



U.S. COMMODITY FUTURES TRADING COMMISSION

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TRISTAN DUBOIS,
Complainant,

v.

ALARON TRADING CORPORATION,
INFOEX INTERNATIONAL, INC., and
PATRICK YANG,
Respondents.

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CFTC Docket No. 95-R152

INITIAL DECISION

Appearances: Tristan DuBois, Berkeley, California,
Complainant, *pro se*.

Patrick Yang, Hong Kong,
Respondent, *pro se*, and representative for
respondent Infoex International, Inc.

Kristina Anderson, Esq., Chicago, Illinois,
For respondent Alaron Trading Corporation

Before: Philip McGuire, Judgment Officer

Tristan DuBois seeks to recover \$15,672 that he lost trading off-exchange leveraged contracts for the purchase and sale of foreign currencies -- Deutschemark and Japanese Yen in this case -- for future delivery ("leveraged forex contracts"). The leveraged forex contracts bought and sold by DuBois were standardized with set amounts per contract, were traded on a margin basis against the U.S. dollar, and were cash settled. DuBois traded the leveraged forex contracts on a principal basis with Sun Hung Kai Forex, Ltd ("SHK Forex"), a Hong Kong leveraged forex dealer. Infoex International, Incorporated ("Infoex") -- a

now bankrupt California introducing broker guaranteed by Alaron Trading Corporation -- acted as "intermediary" for SHK Forex by mass-marketing the purchase and sale of leveraged forex contracts to the general public, by recommending forex trades, and by handling forex orders.

DuBois alleges that Infoex and its owner and president Patrick Yang -- with unregistered Infoex agents Katrina Sham and Louis Lee -- sold illegal off-exchange futures contracts and fraudulently induced him to open an Infoex account under a variety of false pretenses. Among the alleged misrepresentations were: that Infoex would provide sufficient training for DuBois to become a qualified forex trader, when in fact the training lasted only 16 hours and consisted of a barely rudimentary introduction to the forex market; and that Yang would identify "sure" trades for DuBois as he learned to trade, when in fact Yang had no proven ability to select sure trades for Infoex customers. DuBois claims that Alaron as guarantor for Infoex is liable for Infoex's violations.

Infoex and Yang deny the allegations of fraud. Alaron, Infoex and Yang argue that the CFTC lacks subject matter jurisdiction over DuBois' leveraged forex trades under Section 2(a)(1)(A)(i) of the Commodity Exchange Act ("the Act"), 7 U.S.C. § 2a(II), known as the "Treasury Amendment." As such, Alaron Trading Corporation asserts that it cannot be held liable for DuBois' forex trades under its guarantee agreement with Infoex. Complainant, in contrast, asserts that the Treasury Amendment was

intended to exempt only interbank transactions and not any marketing to the general public of off-exchange forex contracts.

The findings and conclusions below are based on the parties' documentary submissions and oral testimony at the hearing held February 13, 1997, and reflect my determination that DuBois' testimony was more believable and plausible than Yang's testimony. Unless otherwise stated, all dates are in 1995, and amounts are rounded to the nearest dollar.

For the reasons set out below, it is concluded that Yang, and unregistered Infoex agents Louis Hop Lee and Katrina Sham, violated Sections 4(a) and 4b(a)(i) of the Commodity Exchange Act; that these violations, separately and together, proximately caused \$15,672 in damages; that Infoex is liable for these violations pursuant to CFTC rule 2(a)(1)(A); and that Alaron is liable as guarantor of Infoex.

FACTUAL FINDINGS

The Parties:

1. Patrick Yang resided in Daly City, California, until December 1995, when he returned to his birthplace, Hong Kong. Yang has been registered as a principal and an associated person with Infoex International, Incorporated since October 1994.

Yang formed Infoex in 1992, and was its owner and president. Yang opened and closed accounts at SHK Forex; hired the Infoex managers, Louis Hop Lee and Katrina Sham; wrote or approved all of the Infoex promotional and "training" materials; conducted the Infoex "training" classes; recommended most of the trades in

DuBois' account; and phoned all of DuBois' orders to SHK Forex. [DuBois testimony at pages 66-67 and Yang testimony at pages 73-82, 86-88 and 106 of hearing transcript; Yang's reply to Interrogatory 1, produced May 30, 1996.]

