UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of:	*	
BRIAN W. RAY,	*	CFTC Docket No. 03-11
Respondent.	*	

INITIAL DECISION

Before: George H. Painter, Administrative Law Judge

Appearances:

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PROCEDURAL HISTORY

On August 21, 2001, the Commission issued a two-count Complaint against Respondent Brian W. Ray ("Ray") a Floor Broker on the Chicago Mercantile Exchange ("CME"). The Complaint charged Ray with using his error account to cheat and defraud his customers in violation of section 4b of the Commodity Exchange Act ("Act") (7 U.S.C. §§ 1 et seq.), and with engaging in prohibited personal trading in violation of a Commission order.[1]

On May 14, 2003, Ray filed an Answer denying both counts of the Complaint. After extensive discovery and a number of joint requests for postponements and extensions of time, a hearing was held in Chicago on July 12, 13, 14 and September 21, 2004. The parties have filed post-trial briefs, including recommended findings of fact and conclusions of law. This matter is ready for decision.

CONTROLLING LAW

Section 6(c) of the Act: The Commission may serve a complaint upon any person the Commission has reason to believe has violated any of the provisions of the Act or the rules, regulations, or orders of the Commission. The Commission may also issue orders to secure compliance with the provisions of the Act and its Regulations.[2]

Section 4b of the Act: It is unlawful for any person, in or in connection with any contract of sale of any commodity for future delivery made, to be made, for or on behalf of any other person (i) to cheat or defraud or attempt to cheat or defraud such other person; (ii) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof; (iii) willfully to deceive or attempt to deceive such other person.[3]

Federal Rule of Evidence 702: The Commission has adopted the standards of Rule 702 which states that qualified experts may testify as to "scientific, technical, or other specialized

[1] Authority to charge a violation of a Commission order is set forth in section 6(c) of the Act.
[2] 7 U.S.C. § 9.
[3] 7 U.S.C. § 6b(a).

knowledge" if it "will assist the trier of fact to understand the evidence or to determine a fact in issue."[4]

Section 17(o)(2) of the Act: Unless the Commission grants review of an order concerning registration issued by a futures association, the order of the futures association shall be considered to be an order issued by the Commission.[5]

FINDINGS OF FACT

The findings of fact set out below are based on reliable testimony and documentary evidence admitted into the record.

General

1. For many years, Bryan Ray filled customer orders as a top-step floor broker in the S&P futures pit at the CME, primarily on behalf of Carr Futures ("Carr"), a registered futures commission merchant ("FCM"), and its predecessor, Dean Witter Reynolds. (Tr. 307, 324, 529, 651, 688, 889)

2. Carr handled approximately 6 percent of the total market share in the S&P pit during the relevant time period. (Tr. 531)

3. Ray was one of the highest volume floor brokers in the S&P pit. (Tr. 671-672)

4. Under CME Rule 541, it is a violation for a top-step floor broker to dual trade in the S&P pit. (DOE Ex. 41)[6]

5. In December 1997, after a full hearing, a CME disciplinary committee found that Ray had cheated and defrauded his customers on eight occasions in 1996 by returning customer orders unfilled when, in fact, he had executed trades sufficient to fill the orders but had taken those trades into his error account. (Tr. 318; DOE Ex. 2)

6. The CME fined Ray $500,000, ordered him to pay $61,175 in restitution to the defrauded customers, and suspended Ray's membership privileges for 6 months. (Tr. 323; DOE Ex. 2, p.5)

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[4] Fed. R. Evid. 702, In re Ashman (1996-1998 Transfer Binder) Comm. Fut. L. Rep. (CCH) ¶27,336 at 46,549 n..55 (CFTC Apr. 22, 1998).
[5] 7 U.S.C. § 21(o)(2).

[6] CME Rule 541 provides, in pertinent part:

> A member shall not trade an S&P futures contract for his own account while on the top step of the S&P 500 futures pit, except that a member may liquidate a position that resulted from error.

7. The CME suspension ran from January 12, 1998 to July 12, 1998 (Tr. 327), after which Ray was permitted to resume trading.

8. A subsequent NFA Order (DOE ex. 4) required Ray to obey the Act, Commission regulations and exchange rules; to abstain from trading for his personal account.

9. In six months of trading in 1998, Ray made $271,017 in trading profits in his error account. (Tr. 308-09); DOE Ex. 19)

10. In 1999, Ray made $419,871 in trading profits in his error account. (Tr. 312; Ex. 20)

11. Between January 1 and February 14, 2000, Ray made $117,610 in trading profits in his error account. (DOE Ex. 45, p.84; see also Tr. 312; DOE Ex. 21)

12. The three-quarters of a million dollars in profits in Ray's error account were about half of his income during the 20 months preceding his departure from the pit in February 2000. (Tr. 313)

The Scaled Order: Brian Ray Took a Profitable Trade He had Filled for His Customer.

13. On May 12, 1999 at 8:18 a.m. (12 minutes before the market opened), Carr received a scaled order from the General Mills Pension Plan to buy 50 June S&P contracts.

14. The order consisted of five component orders written on sequentially numbered tickets- each to buy 10 June S&P contract – commencing at 1341.00 and ranging down to 1329.00 at price increments of 300 points. (Tr. 176-78, 235, 354; DOE Exs. 30-34)

15. At 8:30:20 a.m., the market opened at 1357.00, some 1600 points above the highest price specified in the scaled order. (Tr. 226; DOE Ex. 24, p.6)

16. At 8:47:03 a.m., trading became "fast" and prices began to fall rapidly, dropping 2400 points in less than three minutes. The market penetrated 1341.00 at 8:48:11 a.m. and 1332.00 at 8:48:59 a.m. before touching 1329.00 at 8:49:50 a.m. (Tr. 184, 228-29; DOE Ex. 24, pp.15-17)

17. Fourteen seconds later, the market rallied. In less than a minute, the market was back above 1341.00, where it remained for the rest of the trading day. (Tr. 185; DOE Ex. 24, p.18)

18. As the market fell, Ray executed orders 7757, 7756 and 7755 at their designated prices of 1341.00, 1338.00 and 1335.00, respectively. (Tr. 725)

19. Ray also bought 10 S&P contracts at 1332.00 and 10 contracts at 1329.00. (Tr. 235, 358, 739)

20. Ray assigned the 10 contracts at 1332.00 to his error account using a CME emergency card on which he recorded, "Filled twice I forgot I filled the first time + filled it again." (DOE Ex. 35) The trade cleared Ray's error account at First Options. (Tr. 182; DOE Ex. 36, p.2)

21. General Mills was filled three dollars better on its order to buy 10 contracts at 1332.00.

22. General Mills order 7753 to buy 10 contracts at 1329.00 went unfilled. (Tr. 190, 260-61; DOE Ex. 37)

23. Ray had a pre-existing one-contract short position in his error account. He made $56,250 when he offset this position by selling 9 contracts at 1357.00 and one contract at 1341.00. (Tr. 188, 379)

The "TIA Trade": Brian Ray Took the Opposite Side of His Customer's Order.

