



**U.S. COMMODITY FUTURES TRADING COMMISSION**

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In the Matter of

Rockland P. McMahan,

Respondent.

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CFTC Docket No. 08-07

**INITIAL DECISION**

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Before:

Bruce C. Levine, Administrative Law Judge

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### Overview

McMahan's most obvious worry when the CME and CFTC called is that the CFTC would discover that McMahan had done something wrong – perhaps manipulated the futures market.<sup>1</sup>

The Commodity Futures Trading Commission's Division of Enforcement ("Enforcement") believes that Rockland P. McMahan, a large Texas cattle dealer, manipulated the feeder cattle market in 2004. The complaint, however, does not charge him with that wrong. Instead, it charges him with other offenses that he purportedly undertook in furtherance of this scheme – reporting a sham cattle transaction to the United States Department of Agriculture ("USDA"), not producing records, and lying to Commission investigators as part of a cover-up. However, Enforcement's manipulation theory still looms over this case as the motive supporting an inference that the lesser charged offenses occurred.

Enforcement accuses McMahan of reporting a sham cattle transaction with the intent and effect of moving the Chicago Mercantile Exchange ("CME") Feeder Cattle Index in his favor. The reported transaction resulted in an approximately \$105,000 gain in his futures position. Enforcement points to the gain as evidence of both McMahan's intent to manipulate and his motive for reporting the allegedly fictitious transaction. The problem with Enforcement's evidence is that nothing meaningful can be inferred from the

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<sup>1</sup> Division of Enforcement's Post-Hearing Brief, dated August 6, 2009 ("Enforcement's Post-Hearing Brief"), at 99.

fact that – in one instance – McMahan’s reported transaction profited his futures position. After all, any large but *honest* cattle dealer will frequently profit on his futures positions as a result of his cash transaction reports to the USDA.<sup>2</sup> Moreover, Enforcement failed to establish that the suspect reported transaction – for the purchase of 1800 steers at the price of \$118.00 per hundredweight – was fabricated. The counterparty to the deal testified credibility as to its *bona fides* and there is other, circumstantial, evidence supporting it.

One might think that this ends the case, but it doesn’t. Despite all of the above, Enforcement proved that McMahan violated all three counts of the Commission’s complaint. First, we find that McMahan violated Section 9(a)(2) of the Commodity Exchange Act.<sup>3</sup> Although the record permits nothing but speculation as to his motive, Enforcement proved that McMahan intentionally misled the USDA by averaging the steers’ weight so that the purchase was included in the Feeder Cattle Index when it shouldn’t have been.

Second, we find that McMahan violated Section 9(a)(3) of the Act.<sup>4</sup> He did so by knowingly misleading the Commission’s Division of Market Oversight

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<sup>2</sup> After explaining the methodological flaws in Enforcement’s reasoning, we explain how it might better develop a case of index manipulation in the future.

<sup>3</sup> 7 U.S.C. §13(a)(2).

<sup>4</sup> 7 U.S.C. §13(a)(3). Although motive is not an element of any of the violations, *scienter* is an element of Sections (9)(a)(2) and 9(a)(3). This term of legalese employs the Latin word roughly equivalent to the English “knowingly.” See  
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("Market Oversight") in its subsequent investigation. McMahan knowingly misled Market Oversight regarding changes to the initial steer deal and concealed information that would disclose the manner in which he misreported the 1800 steer transaction to the USDA. Here we have a motive: reducing the risk of prosecution. Indeed, McMahan admitted that "[h]e was concerned that if these investigators learned that the transaction had changed after it had been reported, it would only inflame suspicions."<sup>5</sup>

And third, we find that McMahan violated the Commission's books, records and inspection requirements, Section 4i of the Act and implementing Rules 1.31 and 18.05,<sup>6</sup> as a consequence of his effort to conceal subsequent changes to the steer transaction from Market Oversight.

Lastly, our findings as to McMahan's liability require us to undertake a reasoned assessment, as guided by Commission case law, of the appropriate mix of sanctions. This is no easy task. Like much of its precedent in other

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Black's Law Dictionary 1207 (5th ed. 1979). In short, in order to prove a violation, the prohibited act must be undertaken with a mental state embracing intent to deceive, manipulate, or defraud. However, given the mangled state of Commission case law on this subject, we are forced to discuss the *scienter* requirement at some length. Perhaps it will prompt the Commission to bring greater clarity to its treatment of this important element of law.