2. Louis Hop Lee's license to practice law in California was suspended in 1992 and revoked in 1994.^{1/} Lee -- who has never been registered -- conducted the Infoex "training" classes attended by DuBois; acted as DuBois "authorized representative" in his dealings with SHK Forex; and recommended, or provided trading advice in connection with, about half of the trades in DuBois' account. [¶¶ 4(b) and 9 of DuBois' Final Verified Statement; Account Mandate and Third Party Trading Authorization (DuBois' January 10, 1996 discovery production).] Infoex held out Lee as its "senior currency trader" with "extensive experience" trading foreign currencies.^{2/} [Page 1 of "Spot Training Class" announcement, DuBois' discovery production filed May 31, 1996; see Yang testimony, pages 78-79, 82-83, and 104-106 of hearing transcript.]

Katrina Wan Ye Sham, who has never been registered, was Infoex's "operations manager. Sham signed the promotional letter

^{1/} Respondents did not challenge DuBois' testimony that the California State Bar Court had confirmed Lee's disbarment. See page 102 of hearing transcript. Official notice is hereby taken of the California State Bar Court's suspension of Lee's license in 1992 and disbarment of Lee, effective on June 24, 1995. (Case number 92-0-18818).

^{2/} Infoex's answer, submitted on its behalf by Yang, is purportedly based in large part on Lee's first-hand knowledge. However, Yang did not produce any written affidavit by Lee, and did not offer to produce him as a witness at the telephonic hearing.

that Yang sent to DuBois; spoke to DuBois during the solicitation; assisted Yang and Lee during the training course; "qualified" DuBois; handled some of DuBois' orders; and provided some trading advice.^{3/} [Pages 106-107 of hearing transcript; ¶¶ 4(c), 5(c) and 6 of DuBois' Final Verified Statement; and Yang's reply to interrogatory 6, filed May 31, 1996.]

3. Infoex International, Incorporated is a California corporation which maintained its principal place of business at the Embarcadero Center in San Francisco, California. Infoex was incorporated in 1992, and has been registered with the Commission as an introducing broker since October 1994. Infoex's application to terminate its registration is pending.

[Commission records.] Infoex filed a voluntary petition for bankruptcy in the Northern District of California on January 10, 1996.

In 1992, Infoex began systematically offering to the general public the opportunity to speculate in fluctuations in the price of foreign currencies through the sale of contracts for the purchase and sale of various foreign currencies. Infoex held itself out as a "financial service company, specializing in trading foreign currencies, gold and silver markets in Hong Kong and New York" that acted as "an intermediary between investors and dealers Sun Hung Kai Forex, Ltd in Hong Kong and Alaron

^{3/} Yang did not produce any written affidavit by Sham, and did not offer to produce her as a witness at the telephonic hearing.

Trading Corporation in Chicago." [Page 4 of Infoex Currency Training Manual, DuBois' discovery production filed May 31, 1996; see Katrina Sham's letter to DuBois dated January 17, 1995 (DuBois' January 10, 1996 discovery production).]

Infoex solicited customers through newspaper advertisements that touted employment and investment opportunities with Infoex, such as the classified advertisements in January 16 and 23, 1995 editions of *San Francisco Chronicle* that caught DuBois' attention: "INFOEX, an est[ablshed] invest[ment] co[mpany], offers access to small and medium sized investors to global currency markets." [Yang's replies to interrogatories 4 and 5, produced May 31, 1996; and DuBois' discovery replies produced January 10, 1996.]

According to Yang, Infoex "trained" about 100 customers for forex trading, and about 50 of these customers actually opened forex accounts. The vast majority of Infoex's forex customers were inexperienced and unsophisticated. None of these customers had the capacity to make or take delivery of the currencies, and delivery never occurred. Few, if any, of these customers realized any profits trading leveraged forex contracts through Infoex. [Yang testimony, pages 73-75, and 84-85, of hearing transcript.]

4. Sun Hung Kai Forex, Ltd ("SHK Forex") is a subsidiary of Sun Hung Kai & Company, Ltd ("SHK"), both located in Hong Kong. SHK and Infoex materials sent to DuBois described SHK Forex as a "leveraged foreign exchange trader" that was "licensed" in 1994

by the Hong Kong Securities and Futures Commission ("SFC"), under the Leveraged Foreign Exchange Trading Ordinance.^{4/} [Page 1 of SHK Forex Customer Agreement, and page 7 of SHK 1994 Annual Report; and page 4 of Infoex "Currency Training Manual" (Yang's May 31, 1996 discovery production).]

SHK has never been designated as a contract market for the purchase or sale of commodities for future delivery.

