docket Nos. 91-12, SD 93-14 (CFTC Oct. 31, 1997) (a floor trader who was convicted of one section 4b felony, one RICO felony, two felonies for wire fraud and three misdemeanors, all for acts undertaken on the trading floor, received a ten year trading prohibition); In re Crouch, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,114 (CFTC July 14, 1997) (a floor broker who "was indicted and tried on 39 counts of criminal violations of the Act, jury acquitted on some of the charges and failed to return a verdict on others, and floor broker subsequently agreed to plead guilty to one felony count of violating Section 4b, received a five year trading prohibition); In re Ryan, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,049 (CFTC Apr. 25, 1997) (a floor trader who was convicted of three section 4b felonies, one RICO felony and one misdemeanor, all for acts undertaken on the trading floor, received a six year trading prohibition); but see id. at 44,984 (Tull, C., concurring) ("I do not think it is wise to move beyond the statutory presumption set forth in Section 9(b) and apply a set formula based on the raw number of felonies. Rather sanctions should be assessed based on the seriousness of the underlying conduct, with a view toward consistent treatment for similar violations.") (emphasis added).

¹³¹ Division's Brief at 31-33.

¹³² See In re Staryk, ¶26,701 at 43,942.

how and when to award restitution or how to administer restitution when awarded.

In the face of these procedural gaps, the Division (1) claims that a simple calculation illustrates the amount necessary to restore defrauded customers to their pre-violation positions,¹³³ and (2) proposes that the NFA serve as the administrator of the Court's restitution award.¹³⁴ However, the Division did not submit any customer lists from which to identify

¹³³ As with the civil monetary penalty, the Division proposes to compute the restitution award based upon representations made by Reagan in a sworn deposition and reaffirmed at the oral hearing. Division's Brief at 31-33. (citing Division Exhibit 21 and Tr. at 191-192). To recap, although Reagan claimed to have little knowledge of the financial aspects of R&W, he estimated that R&W had approximately 950 customers who paid between \$2,500 to \$3,995 for one of the trading systems during the time period approximating that covered by the Complaint. Multiplying 950 customers times a maximum sale price of \$3,995, the Division seeks to create a restitution fund totaling \$3,795,250 to be administered by the National Futures Association ("NFA") via procedures established by the NFA and subject to the Court's approval. Id.

¹³⁴ For the first time, in its posthearing brief, the Division proclaims that the "[NFA] has agreed to administer any restitution award." Division's Brief at 32. Respondents object "to the Division's wholly unsubstantiated statements as to what the NFA has supposedly agreed to do," and note that "[n]othing in the record supports the Division's assertion, even though the Division presented an NFA witness." Respondents' Reply Brief at 7 n.5.

It suffices to note that it would be helpful if the Division could have troubled itself to have a representative of the NFA address its restitution proposal at the hearing.

potential claimants nor provide the Court with any procedures by which the NFA would administer the restitution award.¹³⁵

Once again, this Court cannot, and will not, speculate as to the scope and administration of any sanction in the absence of any Commission guidance.¹³⁶ Accordingly, the Division's request for restitution is denied.

Order

Accordingly for all the reasons set for above, the Court **FINDS** and **CONCLUDES** that, as alleged in the Complaint:

1. Respondents R&W Technical Services, Inc., Gregory M. Reagan and Marshall L. Worsham violated Sections 4b(a)(i) and (iii) of the Act, 7 U.S.C. §§6b(a)(1) and (iii);

2. Respondents Gregory M. Reagan and Marshall L. Worsham directly or indirectly controlled respondent R&W Technical Services, Inc., and did not act in good faith or knowingly induced, directly or indirectly, the violations of respondent R&W Technical Services, Inc. set forth in paragraph 1 above, and thereby, pursuant to Section 13(b) of the Act, 7 U.S.C. §13c(b), violated Section 4b(a)(i) and (iii) of the Act;

3. Respondents Gregory M. Reagan and Marshall L. Worsham willfully aided and abetted the violations of respondent R&W Technical Services, Inc. set forth in paragraph 1 above, and thereby, pursuant to Section 13(a) of the Act, 7 U.S.C. §13c(a), violated Section 4b(a)(i) and (iii) of the Act;

¹³⁵ In its posthearing brief, the Division merely refers to a "partial list of R&W customers" and indicates that "respondents can easily complete the list from their existing records." Division's Brief at 32.

¹³⁶ See In re Staryk, ¶26,701 at 43,942.