24. On May 12, 1999, Carr transmitted two orders to Ray to sell a total of 30 contracts at 1343.00. (Tr. 128, 131, 329; DOE Exs. 22-23)[7]

25. Ray sold only 20 contracts at 1343.00 through open outcry. Ray's pit card shows that he sold 9 contracts opposite Anita Domashovetz ("TIA") and 11 contracts opposite Scott Wallach ("WAL"). (Tr. 133, 329-30, 746, 849-50; DOE Ex. 23, p.2)

26. At 9:30 a.m. the market was trading at 1356.50 and at 11:15 a.m., it was trading at 1361.00; at all times between 9:30 a.m. and 11:15 a.m., the market was above the customer's specified price of 1343.00. (Tr. 138; DOE Ex. 24)

27. Ray involved CME Rule 527 as authority for taking the opposite side of the General Mills' order to sell 10 at 1343. (Tr. 335, 741-42; DOE Ex. 27)

28. Ray wrote on his pit card, "Rule 527 assignment for error account No. BOW02" and "I was 19 versus 9 with TIA." (Tr. 129, 350, 741-44; DOE Ex. 22, p.2)

29. Ray offset this position with a sale of 10 contracts at 1363.00 for a profit of $50,000. (Tr. 141, 350; DOE Ex. 29, p.3).

30. Ray's pit card shows a sale of 9 contracts from TIA (DOE ex. 23, p.2), and TIA's cards show that she only bought 9 contracts from Ray. (Tr. 135-36, 148, 857-59; DOE Ex. 26)

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[7] One was an order to sell 10 June S&P contracts at 1343.00 that had been entered by General Mills and recorded on Carr order number 5018. (Tr. 145, 260, 741; DOE Ex. 22) The other was an order to sell 20 June S&P contracts at 1343 that was recorded on Carr order number 7563. (Tr. 131, 146, 740; DOE Ex. 23) According to Time and Sales, the market was active at 1341.00 at 8:51:01 a.m.

31. TIA does not remember the events of May 12, 1999 (Tr. 859-60, 872) and saw nothing in the documentary evidence to suggest that she bought anything other than 9 contracts from Ray. (Tr. 865, 866, 873)

The August 31, 1999 Trades: Brian Ray Misappropriated His Customer's Trading Advantage

32. On August 13, 1999, Time and Sales and a videotape of the S&P pit show generally that from 9:52:07 a.m. to 9:55:46 a.m., the market dropped from 1331.50 to 1328.10, and from 9:55:53 a.m. to 10:00:57 a.m. it rallied back to 1331.00, before declining again to prices in the 1328 range. (DOE Ex. 12, p.6)

33. That morning, the Carr order desk received an order from one of its customers to buy 5 September S&P contracts at 1331.00. (Tr. 758; DOE Ex. 7; Summary Chart[8] ("SC")

34. A Carr desk clerk signaled the order to Ray's clerk. (Tr. 33, 45, 760, 805, 898; SC#2)

35. A little more than 30 seconds later, the Carr desk clerk attempted to cancel the order. (Tr. 33-34, 47, 761, 804-06, 901; SC#4)

36. In response, Ray's clerk signaled back that the order already had been filled. (Tr. 33-34, 768, 805, 901-02; SC#5)

37. The CME's surveillance videotape, however, does not show Ray buying any contracts between the time the Carr desk signaled in the order and attempted to cancel it. (Tr. 33-34, 768-69, 903)

38. At 9:53:10 a.m., Ray had received order 8391 to sell 10 S&P contracts at 1328.50. (Tr. 806, 965; DOE Ex. 9; SC#6)[9]

39. This order was immediately executable as the market was trading more than a dollar higher, but Ray did not fill it for more than two minutes. At 9:55:24 a.m., Ray filled the order by selling 10 contracts at 1328.50. (Tr. 34, 52-53, 809; DOE Ex. 9; SC#7) and simultaneously purchased 5 contracts from the same broker, for Ray's error account also at 1328.50. (Tr. 34, 379; DOE Ex. 10; SC#8)

40. Subsequently, at 10:01;56, Ray signaled, to his former clerk, a purchase of 5 contracts at 1331.00 and a simultaneous sale of 5 contracts at 1330.50. (Tr. 34, 90, 389, 394, 773, 804, 910; SC#s 13 and 14)

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[8] The relevant trading sequence is set forth in the Court's summary chart on page 19, below.)

[9] According to Time and Sales, this order was immediately executable because the market was trading 1330.20 at 9:53:10. (Tr. 811; DOE Ex. 12, p.6) In fact, the market remained above 1328.50 until 9:55:17.

41. This pair of trades gave Ray's former clerk no net position and a profit of $625. (Tr. 390, 816-17)

42. Ray used the 5-contract purchase from his former clerk to fill Carr order 7463 (SC#13), which the customer had attempted to cancel approximately eight minutes earlier (SC#4).

43. Ray subsequently placed the 5-contract sale at 1330.50 in his error account to offset the 5 contracts he had purchased at 1328.50 for a round-turn profit of $2,500 in Ray's error account. (Tr. 35, 42, 390, 771-73, 804-05, 816)

44. On the trading card that reflects these two supposed errors, Ray had written "I bought 5 I was supposed to sell." (DOE Ex. 10)

45. The purchase of five contracts at 1328.50 was not signaled back to the Carr desk to satisfy a customer order. (DOE Ex. 60)

46. At 9:55:43 a.m. Ray put the trading card on which he had recorded the purchase into his jacket pocket. (Tr. 53-54)

47. Ray did not bid in the open market to fill Carr order 7463, but instead hit his former clerk's bid at 1330.50 and simultaneously confirmed a purchase from him at 1331.00. (DOE Ex. 60)

48. Time and Sales and the videotape show that prices lower than the 1331.00 were prevailing when Ray bought from his former clerk. (Tr. 820-22) At the same time a trader standing one person away from Ray, was offering to sell at 1330.70 and 1330.50. (Tr. 820-21) That trader reported his trades to the pit reporter (Tr. 820); Ray did not. (Tr. 120, 853)

49. Time and Sales also shows that the price 1331.00 at which Ray purchased the 5 contracts for his customer was not trading in the pit when Ray bought and sold from his former clerk at 10:01:56 a.m. and had not, in fact, traded for one minute. (Tr. 394; DOE Ex. 12, p.6)

50. Time and Sales show that at 10:01:59 a.m., the price of 1330.80 was removed. This means that prices were trading lower than 1330.80 when Ray filled Carr order 7463. (Tr. 823; DOE Ex. 12, p.6)

September 9, 1999 Trade: Ray Managed his Error Account

51. On September 9, 1999, Time and Sales data indicate that the S&P contract price was 1354.20 at 1:03:52 p.m., and declined to 1354.00 at 1:04:03 p.m.