5. Alaron, a registered futures commission merchant, entered into a guaranteed introducing broker agreement ("guarantee agreement") with Infoex on September 15, 1994.^{5/} The guarantee agreement set out the respective obligations in connection with "accounts [introduced by Infoex] on behalf of its clients to Alaron on a fully disclosed basis [in exchange for]

^{4/} The Leveraged Foreign Exchange Trading Ordinance, which became effective in 1994, authorizes the SFC to supervise a previously unregulated segment of the Hong Kong forex market which consists of leveraged forex dealers such as SHK Forex. The other segment of the Hong Kong forex market, which is subject to an established banking regulatory scheme, consists of licensed banks, restricted-licensed banks, and deposit-taking companies which trade spot and forward forex contracts among themselves and with the public.

^{5/} By September 15 1994, the CFTC had instituted 21 injunctive or administrative complaints against firms engaged in the illegal offer of off-exchange foreign currency futures and options and related fraudulent sales practices. Nine of these cases involved firms located in California. Most of these cases were initiated after 1990. See, e.g., *CFTC v. Frankwell Bullion* Civ. No. 94-2166 (N.D. Cal. filed June 29, 1994); *CFTC v. Dunn* Civ. No. 94-2403 (S.D.N.Y. filed April 5, 1994); *CFTC v. Topworth International, Ltd.*, Civ. No. 94-1256 AAH (C.D. Cal. filed Feb. 28, 1994); *CFTC v. Knight Wealth Inv. Ltd.*, Civ. No. 94-0220 (N.D. Cal. filed Jan. 21, 1994); *CFTC v. Richwell*, Civ. No. 93-3494 EFL (N.D. Cal. filed Sep. 23, 1993); *CFTC v. Standard Forex* Civ. No. 93-0088 (S.D.N.Y. filed Jan. 8, 1993); *CFTC v. Pacific Bullion*, Civ. No. 92-259 (S.D.N.Y. filed Dec. 2, 1992); and *Sun Hing Bullion Inv. Ltd.*, Civ. No. 90-5214 (C.D. Cal. filed Sep. 26, 1990).

Alaron services relating to transactions in commodities, contracts for the future delivery of commodities, and options thereon." [Exhibit A to Alaron's May 31, 1996 discovery production.] Alaron's form 1-FR-1B (Part B), submitted to the NFA by Alaron on October 17, 1994, provided that:

In consideration for the introduction of commodity customer, option customer, foreign futures customer and foreign options customer accounts by Infoex International, Inc., to Alaron, [Alaron] guarantees performance by [Infoex] of, and shall be jointly and severally liable for, all obligations of [Infoex] under the Commodity Exchange Act, and [CFTC] rules, regulations and orders.

[Emphasis added; Exhibit B to Alaron's May 31, 1996 discovery production.]

Neither Alaron nor Infoex produced detailed descriptions of the discussions and meetings before they entered into the guarantee agreement. Alaron has produced no evidence Infoex concealed its forex marketing and trading activities when Alaron officers visited Infoex's office in September 1994. During this visit, the Alaron officers assumed that Lee was acting as an attorney for Infoex. However, Alaron has produced no evidence concerning the specific acts or statements by Yang or Lee that created or fostered that assumption. [¶¶ 1-10 of Alaron's Answer and Motion to Dismiss; Alaron's replies to DuBois' discovery requests (filed January 9, 1996); and Alaron's June 13, 1996 discovery production (second Michael Greenberg affidavit, Steven Greenberg affidavit and Paul Tomey affidavit). See also Yang testimony at pages 78-80, and 94-101 of hearing transcript; and ¶ 13 of DuBois' Final Verified Statement.]

6. DuBois, a resident of Berkeley California, was self-employed as a psychoanalyst at the time that he opened his Infoex account. He has a bachelors and advanced degrees in Psychology. DuBois had minimal investment experience, none of it involving any investments that remotely resembled the leveraged forex contracts peddled by Infoex. When DuBois first contacted Yang and Infoex, he was principally interested in a career opportunity. [Pages 8-10 of hearing transcript; and Infoex application form, Yang's March 22, 1996 discovery production.]