4. Respondents R&W Technical Services, Inc., Gregory M. Reagan and Marshall L. Worsham violated Section 4m(1) of the Act, 7 U.S.C. §6m(1);

5. Respondents Gregory M. Reagan and Marshall L. Worsham directly or indirectly controlled respondent R&W Technical Services, Inc., and did not act in good faith or knowingly induced, directly or indirectly, the violations of respondent R&W Technical Services, Inc. set forth in paragraph 4 above, and thereby, pursuant to Section 13(b) of the Act, 7 U.S.C. §13c(b), violated Section 4m(1) of the Act;

6. Respondents Gregory M. Reagan and Marshall L. Worsham willfully aided and abetted the violations of respondent R&W Technical Services, Inc. set forth in paragraph 4 above, and thereby, pursuant to Section 13(a) of the Act, 7 U.S.C. §13c(a), violated Section 4m(1) of the Act;

7. Respondents R&W Technical Services, Inc., Gregory M. Reagan and Marshall L. Worsham violated Section 4o(1) of the Act, 7 U.S.C. §6o(1), and Regulation 4.41, 17 C.F.R. §4.41;

8. Respondents Gregory M. Reagan and Marshall L. Worsham directly or indirectly controlled respondent R&W Technical Services, Inc., and did not act in good faith or knowingly induced, directly or indirectly, the violations of respondent R&W Technical Services, Inc. set forth in paragraph 7 above, and thereby, pursuant to Section 13(b) of the Act, 7 U.S.C. §13c(b), violated Section 4o(1) of the Act and Regulation 4.41;

9. Respondents Gregory M. Reagan and Marshall L. Worsham willfully aided and abetted the violations of respondent R&W Technical Services, Inc. set forth in paragraph 7 above, and thereby, pursuant to Section 13(a) of the Act, 7 U.S.C. §13c(a), violated Section 4o(1) of the Act and Regulation 4.41;

10. Respondent R&W Technical Services, Inc. violated Regulations 1.31 and 4.33, 17 C.F.R. §§1.31 and 4.33(1995);

11. Respondents Gregory M. Reagan and Marshall L. Worsham directly or indirectly controlled respondent R&W Technical Services, Inc., and did not act in good faith or knowingly induced, directly or indirectly, the violations of respondent R&W Technical Services, Inc. set forth in paragraph 10 above, and thereby, pursuant to Section 13(b) of the Act, 7 U.S.C. §13c(b), violated Regulations 1.31 and 4.33; and,

12. Respondents Gregory M. Reagan and Marshall L. Worsham willfully aided and abetted the violations of respondent R&W Technical Services, Inc. set forth in paragraph 10 above, and thereby, pursuant to Section 13(a) of the Act, 7 U.S.C. §13c(a), violated Regulations 1.31 and 4.33.

It is hereby **ORDERED** that:

1. Respondents R&W Technical Services, Inc., and Gregory M. Reagan **CEASE AND DESIST** from violating Sections 4b(a)(i) and (iii), 4m(1), 4o(1) of the Act, 7 U.S.C. §§6b(a)(i) and (iii), 6m(1), and 6o(1), and Regulations 1.31, 4.33, 4.41(a), 17 C.F.R. §§1.31, 4.33 and 4.41(a);

2. Respondents R&W Technical Services, Inc., and Gregory M. Reagan be **PERMANENTLY PROHIBITED**, directly or indirectly, from **TRADING** on or subject to the rules of any contract market, either for their own account or for the account of any persons, interest or equity, and all contract markets are **PERMANENTLY REQUIRED TO REFUSE** R&W Technical Services, Inc., and Gregory M. Reagan any trading privileges;

3. Respondents R&W Technical Services, Inc., and Gregory M. Reagan jointly and severally **PAY** a civil monetary penalty of **\$7,125,000** within 30 days of the effective date of this order; and,

4. The Complaint as to all matters concerning Dorothy Mobley Worsham, as executrix of the estate of Marshall L. Worsham, is hereby **DISMISSED** with **PREJUDICE**.

IT IS SO ORDERED.¹³⁷

On this 1st day of December, 1997



Bruce C. Levine
Administrative Law Judge

¹³⁷ Under 17 C.F.R. §§10.12, 10.102, and 10.105, any party may appeal this Initial Decision to the Commission by serving upon all parties and filing with the Proceedings Clerk a notice of appeal within 15 days of the date of the Initial Decision. If the party does not properly perfect an appeal -- and the Commission does not place the case on its own docket for review - - the Initial Decision shall become the final decision of the Commission, without further order by the Commission, within 30 days after service of the Initial Decision.