52. At approximately 1:04:02 p.m., Ray was standing on the top step of the S&P pit, having just received an order to sell 10 contracts at 1354.00 or 10 at four-even. (Tr. 57, 59, 659, 780)

53. Ray was not successful at selling any contracts at 4-even, and the market ticked lower.

54. Ray testified that he believed a 420 print effectively "hung" him on the 10 at 4-even offer. (Tr. 93-396)

55. At about 1:04:31 p.m. (Tr. 57, 59, 395-96, 660, 785-86) Ray offered 5 contracts at 1353.70. (Tr. 396, 659, 661, 787, 828-29; DOE Ex. 15)

56. The 10-lot sell order was ultimately cancelled, leaving Ray with a short position of 5 at 1353.70. Ray offset this position by buying 5 contracts from another floor broker, at 1350.50 for a profit of $4,000 in his error account. (DOE Exs. 15, 18, p.1)

Ray Improperly Used his Error Account as a Personal Trading Account

57. On April 13, 1999, after the CME had sanctioned Ray, the NFA issued a Final Order that restricted Ray's Registration. *In the Matter of Brian W. Ray*, NFA Case No. 98-REG-008. (DOE Ex. 4)

58. The NFA order prohibited Ray from, among other things, trading for his personal account and violating any provisions of the Act and regulations for a two-year period commencing May 13, 1999. (DOE Ex. 4)

59. Between May 1999 and January 2000, Ray made more than $366,000 by placing some 433 trades into his error account. (Tr. 158, 200; DOE Ex. 43, p. 10; Resp. Ex. 41) Of the 433 trades, 112 were denominated "customer declined" trades. (Tr. 158, 193)

DISCUSSION

1. The Scaled Order: Brian Ray Took a Profitable Trade He Had Filled for His Customer.

On May 12, 1999, Ray took a trade into his error account that would have filled exactly a customer order (#7753) that remained unfilled. This trade resulted in a profit of $56,000 for Ray. His explanation of the record is as follows:

> During the month of May 12, 1999, Mr. Ray purchased 10 contracts at the price of 1332.00 in connection with order 7754 that was placed by the Carr customer desk or in connection with the placement of an order by one of Mr. Ray's other customer desks. (Res. Ex. 51.9a, 51.9b, Tr. 738-739, 930-932). Upon execution of the 10 contracts at 1332.00, Mr. Ray submitted the execution to the Carr desk to be matched against the appropriate order. (Id.). . . the

> Carr customer desk employees were unable to find a match for the purchase of 10 contracts at a price of 1332.00 and subsequently returned the execution to Mr. Ray. (Tr. 188, 189, 737, 739). Upon receipt of the rejected execution from the Carr customer desk, Mr. Ray submitted the execution to the other customer desks to determine if they were missing an execution to purchase 10 contracts at 1332.00. (Tr. 737-739). Mr. Ray's other customer desks refused the execution leaving Mr. Ray with no recourse other than to honor the trade and place the execution in his error account. (Id.).

Ray's Post Hearing Memorandum ("Ray's Post-Hearing Memo") at 10 (February 15, 2005). Notably, Ray did not call anyone from the Carr desk to support any of these contentions, and no witness other than Ray testified in any means that would support Ray's story.[10]

When stripped of the contrived explanations, "mistake" seems to be the one consistent element of Mr. Ray's various and sundry explanations for his behavior. In truth, the 10 June 1999 S&P contracts belonged to General Mills, not to Mr. Ray.

The Court therefore concludes that, despite his knowledge that General Mills had placed a scaled order as set forth above, and despite the fact that he had executed five orders that exactly filled the General Mills order, Mr. Ray intentionally and wrongfully kept a portion of that order, and subsequent profits, for himself.[11]

Section 4b makes it unlawful for any person, in or in connection with any contract of sale of any commodity for future delivery made, to be made, for or on behalf of any other person

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[10] Yet another explanation may be found on Mr. Ray's emergency trading card, which includes the notation (in Ray's hand) "FILLED TWICE I FORGOT I FILLED THE FIRST TIME & FILLED IT AGAIN."

[11] As the Commission stated in *In the Matter of U.S. Securities & Futures Corp., et al.* [2002-2003 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶29,117 **[SETTLEMENT]** "it is clear hat a futures broker owes a fiduciary duty to his customer, even a customer with whom the broker is not in direct privity; 'It [is] fraud to fail to "level" with one to whom one owes fiduciary duties. The essence of a fiduciary duty is that the fiduciary agrees to act as his principal's alter ego rather than to assume the standard arm's length stance of traders in a market." "*United States v. Ashman,* 979 F.2d 469, 478 (7th Cir. 1992) *cert. denied sub nom. Barcal v. United States,* 510 U.S. 814 (1993) *(quoting United States v. Dial,* 757 F.2d 163, 68 (7th Cir. 1985)).

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

(ii) willfully to make or cause to be made to such other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;

(iii) willfully to deceive or attempt to deceive such other person. (7 U.S.C. §6b(a))

By allocating trade 7753 (which belonged to General Mills), to his own error account Ray cheated General Mills, and intentionally misappropriated funds thereby violating Section 4b(a)(2)(i) and (iii) of the Act. The Commission has consistently held that the intentional allocation of trades to disadvantage one or more customers constitutes fraud under Section 4b(a)(2)(i) and (iii) of the Act. *In re Lincolnwood Commodities, Inc.,* [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,246 (CFTC Jan. 31, 1984) (respondents allocated winning day trades to their account and losing day trades to customers' accounts); *In re GNP Commodities, Inc.,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,206 (CFTC Aug. 11, 1992), *aff'd sub nom. Monieson v. CFTC,* 996 F.2d 852 (7th Cir. 1993) (respondents allocated winning trades to respondents' accounts and losing trades to customer's account). Although trade allocation usually involves allocating winning trades to the violators' accounts and losing trades to the victims' accounts, in this case Ray allocated his customer's winning trades to his own account and did not allocate a corresponding losing trade to the General Mills account. Rather, Ray simply lied to his customer and reported that trade 7753 had not been filled. Allocation schemes such as this violate Section 4b(a) because allocating winning trades to one account (even without the corresponding allocation of losing trades to another account) deprives the victim of a fair opportunity to obtain profitable trades. *See In re*

Nikkhah, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,879 (CFTC May 12, 2000).

Violation

To establish a violation of Section 4b of the Act, the Commission must show that the defendant's wrongful acts "were committed intentionally or with reckless disregard to [his] duties under the Act." *Hammond v. Smith Barney, Harris Upham & Co.,* [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,659 (CFTC March 1, 1990). *See also, Drexel Burnham Lambert, Inc. v. CFTC,* 850 F.2d 742, 748 (D.C. Cir. 1988) (A violation of Section 4b requires that the wrongdoer act with scienter). Scienter "refers to a mental state embracing intent to deceive, manipulate, or defraud." *CFTC v. Rosenberg*, 85 F. Supp. 2d 424, 448 (D. N.J. 2000). In determining whether Ray had the requisite mental state, direct evidence is not required. (*In re Lincolnwood,* ['82-'84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,255 (CFTC 1984); *In re Buckwalter,*['90-'92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,686 (CFTC 1991); *n8 In re Western Financial Management,* ['84-'86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC 1985) rather, we are "free to infer the requisite knowing conduct from all the attendant circumstances." *In re Lincolnwood,* ¶21,986 at 28,255 ("Given the difficulties in probing the minds of men, the Commission is not foreclosed from inferring knowledge from the evidence adduced.")