The Leveraged Forex Contract

7. Infoex and SHK Forex offered high-risk leveraged forex contracts to customers as a means of speculating on the underlying foreign currency.^{6/} Each contract was standardized as to size to facilitate offset, and provided for the same quantity of the underlying foreign currency as the contracts sold on the Chicago Mercantile Exchange: each contract for the Deutschemark consisted of 125,000 Deutschemarks and each contract

^{6/} SHK Forex characterized the contracts as "leveraged foreign exchange" contracts or "FX" contracts. [SHK Forex Customer's Agreement; "Dear Customer" letter; and Third Party Trading Authorizations (Yang's discovery replies produced May 31, 1996).] In contrast, Alaron, Yang and Infoex characterized the contracts as "spot" contracts. [Alaron's Answer; Greenberg affidavit (Alaron's discovery reply filed May 31, 1996); Yang's Answer; Infoex's Answer; Infoex's "Currency Training Manual," "Currency Trading Exam," and promotional brochure (Yang's discovery reply filed May 31, 1996); and Sham letter to DuBois dated January 1, 1995 (DuBois' discovery replies, filed January 10, 1996).]

for the Japanese Yen consisted of 12,500,000 Yen.^{2/}

To buy or sell a leveraged forex contract, DuBois had to deposit initial margin which permitted him to speculate on a highly leveraged basis, and DuBois had to maintain margin to cover any unrealized losses. The contract could be held indefinitely and did not require delivery. Like most, or all, Infoex customers, DuBois lacked the capacity to make or take delivery of the foreign currencies underlying the leveraged forex contracts, and did not intend to make or take delivery. [DuBois' reply to interrogatory 12, produced May 31, 1996.]

An open contract could be "offset" or "liquidated" through an opposite and offsetting trade. During the time that the contract was held, interest charges on any debit balances would accrue and be applied to the proceeds upon liquidation. Settlement was in cash (Hong Kong Dollars).

DuBois was liable for a loss, or entitled to a profit, based on the price differential between the time that the contract was entered and the time that the contract was liquidated. [See SHK Customer's Agreement, SHK "Dear Customer" letter, Yang's replies to Interrogatories 15 and 16 (Yang's May 30, 1996 discovery production).] The price was set by SHK Forex, and was supposedly "based on interbank market prices." [Page 4 of Infoex "Currency Training Manual" (DuBois' January 10, 1996 discovery production).]

^{2/} Leveraged forex contracts were also offered for the Australian Dollar, the British Pound, the Canadian Dollar, and the Swiss Franc.

8. According to Yang, SHK Forex made its money on the bid-ask spread. [Pages 83-84 of hearing transcript.] Yang did not disclose this fact to DuBois. [Page 21-22 of hearing transcript.]

Infoex charged a \$90 round-turn commission per contract. Alaron received no compensation in connection with the DuBois forex account.^{8/}

Infoex's Solicitation and "Training" Course:

9. In early 1995, DuBois was considering a career change, and in this regard responded to two Infoex classified advertisements in January 16 and 23, 1995 editions of the *San Francisco Chronicle* that read: "INFOEX, an est[ablshed] invest[ment] co[mpany], offers access to small and medium sized investors to global currency markets." Yang spoke to Sham who sent him package of documents.

10. Various documents contained references or warnings about the high risks involved in trading leveraged forex contracts. Some of these references or warnings approximated the CFTC rule 1.55 standard futures risk disclosure statement in clarity and content. [¶ 8.4 of SHK Forex Customer's Agreement, and ¶ 1 of Appendix to SHK Forex Customer's Agreement; see also Infoex "Currency Training Manual" and "Currency Training Examination" (Yang's discovery replies filed May 31, 1996).]

^{8/} Infoex introduced a total of eleven accounts to Alaron. ¶ 3 of Alaron's May 31, 1996 discovery production.

Other written risk disclosures were more vague and equivocal. For example, the SHK Forex "Dear Customer" letter stated: [T]he nature of [trading leveraged forex contracts] is highly speculative and will, therefore, involve a lot of risks which may sometimes be high." [Emphasis added, Yang's discovery replies filed May 31, 1996.] Significantly, the only discrete and unambiguous disclosure statement -- an Infoex "Additional Risk Disclosure Statement" -- was not given to DuBois until well after he had suffered significant losses. [Yang's discovery replies filed May 31, 1996.]

11. Infoex documents identified Louis Hop Lee as the class instructor who had "extensive" forex trading experience," and stated that the training would enable the trainee "to gain market knowledge and analytical skills . . . to trade and to profit from the foreign currencies market." The Infoex "Mission Statement" stated that Infoex would provide its clients "with only experienced and knowledgeable traders to solidify the prosperity [sic] is rooted in the success of our traders and the performance of our clients accounts." [DuBois' January 10, 1996 discovery production.]