<sup>5</sup> Respondent Rockland P. McMahan's Post-Hearing Brief, filed September 3, 2009 ("Respondent's Post-Hearing Brief"), at 47-48.

<sup>6</sup> 7 U.S.C. §6i; 17 C.F.R. §§1.31, 18.05.

areas, the Commission's law of sanctions – mired in the ambiguous rhetoric of case-specific considerations and general pieties – thwarts the development of reasoned, predicable rules. However, muddling through as best we can, we impose on McMahan a cease and desist order, a three-month trading ban, and a \$120,000 civil monetary penalty.

### **Introduction**

#### **Factual Background**

The USDA compiles a weekly report of cattle transactions – direct sales, and various kinds of auctions – that includes price, weight, and quality among other factors.<sup>7</sup> To collect direct sale information, the USDA establishes long-term relationships with trusted cattlemen and calls them once a week with requests for descriptions of their transactions.<sup>8</sup> Participation by cattlemen is strictly voluntary.<sup>9</sup> The CME uses the information collected to create the

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<sup>7</sup> Complaint and Notice of Hearing Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, dated March 18, 2008 (“Complaint”), at ¶16; Answer and Defenses of Respondent Rockland P. McMahan to Complaint and Notice of Hearing, dated April 25, 2008 (“Answer”), at ¶16.

<sup>8</sup> Written Testimony of Edward F. Czerwien, dated April 30, 2009 (“Czerwien Written Testimony”) at ¶6; Testimony of Edward F. Czerwien (“Czerwien Tr.”) at 343-45. Throughout this opinion, “Tr.” refers to the Transcript of Oral Hearing, dated May 19-21, 2009. During the relevant period, Czerwien was the USDA employee who made the calls and collected the data for cattle transactions in Texas. Czerwien Tr. at 343.

<sup>9</sup> Written Testimony of David A. Kass, dated May 8, 2009 (“Kass Written Testimony”) at ¶4. Kass is a Senior Economist with the Commission's Division of Market Oversight.

Feeder Cattle Index; during the relevant period, this index measured the prices paid for young steers between 700 and 849 pounds of grade 1 muscling and a medium to medium-large frame.<sup>10</sup> This index is used by cattlemen to structure transactions in cattle (and related products), as well as for hedging and speculative purposes in the futures market.<sup>11</sup>

McMahan was among the trusted cattlemen who voluntarily reported his transactions to the USDA, and he did so for many years.<sup>12</sup> Each Thursday or Friday, he would describe the cattle he had bought or sold that week to Ed Czerwien, his contact at the USDA.<sup>13</sup>

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<sup>10</sup> Written Testimony of John B. Cook, Jr., dated May 14, 2009 (“Cook Written Testimony”), at ¶¶4-5; Testimony of John B. Cook, Jr. (“Cook Tr.”) at 443-44; DX-38-1. Although the “DX” series of evidentiary exhibits were introduced by Enforcement, they were adopted by McMahan. *See* Tr. at 7-8. Cook is the CME employee who oversees the calculation of the Feeder Cattle Index. Cook Written Testimony at ¶2.

<sup>11</sup> The index value determines the settlement price of the CME Feeder Cattle futures contract. The contract is cash-settled to the value of the index at expiration. Cook Written Testimony at ¶3. *See also* Testimony of Rockland P. McMahan (“McMahan Tr.”) at 31-32, 49, 74-76.

<sup>12</sup> Joint Chronology of Facts Not in Dispute (“Joint Chronology”), dated March 31, 2009, at ¶1. “His name was on a list to me of reputable contacts to call.” Czerwien Tr. at 372. The Joint Chronology contains the parties’ joint stipulations and was received in evidence at the hearing. Tr. at 9-10.

<sup>13</sup> Joint Chronology at ¶1.