That Mr. Ray's conduct as intentional is amply demonstrated by all the attendant facts and circumstances. In particular, the very fact that Ray had a customer order and a fill that matched that order perfectly and yet he kept the trade for himself simply cries out with intent of the fraudulent kind. Ray's argument that it was a hectic day in the S&P pit and he simply made a mistake is not persuasive. First and foremost, hectic market conditions do not justify Ray's conduct. As the Commission has observed "[s]uch conditions are a fact of life in the futures markets that neither justify nor mitigate resort to illegal practices." *In re Cox,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,939 at 44,529 (CFTC Jan. 17, 1997). Moreover, a sincere claim of mistake is usually followed by a sincere attempt to rectify that mistake. There is no evidence in this record of any such attempt by Ray to confess error and make his customer whole. Accordingly, we find that Ray had the requisite fraudulent intent and that he violated section 4b by misappropriating General Mills' trade #7753.

2. The "TIA" Trade:" Brian Ray Took the Opposite Side of His Customer's Order.

Apparently, $56,000 was not sufficient remuneration for the "excellent service" provided to General Mills on May 12, 1999. In fact, on that same day, Mr. Ray helped himself to a second General Mills trade; this trade was worth $50,000.

Sometime between 9:30 and 11:15 a.m., according to Ray, he realized that he had an outstanding order to sell 10 S&P contracts at 1343.00. (Tr. 138, 348-49) At all times between 9:30 a.m. and 11:15 a.m., the market was above the customer's specified price of 1343.00. (Tr. 138; DOE Ex. 24) Ray could have gone into the market and immediately filed General Mills' sell order at the market; a price significantly higher than the specified limit, generating a windfall of approximately $50,000 for General Mills.

Ray, however, did not allow his customer the benefit from the windfall. Instead, Ray breached his fiduciary duty to his customer and improperly invoked CME Rule 527 as authority for taking the opposite side of the General Mills' order to sell 10 at 1343. (Tr. 335, 741-42; DOE Ex. 27) Ray kept the $50,000 for himself. To that end, Ray wrote on his pit card, "Rule 527 assignment for error account No. BOW02" and "I was 19 versus 9 with TIA." (Tr. 129, 350, 741-44; DOE Ex. 22, p.2) By taking the opposite side of the General Mills order, General

Mills received its limit price, and Ray obtained a 10-contract long position significantly below the prevailing market price. Ray offset this position with a sale of 10 contracts at 1363.00 for a profit of $50,000. (Tr. 141, 350; DOE Ex. 29, p.3)

The plain language of CME Rule 527 allows for no such result. Rather, CME Rule 527 D.2.b. [Unclear Customer Transactions Discovered More than Ten Minutes After Execution] provides:

> If a floor broker discovers that all or some portion of a transaction that has been confirmed to a customer cannot be cleared and ten minutes or more have elapsed since such transaction and the bracket period in which the execution of the order giving rise to the out-trade has ended, the opposite side of the portion that cannot be cleared shall be assigned to the floor broker's error account, and the customer shall be assigned a fill at the confirmed price. The floor broker may liquidate the assigned position if at least ten minutes have elapsed after execution of the order giving rise to the out-trade and, in any event, the bracket period in which the out-trade arose has ended.

Rule 527 requires a floor broker who, more than 10 minutes after execution, discovers that all or part of a transaction that has been confirmed to a customer cannot be cleared, to assign the opposite side of the portion of the customer's order that cannot be cleared to his or her error account and to assign a fill to the customer at the confirmed price. This rule only applies where the broker has executed and confirmed a trade that cannot clear. If the broker simply fails to fill the order, Rule 527 does not apply, and the broker is required to go into the market and fill the customer order at the prevailing price. If the price is disadvantageous to the customer, the broker must compensate the customer by issuing him a check for the difference. If the price is advantageous to the customer, it is just that: advantageous to the CUSTOMER, not to the broker.

The striking part about the documentary evidence is that there is no discrepancy between pit cards. Ray's pit card shows a sale of 9 contracts to TIA (DOE Ex. 23, p.2), and TIA's cards show that she only bought 9 contracts from Ray. (Tr. 135-36, 148, 857-59; DOE Ex. 26). Thus, on the face of the documents, there does not appear to have been any error. Ray has argued, however, that there is "a contemporaneous record of his 11-lot and 19-lot transactions with Mr. Wallach and Ms. Domashovetz." (*Brian Ray's Post-hearing memorandum* at 14) and refers the Court to Respondent's Exhibits 52.1a-52.26, and Transcript pages 740-742. The Court has reviewed these exhibits and to the extent that they are contemporaneous with the original trades they show an 11 lot trade with Mr. Wallach and only a 9 (nine not nineteen) lot transaction with Ms. Domashovetz. Res. Ex. 52.1b. The remainder of the documents cited by Ray are his self-serving, *post-facto* out-trade cards. These add nothing to Ray's defense, in fact, they are evidence of the violation here at issue.

Ray nevertheless claims that he was offering to sell 30 contracts at 1343, and both TIA and WAL hit him at the same time. He claims that TIA, who stood next to him, yelled, "Balance". (Tr. 330, 339-40, 750) Ray then claims that he recorded the sale of 30 contracts on two cards. On one card, Ray recorded a total of 20 sales – *i.e.,* 9 contracts opposite TIA and 11 contracts opposite WAL. (Tr. 330; DOE Ex. 23, p.2) Ray claims he recorded the remaining 10 contracts that he sold to TIA on a separate card (Tr. 330-31), but no such card appears in the record. (Tr. 136, 336-39) Moreover, there is no evidence in the record that the trade was ever confirmed to General Mills.

For her part, TIA does not remember the events of May 12, 1999 (Tr. 859-60, 872) and saw nothing in the documentary evidence to suggest that she bought anything other than 9 contracts from Ray. (Tr. 865, 867, 873) The only light TIA could shed on the subject is that she does not normally say, "Balance," to anyone. (Tr. 873)

All of the evidence and argument regarding whether Ray and TIA traded 9 or 19 is nothing more than a smokescreen designed to distract attention from the real issue: to whom did the $50,000 windfall belong? Moreover, even if we were to assume that the trade in question occurred as Ray claims, as a fiduciary and a self described provider of "excellent service," his obligation was to seek the best possible price for his customer and not to take that profit to himself. *In the Matter of John Joyce,* [2002-2003 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶29,178 (CFTC, 2002) ("A broker executing customer orders is a fiduciary and has an obligation to act in the best interest of his customers, which includes a duty to seek the best possible price for his customers. As such, executing floor brokers act "on behalf of" their customers, and thus are subject to the anti-fraud provisions of Section 4b of the Act.")

Accordingly, and in consideration of the testimony of Mr. Ray and Ms. Domashovetz, the documentary evidence offered, as well as the conspicuously absent trading card and customer confirmation, the Court concludes that this was not an out-trade (i.e. a mistake of quantity) between brokers (so Rule 527 does not apply), rather Mr. Ray failed to file a customer order and knowingly took advantage of the subsequent favorable market move that rightfully belonged to his customer, General Mills.