12. DuBois told Yang that he hoped to build a new career and that he would be financing his trades with his life savings. Throughout the solicitation and training classes, Yang and Lee told DuBois that they had successfully trained other individual's like DuBois with limited means and experience to trade successfully in the forex market. Yang and Lee assured him that

they would enable him to overcome the risks by teaching him successful conservative trading strategies and by identifying "sure" or "high-probability" trades.

Yang and Lee portrayed the fact that forex trading was much less regulated than futures trading as a tremendous advantage to DuBois, because the unregulated forex market supposedly provided "greater liquidity" and "better fills" than the regulated futures market. Yang and Lee never mentioned any of the profound disadvantages of the leveraged forex market compared to the regulated futures markets, most significantly the lack of a fair auction market assured by competitive bidding, price transparency and an audit trail. Yang and Lee also did not disclose that DuBois would be severely disadvantaged by the fact that SHK would be setting the bid-ask spread, and neither did they reveal that all of Infoex's customers had lost money. [See pages 1-20 of DuBois' final verified statement; page 5 of Complaint; and DuBois' testimony at pages 8-28 of hearing transcript.]

13. On February 9, DuBois signed a variety of account-opening documents, including an SHK Forex "Customer's Agreement" (Yang's March 22, 1996 discovery production); an SHK Forex "Account Mandate and Third Party Trading Authorization" that designated Sham to place orders with SHK Forex for DuBois) (Yang's March 22, 1996 discovery production);^{2/} and an "Independent Contractor Agreement" providing that DuBois would provide Infoex with "market research and analysis" and act as a

^{2/} On March 3, DuBois would sign a similar authorization for Lee.

"currency trader" and "sale[s] representative" (DuBois' January 10, 1996 discovery production);

14. The Infoex "Currency Training Manual" described such basic matters as account-opening procedures and understanding the difference between daily and weekly statements, a one-page glossary of basic trading terminology (e.g., terms like bid, ask, tick, long, short, position, bear and bull), cursory descriptions of technical and fundamental analysis, and basic trading philosophies. During the classes, Lee and Yang repeatedly assured the trainees that they would soon be realizing tremendous profits. Lee and Yang buttressed their unfounded promises with tactics such as using hypothetical trades that almost always resulted in profits, or discussing the use of stops to protect profits rather than also to limit losses. Yang and Lee encouraged the trainees to commit their own funds and begin soliciting new customers as soon as possible. After this rudimentary introduction, DuBois took a written test, which essentially required him to regurgitate the information supplied by Infoex, and then conducted "computer practice" using the reporting services of Knight-Ridder and Telerate. [DuBois' discovery replies filed January 1, 1996; Yang's discovery replies filed May 31, 1996; and pages 13-19, and 62 of hearing transcript.] Thus armed, DuBois began to trade with SHK Forex.

Trading Between DuBois and SHK:

15. On February 14, DuBois wired \$12,000 to SHK Forex's account at the Bank of New York.

From February 16 to March 7, DuBois authorized ten round-turn trades in the Deutschemark contract. All but two of these trades were day trades. One trade was an overnight trade (sell on February 16 and buy on February 17) and one trade was open for eight business days (sell on February 24 and buy on March 7). Two of the Deutschemark trades realized a profit. The greatest loss was on the eight-day trade which wiped out his initial investment with a \$12,376 loss on March 7.

On March 3, as the market moved against his D-mark position, Sham and Yang worked together on DuBois, with Sham urging DuBois to deposit additional funds in anticipation of a margin call and Yang advised DuBois against placing a stop order, because he would "lose too much money if [he] got out." DuBois later discovered that Yang used stop-loss orders for his own personal trades. [Pages 38-40 of hearing transcript.]

16. After the big loss on March 7, DuBois wrote a letter to SHK Forex complaining about Infoex's failure to provide the sort of services and advice promised during the solicitation and training. SHK Forex never responded to that letter.

Yang promised DuBois to provide more "sure" trade recommendations to enable him to "trade back" his losses, but insisted that DuBois first sign an "Additional Risk Disclosure Statement." [Yang's discovery replies filed May 31, 1996; see pages 44-49 of hearing transcript and page 20 of DuBois' final verified statement.] On April 25, DuBois then wired \$9,858 to SHK Forex's bank.

17. From April 25 to May 15, DuBois authorized four round-turn trades in the Yen contract. All of these trades were day trades and all realized a loss. On July 17, DuBois made one more Yen trade. Soon afterwards, DuBois instructed SHK Forex to close the account.