In mid-October of 2004, McMahan told Czerwien that he had found some feeder cattle in which he was potentially interested.<sup>14</sup> Shortly thereafter, on October 21, McMahan informed Czerwien that he had purchased approximately 1800 feeder steers, weighing an average of 725 pounds, and at a cost of \$118.00 per hundredweight from Bovina Feeders, Inc. (“Bovina”).<sup>15</sup>

Czerwien included the purchase in the USDA report.<sup>16</sup> As usual, the CME used the information from the USDA report – including McMahan’s reported transaction – to create its Feeder Cattle Index.<sup>17</sup> The price of \$118.00 per hundredweight was above the average price reported that week and increased the index’s settlement price; the October 2004 CME Feeder Cattle Futures Contract settled at \$113.83, which was \$.62 higher than it would have been absent McMahan’s transaction.<sup>18</sup> McMahan had net-long futures and

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<sup>14</sup> *Id.* at ¶3. There is a suggestion that McMahan might have told someone other than Czerwien, but this is unimportant. *Id.*

<sup>15</sup> *Id.* at ¶7; McMahan Tr. at 63; Testimony of Steven Harper (“Harper Tr.”) at 391. We sometimes will refer to this as “the all-steer deal.” Bovina is a 42,000-head capacity custom feedlot located in Farwell, Texas, in which McMahan is a 10 percent owner. Complaint ¶8; Answer ¶8. During the relevant period, Harper was McMahan’s accountant. McMahan Tr. at 104-05, 108.

<sup>16</sup> Czerwien Written Testimony at ¶13.

<sup>17</sup> Joint Chronology at ¶8.

<sup>18</sup> Czerwien Written Testimony at ¶13; Cook Written Testimony at ¶¶17- 25.

options positions, and he directly benefited by approximately \$105,000 as a result of his report.<sup>19</sup>

Responding to a complaint from another cattleman,<sup>20</sup> Market Oversight questioned McMahan about the report.<sup>21</sup> McMahan provided Market Oversight with an invoice reflecting a purchase of 1750 steers weighing an average of 705 pounds at a price of \$118.00.<sup>22</sup> Both the number of steers and their average weight differed from McMahan's report to Czerwien.<sup>23</sup> However, Enforcement does not accuse McMahan of any violation with respect to this discrepancy.<sup>24</sup>

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<sup>19</sup> McMahan Tr. at 78; DX-35-2; DX-35-3; Written Testimony of Hugh J. Rooney, dated May 15, 2009 ("Rooney Written Testimony"), at ¶19. Rooney is an auditor employed with the Commission. Rooney Written Testimony at ¶1.

<sup>20</sup> Written Testimony of Thomas Pritchard, dated May 7, 2009 ("Pritchard Written Testimony"), at ¶3. Pritchard, who resides in Idaho, "routinely used the [USDA] reports of cattle sales in making decisions on buying and selling cattle." *Id.* at ¶1.

<sup>21</sup> Testimony of William J. Kokontis ("Kokontis Tr.") at 523. During the relevant period, Kokontis was the Director of the Market Surveillance Branch of Market Oversight. *Id.* at 517; DX-6-2.

<sup>22</sup> DX-9-18. McMahan provided varying estimates for the number of steers in the all-steer deal and their average weights. In referring to McMahan's reports, we therefore do as well. To avoid any confusion, we make clear from the outset that references to 1750 steers and 1800 steers both refer to the all-steer deal. Similarly, references to average weights of 705 pounds and 725 pounds both refer to the all-steer deal.

<sup>23</sup> Compare Joint Chronology at ¶7, with DX-9-18.

<sup>24</sup> Instead, it questioned McMahan only casually on the subject and appeared to accept his answer. McMahan Tr. at 105-06. See Kokontis Tr. at 578.

And yet, there are substantial other problems with McMahan's transaction as reported. First, none of the steers that McMahan estimated as averaging 725 (and then 705) pounds actually weighed that amount. Rather, McMahan admits to combining the averages of two sets of steers – approximately 930 weighing an average of 900 pounds and approximately 875 weighing an average 525 pounds.<sup>25</sup> It is undisputed that neither group of steers qualified for the Feeder Cattle Index – steers weighing between 700 and 849 pounds.<sup>26</sup>

Also, there is also no dispute that McMahan never received the 875 steers weighing 525 pounds.<sup>27</sup> At some point, approximately 1825 heifers were apparently substituted for them; the final transaction was for the approximately 930 heavier steers and 1825 heifers.<sup>28</sup> Once again, none of these qualify for the Feeder Cattle Index.<sup>29</sup>

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<sup>25</sup> Answer at 10.