Violation

A futures broker owes a fiduciary duty to his customer, even a customer with whom the broker is not in direct privity. *United States v. Ashman, 979 F.2d 469, 478 (7th Cir. 1992) cert. denied sub nom; Barcal v. United States, 510 U.S. 814 (1993) (quoting United States v. Dial, 757 F.2d 163, 68 (7th Cir. 1985); see also Hearings on H.R. 3009 Before the House Committee* *on Agriculture,* 74th Cong., 1st Sess. 24 (Feb. 5, 1935) (remarks of Chairman Marvin Jones) (the customer-floor broker relationship "is a peculiar trust, a relationship that requires a high a degree of integrity as that required of the attorney or the doctor. . . ."); Id. at 25 (remarks of Edwin Kuh, Jr., representing the Chicago Board of Trade:" A broker knows that he is in a position of trust and that his function is to do the best he can for the customer"). A broker violates his fiduciary duty to his customer and commits fraud when he chooses to act on behalf of himself (or someone other than his customer) to the disadvantage of his customer. *Id.*

Again, this trade sequence is not a typical trade allocation scheme. Rather, market moves presented Ray with the opportunity to benefit his customer, but Ray chose to keep that benefit for himself; Ray was not free to make that choice. By appropriating the windfall that rightfully belonged to General Mills, Ray breached his fiduciary duty and cheated General Mills out of $50,000, thereby violating Section 4b(a)(2)(i) and (ii) of the Act. *United States v. Ashman, 979 F.2d at 478; In re Murphy,* [Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶22,798 at 31,351-52. *See also In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,879 (CFTC May 12, 2000).

Ray does not argue that his opportunistic behavior was a mistake or otherwise unintentional; rather, he argues that it was proper. Tr. 349-350. As discussed above, it was neither proper nor legal. It was, however, volitional. Upon discovering that a customer order had not been filled and that the market had moved in his customer's favor, Ray could have filled the order at the higher price and for his customer's benefit or (as he did) he could unlawfully keep the benefit for himself.

Scienter "refers to a mental state of embracing an intent to deceive, manipulate, or defraud." *CFTC v. Rosenberg,* 85 F. Supp. 2d at 448. It is clear from all the attendant circumstances that Ray had the requisite mental state and that his conduct was knowing and intentional. *In re Lincolnwood,* ['82-'84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,255 (CFTC 1984); *In re Buckwalter,* ['90-'92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at 37,686 (CFTC 1991); *n8 In re Western Financial Management,* ['84-'86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC 1985) Ray had the requisite fraudulent intent and violated section 4b of the Act by appropriating to himself a benefit that properly belonged to his customer.

3. The August 31, 1999 Trades: Brian Ray Misappropriated His Customer's Trading Advantage.

On August 13, 1999, according to the Division, Ray bucketed two customer orders resulting in a benefit to himself of $2,500. In fact, Ray did take advantage of an apparent error by his clerk in reporting to the desk that Ray had filled an order when he had not. Although it is not unusual for a broker to benefit from trading errors, it is inappropriate and illegal for a broker to appropriate his customer's advantage to himself. That is exactly what Ray did on August 13, 1999.

At issue is how Ray handled customer order #7463 to buy 5 S&P at 1331.00. Ray received order 7463 at about 9:52 a.m. and a second order customer order (#8391) to sell 10 S&P at 1328.50, at about 9:53:10 a.m. Both orders, as it happened, were immediately executable at the time they were time-stamped in. From 9:52:07 a.m. to 9:55:46 a.m. the market dropped from 1331.50 to 1328.10, and from 9:55:53 a.m. to 10:00:57 a.m. it rallied back to 1331.00, before declining again to prices in the 1328 range. (DOE Ex. 12, p.6) At any time during this eight or nine minutes, Ray could have filled Carr order #7463 at a price better than 1331 to the benefit of his customer. Likewise, Ray had the opportunity to fill order #8391 at a price better than 1328.50, to the benefit of his customer. Instead, at 9:55:24 a.m., Ray filled order #8391 by selling 10 contracts at 1328.50, and simultaneously purchased 5 contracts from the same broker, for Ray's error account also at 1328.50. (Tr. 34, 379; DOE Ex. 10; SC#8) Approximately six minutes later, Ray signaled, to his former clerk, a purchase of 5 contracts at 1331.00 and a simultaneous sale of 5 contracts at 1330.50. Thus, Ray's former clerk had no net position and a profit of $625. Ray used the 5-contact purchase from his former clerk to fill Carr order #7463 (SC#13), which the customer had attempted to cancel approximately eight minutes earlier. (SC#4). Ray placed the 5-contract sale at 1330.50 in his error account to offset the 5 contracts he had purchased at 1328.50 for a profit to Ray of $2,500.

The above described series of trades had the net effect of misappropriating benefits that rightly belonged to Ray's customers. In his defense, Ray does not explain why he waited so long to fill order #7463, he does not explain why he did not fill #7463 at a better price, nor does he make any attempt to explain his failure to immediately fill order #8391 at a better price. Ray argues, instead, that his clerk's report of a fill was in error, simply due to the fact that when 1331.00 began to trade, his clerk likely misheard Ray filling a different order, an order to sell 20 contracts at 1331 or better, in 5-lot increments. (Tr. 768-770) One may assume, without deciding, that there was a miscommunication and that the *initial* failure to fill was not intentional. This explanation, however, does not address the question of why the order was not subsequently filled for the next eight or nine minutes while the market was trading between 1331 and 1328.20.

Summary of Ray's Activity on August 31, 1999

	Time		buy	sell	price	time & sales	Comments
1	9:51:45 am	Carr received order 7463					
2	9:51:58 am	Signaled to Ray's clerk					
3	9:52:07 am	Time & Sales	5		1331.00		
4	9:52:30 am	Attempt to Cancel					
5	9:52:35 am	Fill Signaled					
6	9:53:10 am	RB&H received order		10	1328.50		
7						1328.30	as of 9:55:22; at 9:55:17—1328.50
8	9:55:24 am	Ray traded w/local	5		1328.50	1328.30	For Ray's account
9	9:55:43 am	Ray pockets card					
10	9:55:46 am	Time & Sales				1328.20	
11	9:55:53 am	Time & Sales				1328.30	
12	10:00:57 am	Time & Sales				1331.00	
13	10:01:56 am	Ray trades w/former clerk	5		1331.00	1330.70 (10:01:57)	Ray places trade in error account; former clerk no net position but has $625 profit
14				5	1330.50		
15	10:01:57 am	Time & Sales				1330.70	
16	10:04:40 am	Time & Sales				1328.30	

The CME videotape discloses two pieces of information that cast further suspicion on this transaction. First, the purchase of five contracts at 1328.5 was not signaled back to the Carr desk to satisfy a customer order. Second, at 9:55:43 a.m., Ray put the trading card on which he had recorded the purchase straight into his jacket pocket rather than passing it back to his clerk, which would have been normal practice. (Tr. 53-54) The act of pocketing the trading card, although not dispositive, suggests that Ray intended the trade for his personal account all along.

Additionally, the videotape shows that Ray did not bid in the open market to fill Carr order #7463, but instead hit his former clerk's bid at 1330.50 and simultaneously confirmed a purchase from him at 1331.00. No other member of the pit had the opportunity to trade opposite Ray's customer. Moreover, Time and Sales and the videotape show that prices lower than the

1331.00 were prevailing when Ray bought from his former clerk.[12] In particular, a trader standing one person away from Ray, was offering to sell at 1330.70 and 1330.50. (Tr. 820-21) That trader reported his trades to the pit reporter (Tr. 820); Ray did not (Tr. 120, 853).

On the trading card that reflects these two supposed errors, Ray has written "I bought 5 I was supposed to sell." Yet, nowhere in the record are we pointed to an order to sell five that might correspond to the five Ray claimed he was "supposed to sell."