18. With the exception of the last trade, DuBois authorized all of the trades on the recommendations of Yang.^{10/} Lee also gave advice in connection with most of the trades. [DuBois document production filed February 25, 1997; and pp 9-10 of DuBois' final verified statement.]

19. DuBois invested a total of \$21,858 (\$12,000 on February 14, 1995 and \$9,858 on April 25, 1995), and when he closed his account received from SHK a check for \$7,086, for a net out-of-pocket loss of \$15,672. DuBois paid \$900 in commissions to Infoex. [See page 53 of hearing transcript.]

CONCLUSIONS

Subject Matter Jurisdiction

Respondents argue that the leveraged forex contracts between DuBois and SHK Forex are specifically exempt from regulation under the Commodity Exchange Act. Respondents rely on the Treasury Amendment, section 2(a)(1)(A)(ii) of the Act, which states:

^{10/} Yang's attempt to obscure or downplay his role as DuBois' trading advisor was unconvincing. See pages 87-88 of hearing transcript.

Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, . . . unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. §2(i). The Act defines the term "board of trade" to mean:

any exchange or association, whether incorporated or unincorporated, of persons who are engaged in the business of buying or selling any commodity or receiving the same on consignment.

7 U.S.C. §1a(1). Respondents assert that the Treasury Amendment on its face exempts all transactions in foreign currency from the Act except those conducted on exchanges already regulated by the Commission. Complainant, in contrast, asserts that the Treasury Amendment was intended to exempt only interbank transactions and not any marketing to the general public of off-exchange forex contracts.

The scope of the Treasury Amendment has been the subject of much debate and litigation. Since 1985, the CFTC has interpreted the Treasury Amendment to exclude certain forex transactions between sophisticated participants, but not to exclude "any marketing to the general public of futures transactions in foreign currencies." *Statutory Interpretation Regarding Trading in Foreign Currencies for Future Delivery*, 50 Fed. Reg. 42983 (CFTC Oct. 23, 1985). Federal circuit courts of appeal have differed in their interpretations of the Treasury

Amendment.^{11/} On the one hand, the Ninth Circuit has held that the plain meaning of the Treasury Amendment is that off-exchange foreign currency futures are exempted from the Act. CFTC v. Frankwell Bullion, Ltd., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,807 (9th Cir. October 29, 1996). On the other hand, several other courts have concluded that the Treasury Amendment was intended to exempt only regulated "interbank" transactions. See, e.g., *CFTC v. American Bd. of Trade, Inc.*, 803 F.2d 1242, 1249 (2d Cir. 1986); *Chicago Mercantile Exchange v. SEC*, 833 F.2d 537, 539-50 (7th Cir. 1989), cert. denied, 496 U.S. 936 (1990); and *CFTC v. Standard Forex, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,063 at pp. 41,452-56 (E.D.N.Y. 1993) ("*Standard Forex*") (holding that the Treasury Amendment excludes off-exchange transactions amongst banks already regulated, but not transactions on a board of trade with "private unsophisticated investors"). In view of the conflict in appellate decisions, the Commission's interpretation will be applied here, resulting in the conclusion that the leveraged forex contracts traded by DuBois are not excluded by the Treasury Amendment from CEA jurisdiction, because they are standardized contracts mass-marketed to relatively unsophisticated individuals. Respondents'

^{11/} The Supreme Court's decision in *Dunn, et al. v. CFTC*, 1997 WL 75492 (Feb. 25, 1997) has no affect on the status or outcome of this proceeding. In *Dunn*, the Court decided the narrow issue of whether futures and options are treated the same under the Treasury Amendment, and concluded that options are treated in the same manner as futures under the Treasury Amendment. 1997 WL 75492 at page 3.

reliance on the district court's decision in *Salomon Forex Inc. v. Tauber*, 795 F. Supp. 768 (E.D.Va. 1992) in support of their plain meaning argument is misplaced. Although the Fourth Circuit affirmed the district court's decision on appeal, it affirmed on narrower grounds and used reasoning that supports complainant's argument that respondents' forex activities are within reach of the Act. *Salomon Forex Inc. v. Tauber*, 8 F.3d 966 (4th Cir. 1993), cert. denied 114 S.Ct. 1540 (1994). The appellate court held only that "individually-negotiated foreign currency option and futures transactions between sophisticated, large-scale foreign currency traders," such as Tauber, fall within the Treasury Amendment exclusion. 8 F.3d at 978. The appellate court expressly qualified and limited its holding, stating:

[This ruling is not intended to] result in the use of this circuit as a base for marketing off-exchange futures contracts to the general public. . . . This case does not involve mass marketing to small investors which would appear to require trading through an exchange, and our holding in no way implies that such marketing is exempt from the CEA.

Id. Also worth noting is the fact that, in sharp contrast to DuBois' absolute lack of trading experience and limited wealth, Tauber was an experienced professional foreign currency trader, with a net worth of nearly one-half billion dollars, who regularly negotiated billions of dollars worth of currency contracts, who owned his own foreign currency trading company, and who held a seat on the largest foreign currency exchange in the United States. 8 F.3d at 969.

Violations by Yang and Infoex

Illegal Futures Contract

The Commodity Exchange Act does not define the term "futures contract." When determining whether a particular instrument constitutes a futures contract within the meaning of the Act, the Commission and the Courts have holistically evaluated the instrument with a focus on its underlying purpose. See *In re First National Monetary Corporation*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,698 at p. 30,974 (CFTC August 7, 1985) ("*FNTC*"), and cases cited therein. The Commission has identified certain characteristics that establish that an instrument is a futures contract: the purchase or sale of a commodity in the future at a price or pricing formula that is agreed upon when the transaction is entered; the use of the contract to shift or assume the risk of price changes; standardization as to terms and conditions other than price; the ability to satisfy the contract by either delivering the underlying commodity or offsetting the original contract with another; standardization of commodity units; no right or interest in a particular lot held by the customer; initial and maintenance margin; undertaken primarily to speculate on commodity price changes; and generally entered into not to take or make delivery, but rather to be discharged through offsetting transactions. *FNTC*, at pp. 30,974-75.

The SHK leveraged forex contract possesses many of these characteristics of a futures contract and thus meets the basic

definition of a futures contract. The SHK leveraged forex contract is an agreement to buy or sell a specified commodity, in this case currencies, at a price set at the time of formation of the contract with delivery to occur in the future. The underlying purpose of the SHK leveraged forex contract is to provide a speculative investment opportunity for customers who do not expect to take or make physical delivery. And, the SHK leveraged forex contract is standardized (only the price may vary), and requires the payment of initial and maintenance margin. See *In re Co Petro Marketing Group*, F.2d 566, 579-581 (9th Cir. 1982); and *Standard Forex*, at pp. 41,460-41,461.

Although, the Infoex promotional and training materials characterize the SHK leveraged forex contract as "spot" contracts, the transactions actually entered into by DuBois lack an essential characteristic of transactions in spot contracts. Spot transactions are transactions in the "current" market, and thus involve "contracts which call for delivery of the currency within two days of formation of the contract." *Standard Forex*, at p. 41,461, citing *Bank Brussels Lambert, S.A. v. Intermetals Corp.*, 779 F.Supp. 741, 742-743 (S.D.N.Y. 1991). In contrast, the SHK leveraged forex contract has no time limit, and DuBois held a position open for as long as eight business days. Therefore, DuBois' trades with SHK Forex cannot properly be viewed as spot transactions. See *Standard Forex*, at p.41,461.

Since, the SHK leveraged forex contract is a futures contract, it must be traded on a board of trade designated as a

contract market by the Commission, and the transactions must be handled by members of such a designated contract market.

Sections 4(a)(1) and (2) of the Act. However, SHK Forex does not trade the SHK leveraged forex contract on a designated contract market, and neither SHK Forex nor Infoex and Yang are members of such a designated contract market.

Fraud

Infoex, its owner Yang, and Infoex agents Lee and Sham acting under the direction and control of Yang, made various material misrepresentations concerning the likelihood of profits and the risk of loss from trading leveraged forex contracts, including: that Infoex would provide sufficient training for DuBois to become a qualified forex trader, when in fact the training lasted only 16 hours and consisted of a barely rudimentary introduction to the forex market; that Louis Hop Lee was an experienced forex trader, when in fact he was a recently debarred attorney; that Yang would utilize or recommend risk management strategies such as stop-loss orders, when in fact such strategies would never be utilized or recommended; that Yang and Lee would assure that DuBois would overcome the risks by teaching him successful conservative trading strategies and by identifying "sure" or "high-probability" trades, when in fact neither had the proven ability to select sure trades for Infoex customers; that Yang would provide more "sure" trade recommendations to enable him to "trade back" his losses; and that the unregulated nature of the leveraged forex market assured lower risk of loss

and greater probability of profits.