Violation

All these factors taken together, as well as the fact that witnesses called by Ray offered nothing but failed memories, leads to the inescapable conclusion that Ray violated his fiduciary duty to his clients and appropriated to himself trading advantages that belonged to his clients. As set forth in greater detail above, such a breach constitutes a violation of section 4b of the Act. *United States v. Ashman, 979 F.2d at 478; In re Murphy,* [Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶22,798 at 31, 351-52. *See also In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,879 (CFTC May 12, 2000).

Although this trade sequence may have been initiated in response to an error by Ray's clerk, Ray consciously took advantage of that error to execute the complex trade sequence described above. Moreover, this trade sequence served no purpose other than to enhance Ray's bottom line. Ray's actions were intentional, venal and a violation of Section 4b of the Act. *In re Lincolnwood,* ['82-'84 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,986 at 28,255 (CFTC 1984); *In re Buckwalter,* ['90-'92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,995 at

[12] Time and Sales also shows that the price 1331.00 at which Ray purchased the 5 contracts for his customer was not trading in the pit when Ray bought and sold from his former clerk at 10:01:56 a.m. and had not, in fact, traded for one minute. (Tr. 394; DOE Ex. 12, p.6) Moreover, Time and Sales shows that at 10:01:59 a.m., the price of 1330.80 was removed, which, in turn, means that prices only lower than 1330.80 were trading in the pit when Ray filled Carr order 7463. (Tr. 823; DOE Ex. 12, p.6).

37,686 (CFTC 1991); *n8 In re Western Financial Management,* ['84-'86 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC 1985)) *In re Rousso,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,308 ("The existence of . . . a [suspect] pattern permits the inference that the trades that form the pattern were intentionally achieved by noncompetitive means.") (CFTC July 29, 1997), *aff'd sub nom. Rousso v. CFTC,* No. 97-4232, (2d Cir. March 11, 1998). *Accord in re Solomon Mayer,* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 (CFTC Feb. 3, 1998), *aff'd sub nom. Reddy v. CFTC,* 191 F.3d 109 (2d Cir. 1999) ("In appropriate circumstances a pattern marked by characteristics unlikely to occur in an open and competitive market is indicative of noncompetitive trading.")

4. September 9, 1999 Trade: Ray Managed his Error Account

The Division alleges that on September 9, 1999, Ray improperly initiated a trade for his error account without an associated customer order. Ray, on the other hand, asserts that the trade in question was an attempt to partially protect himself in the event that he was "hung" on an earlier customer order.[13] It appears that the Division and Ray agree that Ray received the order to sell 10 at, or very near (within seconds) the time that the price of 1354.20 was extant. Ray was not successful at selling any contracts at 4-even, and the market ticked lower at which point, according to Ray:

> my clerk notified me that there was a 420 print, which we believed hung us and owed the customer a fill . . . The 420 print, as far as we were concerned – and we were waiting for verification from the desk – hung us on that 10 at four even offer.

(Tr. 780) Ray testified that while waiting for this verification, and in order to protect himself in the event that he was "hung" on the order, he offered 5 contracts at 1353.70 (Tr. 396, 659, 661,

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[13] There is no allegation that Ray defrauded anyone in connection with the September 9 transaction.

787, 828-29; DOE Ex. 15) This took place at about 1:04:31 p.m. (Tr. 57, 59, 395-96, 660, 785-86)

Although the Division argues that Ray was not hung on the order (and with the benefit of 20-20 hindsight, the Division may be correct), Ray's contention that he *believed* that he was hung is at least equally plausible. Ray's testimony that he cannot fix his gaze permanently on the "board" where current prices are posted, is supported by both the video tape and common sense. Moreover, it is not difficult to accept that Ray's last glance at the board just prior to receiving the 10 lot sell order revealed a price of 1354.20 and as the market dropped to below the order price of 1354.00, it is reasonable that Ray might have believed that the market had "printed through" his order and he was hung. Thus, his assertion that the trade in question was initiated to protect himself in the event that he was hung, is not unreasonable.

The fact that the 10-lot sell order was ultimately cancelled left Ray with a short position of 5 at 1353.70. Ray offset this position by buying 5 contracts from another floor broker, at 1350.50 for a profit of $4,000 in his error account. (DOE Exs. 15, 18, p.1) As everyone agrees, managing one's error account to maximize profits and minimize losses is not in and of itself a violation of any statute or regulation.

Under the circumstances, we find that Ray's use of his error account in connection with the above described September 9, 1999 trades was not improper and did not violate any outstanding Commission order.

5. <u>Ray Improperly Used his Error Account as a Personal Trading Account</u>

Between May 1999 and January 2000, Ray made more than $366,000 by placing some 433 trades into his error account. (Tr. 158, 200; DOE Ex. 43, p.10; Resp. Ex. 41) The Division argues that of these 433 trades, 112 purported "customer declined" trades were not legitimate errors, rather they were personal trades made by Ray in violation of a CME Rule and a final Commission order. The Division supports its argument with, among other things, the expert testimony of Dr. Susanne Aref, a Research Scientist in the Department of Statistics at Virginia Polytechnic Institute and State University.

Rather than present his own expert to counter Dr. Aref, despite the opportunity to do so, Ray attacks Dr. Aref's testimony as not "aiding the trier of fact in determining the likelihood of whether the five (5) transactions at issue were properly executed."[14] *Brian Ray's Post-Hearing Memorandum at* 39. As the parties will note, the Court's decisions on the four transactions set forth above do not solely rely on Dr. Aref's testimony. Rather, Dr. Aref's testimony was offered to show that it is statistically improbable to make $178,000 on the 112 "customer declined" trades here at issue. Accordingly, we find Dr. Aref's testimony to be highly relevant and material. F.R.E. 401. (Rule 401 provides that evidence is relevant if it has "any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence").

The Court also finds Dr. Aref's testimony to be reliable, Ray's protestations to the contrary notwithstanding. First, Ray argues that Dr. Aref is not qualified as an expert because she has insufficient knowledge of and experience in the futures industry in general and the brokerage industry in particular. This argument might have some validity if Dr. Aref were testifying about whether or not Ray's conduct conformed to the standards of the industry.

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[14] Federal Rule of Evidence 702 states that qualified experts may testify as to "scientific, technical, or other specialized knowledge" if it "will assist the trier of fact to understand the evidence or to determine a fact in issue." Fed. R. Evid. 702. With regard to the admissibility of expert testimony, the Commission has adopted the standards of Rule 702. In re Ashman, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,336 at 46,549 n.55 (CFTC Apr. 22, 1998).

Rather, Dr. Aref's testimony addresses the question of the statistical likelihood of achieving certain trading results under given circumstances. Dr. Aref is eminently qualified to offer the statistical analysis and opinion contained in Division Exhibit 38. Page one of Exhibit 38 sets forth those qualifications, with which Ray does not argue, he simply says that they are not enough. Ray is wrong. Even a cursory review of Dr. Aref's *curriculum vitae* reveals that she is eminently qualified.