Yang, Lee and Sham failed to disclose that few, if any, of Infoex's customers realized any profits trading leveraged forex contracts, and failed to disclose that Infoex's customers were severely disadvantaged by the fact that SHK would be setting the bid-ask spread. Yang and Lee facilitated their fraud by failing to provide an effective written risk disclosure until after DuBois had lost his entire initial investment, and Yang undermined that written disclosure with his promise to select "sure" trades. The intentional nature of these misrepresentations is underscored by Yang's knowledge that they were simply false or lacked a reasonable basis. Finally, DuBois credibly testified that he relied to his detriment on these deceptions, misrepresentations and omissions, especially Yang's promise that he would select "sure" trades.

Alaron's Liability Under the Guarantee Agreement

The CFTC adopted rules permitting the use of a guarantee agreement as an alternative minimum capital mechanism for certain introducing brokers ("IBs") to protect the customers of IBs. Under the guarantee agreement, the guarantor futures commission merchant ("FCM") agrees to "guarantee performance by the IB of its obligations under the Act and the rules, regulations and orders thereunder." 48 Fed. Reg. 35248, at 35249 (August 3, 1983), reprinted at [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,792; see CFTC rules 1.10(j), and 1.17(a)(2)(ii). At the time that the CFTC adopted these rules, the CFTC stated

that the "Commission believes that the alternate adjusted net capital requirement embodied in the guarantee agreement is consistent with two of the factors upon which an adjusted net capital requirement for IBs should be based: (1) insuring that IBs are not judgment proof; and (2) providing coverage for potential liabilities of IBs arising from business operations and customer relations." 48 Fed. Reg, at 35264. Since the guarantee agreement between a guaranteed IB and its guarantor FCM is intended to provide sufficient protection for wronged customers and to act an adequate substitute for maintenance of a minimum level of regulatory capital by the IB as required by the CEA and CFTC regulations, the liability of guarantor FCM's has been well-established in reparations.^{12/}

Alaron's argument that its guarantee agreement with Infoex did not cover the off-exchange leveraged forex contracts sold by Infoex was based solely on its subject matter defense. [See ¶ 4 Michael Greenberg's Verified Statement (filed May 31, 1996), and ¶¶ 3 to 6, 8, and 9 of Alaron's answer.] Having failed to establish a lack of subject matter jurisdiction, Alaron's assertion that its guarantee agreement with Infoex did not cover

^{12/} Similarly, the National Futures Association recently amended its arbitration rules to assure that guarantor FCMs be held accountable for their obligations under their guarantee agreements with their guaranteed IBs. NFA Notice of Proposed Amendments to NFA's Arbitration Rules (March 4, 1997); see *The Boston Cattle Group, and Zachary Adelson v. ADM Investor Services, Incorporated, and Blalock and Company*, Order Remanding Awards to NFA Arbitration Panel for Clarification (N.D. Illinois, December 1, 1995) (remanding two "indefinite awards" to the NFA arbitration panel to clarify an FCM's liability under guarantee agreement).

the leveraged forex contracts marketed by Infoex must also fail.

The guarantee agreement between Alaron and Infoex provides that Alaron will be jointly and severally liable to Infoex's customers for Infoex's obligations under the Commodity Exchange Act or any CFTC regulations. The evidence in the record establishes that the conduct of the guaranteed introducing broker Infoex has resulted in obligations under the Commodity Exchange Act, and that this conduct occurred while the guarantee agreement was in effect, thus establishing Alaron's liability.

ORDER

It is concluded that Infoex International, Incorporated, Patrick Yang, Louis Hop Lee and Katrina Sham violated Sections 4(a) and 4b(a)(i) of the Commodity Exchange Act; that these violations, separately and together, proximately caused \$15,672 in damages; that Yang failed to supervise adequately Lee and Sham in violation of CFTC rule 166.3; that Infoex is liable for Yang's, Lee's and Sham's violations pursuant to CFTC rule 2(a)(1)(A); and that Alaron Trading Corporation is jointly and severally liable as guarantor of Infoex. Accordingly, Patrick Yang and Alaron Trading Corporation are ORDERED to pay to Tristan DuBois reparations of \$15,672, plus interest on that amount at 5.88% compounded annually from February 14, 1995, to the date of payment, plus \$25 in costs for the filing fee. Liability is joint and several.

Based on its bankruptcy petition, the complaint against Infoex International, Incorporated is barred and must be

DISMISSED WITHOUT PREJUDICE, pursuant to CFTC rule 12.24(d)(2).

Dated May 28, 1997.

A handwritten signature in cursive script, appearing to read "Philip V. McGuire".

Philip V. McGuire,
Judgment Officer