Ray also challenges Dr. Aref's methodology in reaching her opinion:

> Aref simply failed to explore other possible causes of trade errors which could result in the mathematical patterns that she observed. The Division's staff – not – Aref – choose (sic) and classified data utilized by Aref. The Division's expert compiled an analysis that improperly skewed the profits/losses that Ray obtained in his error account into subjectively mischaracterized categories. Not only is the statistical analysis provided by the Division's expert irrelevant to the issues in the case but the very data utilized by the Division's expert has been tainted by the Division's involvement in compiling, sorting, formulating and making subjective decisions on how to classify the data. The Division admits in its pleadings that the very statistical evidence utilized by Aref was "developed" by the Division.

Brian Ray's Post-Hearing Memorandum at 43. Ray, however, offers no specific analysis or discussion of how the Division participation in the collection and organization of statistical evidence was flawed or would otherwise render Dr. Aref's methodology and subsequent conclusions invalid. This would indeed have been the province of Ray's expert had he chosen to offer one; he did not. Moreover, Dr. Aref's report is based on standard statistical methodology commonly known as Bernoulli trials, where a single action, such as flipping a coin, is repeated numerous times. The results of the actions are denominated as "success" or "failure," and specific formula[15] is used to determine the probability of a given outcome. Using this method Dr. Aref determined that:

> For the "customer decline" trades the probability that the number of positive trades is 94 (or more out of 103 trades is, if the trades are equally likely to be positive or negative, 2.8×10^{-25} . If allowing for a positive bias of 60% positive trades, the probability of this happening is still very small: 9.4×10^{-11} . Indeed a positive bias of 70% has a probability of 2.5×10^{-6} and a positive bias of 80% has a probability of 4.3×10^{-3} of getting 94 or more positive trades out of 103 trades.

Written Testimony of Susanne Aref, Ex. 38, p.4. It is not surprising that Ray has mounted no serious challenge to Dr. Aref's methodology or conclusions because, in point of fact, the methodology used by Dr. Aref is sound as are her conclusions. Accordingly, we find that the testimony of Dr. Aref is relevant, reliable, methodologically sound and provides assistance to the Court in determining a fact in issue.

Even if we were to find Dr. Aref's testimony somehow wanting, Ray's claim that he was able to turn 94 of 112 "random" error trades into profitable trades is not believable and flies in the face of common sense and reason.[16] Moreover, Ray presented no evidence to support his outlandish claim. First and foremost, one would assume that for most, if not all, legitimately declined trades, there would be a customer order initiating that trade. Ray introduced no evidence of such initiating trades. Neither did Ray call a single customer witness to verify his fictitious account of customers' declining to accept any of the trades in question. Accordingly,

[15] Binomial Probability Formula.

[16] According to Ray, the customer declined trades at issue were executed customer trades that were subsequently voided when the fill price was determined not to be a valid price. (Tr. 190) In these instances, Ray testified, he would execute a trade at the next available price and offer it to his customer. (Tr. 191, 416-23, 705) If the customer did not accept the new price, Ray claims he then took the trade into his error account. (Tr. 191, 418-23; DOE Ex. 40)

we find that these trades were not errors. They were intentional trades that Ray initiated for his personal account and gain, and that is why the trades were so overwhelmingly profitable.

Violation

On April 13, 1999, after the CME had sanctioned Ray, the NFA issued a Final Order that restricted Ray's Registration. *In the Matter of Brian W. Ray,* NFA Case No. 98-REG-008. The NFA order prohibited Ray from, among other things, trading for his personal account and violating any provisions of the Act and regulations for a two-year period commencing May 13, 1999.

Pursuant to Section 17(o)(2) of the Act, 7 U.S.C. § 21(o)(2)(2002), orders issued by the NFA may be considered to be final orders by the Commission. Section 17(o)(2) states, in relevant part:

> Unless the Commission grants review under this section of an order concerning registration issued by a futures association, the order of the futures association *shall* be considered to be an order issued by the Commission. (emphasis added)

The Commission has not granted review of the NFA order here in question. Accordingly, we find that the NFA order is "an order issued by the Commission." We also find that Ray violated that Commission order by executing at least 112 personal trades, using his error account as a personal trading account and by defrauding his customers all in violation of the Commission order as set forth above.

Section 6(c) of the Act, 7 U.S.C. § 9 (2002) makes a violation of a Commission order a chargeable offense subject to the civil penalties set forth in that section. Ray violated a Commission order and is therefore subject to the penalties of section 6(c).

CONCLUSIONS OF LAW

Based upon the findings of fact set forth above, the Court concludes that the Division has proved by a preponderance of the evidence that:

1. On May 12, 1999, in connection with the scaled order described in Findings of Fact 12 through 23, above, Ray cheated and defrauded General Mills, and intentionally misappropriated funds by allocating trade 7753 (which belonged to General Mills), to his error account, thereby violating §§4b(a)(2)(i) and (iii) of the Act.

2. On May 12, 1999, in connection with the orders described in Findings of Fact 24 through 31, above, Ray cheated and defrauded General Mills, and intentionally misappropriated an advantageous trading position belonging to General Mills, thereby violating §§4b(a)(2)(i) and (iii) of the Act.

3. On August 31, 1999, in connection with two orders described in Findings of Fact 32 through 50, above, Ray violated his fiduciary duty to his clients and appropriated to himself trading advantages that belonged to his clients, thereby violating §§4b(a)(2)(i) and (iii) of the Act. *United States v. Ashman,* 979 F. 2d at 478; *In re Murphy,* [Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶22,798 at 31,351-52. *See also in re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,798 at 31,351-52. *See also In re Nikkhah,* [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,879 (CFTC May 12, 2000).

4. The Division alleges that on September 9, 1999, Ray improperly initiated a trade for his error account without an associated customer order. Ray, on the other hand, asserts that the trade in question was an attempt to partially protect himself in the event that he was "hung" on an earlier customer order.[17] Under the circumstances as set forth in Findings of Fact 51 through 56, we find that Ray's use of his error account in connection with the above described September 9, 1999 trades was not improper and did not violate the Act or any outstanding Commission order.

5. Ray violated a Commission order by trading for his personal account as set forth in Findings of Fact 57 through 59, above, and by defrauding his customers set forth in Findings of Fact 12 through 50, above.

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[17] There is no allegation that Ray defrauded anyone in connection with the September 9 transaction.

SANCTIONS

"Sanctions in enforcement proceedings are imposed 'to further the Act's remedial policies and to deter others from committing similar violations.'" *In re Gorski,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,726 at 56,085 (citing *In re Volume Investors Corp., Inc.* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,234 at 38,679. A finding of fraud operates as a statutory disqualification from registration and raises a presumption of unfitness for continued registration under Section 8a(2) of the Act, 7 U.S.C. § 12a(2). *In re Reddy,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (CFTC) Feb. 4, 1998), *aff'd sub nom. Reddy v. CFTC,* 191 F.3d 109, 126 (2d Cir. 1999); *In re Rousso,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,310.

For the most part, customers of the commodity futures markets are not, and cannot be on the floor of the exchange to ensure that their brokers are acting in the customers' best interests; rather, the customers must *trust* their brokers. Accordingly, brokers must be trustworthy. Ray, however, repeatedly has shown that he is not worth of trust. His registration is therefore revoked.

Trading Prohibition

Trading prohibitions serve to protect the futures markets from conduct that threatens their orderly operation. *In re Incomco, Inc.,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537 (CFTC Dec. 30, 1991). When the record shows that a respondent's misconduct represents an inherent threat to the integrity of the futures market, a trading prohibition is appropriate. *In re Staryk,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,826 at 56,452 (CFTC July 23, 2004); *Miller I,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914.

Ray has repeatedly committed core violations of the Act by engaging in fraudulent trade practices and abusing his position of trust to enhance his bottom line. A trading ban is therefore appropriate. Given the nature, extent and repetition of Ray's violations, the trading ban is permanent. *In re Staryk,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,826 at 56,452 (if there is a nexus between the respondent's violations and the integrity of the market, the term of the prohibition turns on the gravity of the violations); *In re Incomco, Inc.,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537; *In re Murphy,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,798 at 31,356. The Commission construes the nexus between the violations and the integrity of the market broadly; *Miller II,* [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914 (a ban is appropriate when there is injury to the market in the public eye). It has been held that a prohibition should be long enough to discourage future violations by the respondent and by other potential violators. *In re Murphy,* [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,798 at 31,356. Ray has made it abundantly clear that given the opportunity he will repeatedly ignore any statutory or regulatory impediments to increasing his net worth. Accordingly, we must conclude that the only way to discourage future violation is to permanently ban Ray from trading. Such a permanent trading ban is also appropriate given the intentional and egregious nature of Ray's conduct. *In re Staryk,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,826 at 56,452, *citing In re GNP Commodities,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,222.[18]

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[18] Permanent trading prohibitions in situations such as this are common. *In re Glass,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,561-9 (CFTC April 27, 1998) (permanent trading prohibitions, registration revocations, and monetary penalties of $300,000 and $500,000 imposed on respondents who engaged in 12 noncompetitive trades over a five month period); *In re Mayer,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at

Civil Monetary Penalty

Section 6(c) of the Act and Commission Regulation 143.8(a)(1), 17 C.F.R. § 143.8(a)(1), provide for a maximum civil monetary penalty of $110,000 per violation for acts committed between November 27, 1996 and October 22, 2000 or triple the monetary gain to the Respondent, whichever is greater. Congress has directed that "[i]n determining the amount of the money penalty assessed under [the Act], the Commission shall consider the appropriateness of such penalty to the gravity of the violation." Section 6(e)(1) of the Act; *Accord In re Staryk,* [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,826 at 56,452. The Commission has identified eight factors relevant to the "gravity" of a violation:

> (1) whether the violation involves core provisions of the Act (i.e., fraud, manipulation and other violations having an effect on market integrity), (2) benefits to respondent, (3) harm to victims, (4) intentional or willful nature of conduct, (5) nature of violations, (6) duration of violations, (7) acting in concert with others, and (8) attempts to cure [the] violation or provide restitution.

A Study of CFTC and Futures Self-Regulatory Organization Penalties, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,264 at 42,219 (Nov. 1994). Ray's conduct implicated seven of the above eight "gravity" factors:

1. Ray, a fiduciary on the floor of a major exchange committed fraud, a core provision of the Act;

2. As a result of his violations, Ray benefited by at least $239,000;

3. As a result of his violations, General Mills Pension Fund was harmed to the tune of at least $80,000;

46,141 (permanent trading prohibitions for some respondents and ten-year bans for others, depending on the level of involvement, registration revocations, and monetary penalties of $250,000 and $500,000 for individuals involved in prearranged and wash trading and bucketing over the course of 26 months).

4. Ray's conduct was willful and intentional (see discussions above at pgs. 11, ¶2-3; p.16, ¶3-4; and p. 20, ¶4.)

5. Ray's conduct (fraud by a fiduciary) implicates a core provision of the Act and threatens the public confidence and trust in the integrity of the markets;

6. Ray's violations were not isolated incidents, they were ongoing, and repeated for months at a time;

7. Although Ray may have acted in concert with others, there was not sufficient evidence of complicit conduct to implicate this factor;

8. Ray has offered no evidence of attempts at restitution.

We find that Ray's conduct was nothing if not grave; and that the most severe sanctions are therefore appropriate. Accordingly, we impose a civil monetary penalty of $860,250, calculated as follows:

$ 56,250 (May 12, 1999 – scaled order)
$ 50,000 (May 12, 1999 –"TIA Trade")
$ 2,500 (August 13, 1999 – Bucketed Trade)
$<u>178,000</u> ("Customer Declined" Trades)
$286,750 x 3 = $860,250

In addition to stripping Ray of his ill-gotten gains, this penalty will have the salutary effect of deterring other members of the futures industry who might be considering similar conduct. Moreover, this penalty vindicates the public interest and will increase public confidence in the integrity of the markets. "[E]ffective deterrence occurs when it is no longer worthwhile for the wrongdoer to risk engaging in acts that threaten the integrity of the markets." *In re Mayer,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,141. Commission precedent recognizes that under both of Section 6(c)'s alternative approaches to calculating the maximum permissible civil monetary penalty, the Commission's goal of effective deterrence sometimes requires a civil penalty in excess of the net profit a respondent derived from his wrongdoing. *In re R&W Technical Services and Reagan* [Current Transfer Binder]

Comm. Fut. L. Rep. (CCH) ¶29,556 at 55,392 (CFTC Aug. 6, 2003) (*"R&W III"), citing In re Grossfeld,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,469 (CFTC Dec. 10, 1996), *aff'd sub nom. Grossfeld v. CFTC* 137 F.3d 1300 (11th Cir. 1998). The imposition of a significant penalty is warranted in trade practice cases because of the difficulty of detecting and proving fraud, where lawful and unlawful trading may be intertwined and susceptible to repetition. Violative conduct in trade practice cases thus has especially great potential for threatening the integrity of the markets and the confidence of those who rely on them for risk shifting and price discovery. *In re Reddy,* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 and n.19. Thus, a "premium" is needed to "offset the benefits from engaging in . . . undetected violations." *In re GNP Commodities, Inc.,* [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,223.

Finally, it should be emphasized that, Ray's conduct over a period of at least 20 months was systematic, repetitive and intentional. Despite the fact that he was given a second chance to participate in the futures industry and handle customer business, upon his return to the trading floor Ray resumed his violations of the Act and regulations and cheated his customers, rather than making any effort to conform his behavior to the law. He stood before this Court unrepentant. He has learned nothing from his rebuke by the NFA and it is doubtful he will voluntarily refrain from further violations of the Act. These factors justify the imposition of the serious remedial sanctions set out below.

ORDER

Respondent Ray is **ORDERED** to **cease and desist** from further violations of sections 4b(a)(1)(i) and (iii) of the Commodity Exchange Act, as amended, 7 U.S.C. §§ 6b(a)(1(i) and (iii)(2002), and from further violations of the Commission's order of May 31, 1999.

Ray's floor broker registration is hereby **revoked**.

Ray is **permanently prohibited** from trading on or subject to the rules of any registered entity and all registered entities are required to refuse him all privileges thereon.

Ray is **ORDERED** to pay a civil monetary penalty in the amount of $860,250, triple his monetary gain from his violations.

So ordered.

Issued this 25th day of August, 2005

George H. Painter
Administrative Law Judge

Steven J. Mickelsen, Law Clerk