<sup>26</sup> Cook Written Testimony at ¶5; DX 38. See McMahan Tr. at 156-58.

<sup>27</sup> DX-10-2.

<sup>28</sup> Although of no consequence for our purposes, the record is also imprecise as to the number of cattle involved in the final transaction. Compare Answer at 10-11 with DX-10-2. See *supra* note 22.

<sup>29</sup> Cook Written Testimony at ¶14.

The cattle industry is apparently quite informal; deals are made with handshakes and often little else.<sup>30</sup> McMahan argues that just such a deal was made for the 1800 steers, and that he legitimately reported the deal to the USDA.<sup>31</sup> When the deal subsequently changed, McMahan says that he did not inform the USDA simply because there is no provision for reporting cancelled or changed deals.<sup>32</sup> With respect to averaging cattle of different weights, McMahan explanation is simply that “that’s the way I had always done it.”<sup>33</sup>

### **Enforcement’s Charges**

Enforcement charges McMahan with violating three sections of the Commodity Exchange Act. The first is Section 9(a)(2), which makes it unlawful for any person to knowingly deliver or cause to be delivered, for transmission through interstate commerce, “false, misleading or knowing inaccurate” reports concerning market conditions that affect or tend to affect the price of a commodity in interstate commerce.<sup>34</sup>

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<sup>30</sup> Czerwien Tr. at 360-61.

<sup>31</sup> Respondent’s Post-Hearing Brief at 12; McMahan Tr. at 146-150.

<sup>32</sup> Respondent’s Post-Hearing Brief at 44. See *CFTC v. Delay*, 2006 U.S. Dist. LEXIS 85068, at \*24 (D. Neb. Nov. 17, 2006) (*holding* that “[t]here is no requirement to report to USDA that a transaction previously reported was not completed”).

<sup>33</sup> McMahan Tr. at 154-55.

<sup>34</sup> 7 U.S.C. §13(a)(2). See Complaint at ¶¶37-39.

Enforcement argues that McMahan's report was false, misleading, or knowingly inaccurate because there never was an all-steer deal,<sup>35</sup> and that McMahan falsely reported it in an attempt to benefit his futures position.<sup>36</sup> In the alternative, Enforcement argues that if there was an all-steer deal, McMahan's report still violated Section 9(a)(2) because he knowingly misled the USDA by averaging the weights of two groups of steers – neither of which conformed to the Feeder Cattle Index's weight requirements.<sup>37</sup> Further, given McMahan's years of experience trading in cattle futures, he certainly knew or should have known that his report to Czerwien was likely to be included in the CME's Feeder Cattle Index.<sup>38</sup> As such, McMahan's report concerned market information of a type that generally affects or tends to affect the price of a commodity in interstate commerce.<sup>39</sup>

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<sup>35</sup> Enforcement's Post-Hearing Brief at 2, 35-39.

<sup>36</sup> *Id.* at 1-5.

<sup>37</sup> *Id.* at 55. Presumably, McMahan's motivation for allegedly averaging the steers improperly was the same – to qualify them for the Feeder Cattle Index to benefit his futures position.

<sup>38</sup> Complaint at ¶26. Indeed, substantial testimony was devoted to an instance in which McMahan complained to the USDA that a transaction that he reported was improperly excluded from the index. McMahan Tr. at 72-77. McMahan was aggrieved because USDA's omission of the reported purchase from the index "hurt our hedging position." McMahan Tr. at 76.

<sup>39</sup> Complaint at ¶38. See 7 U.S.C. §13(a)(2).

Second, McMahan is alleged to have violated Section 4i of the Act and implementing Rules 1.31 and 18.05, which require that McMahan keep books and records showing all details concerning all positions and transactions in the cash commodity and upon request furnish to the Commission any pertinent information concerning such positions, transactions or activities.<sup>40</sup> Enforcement argues that McMahan violated these provisions by failing to produce adequate cash market and other records to Market Oversight, and also by delivering false, misleading or knowingly inaccurate responses to its requests.<sup>41</sup> Enforcement notes that *scienter* is not an element of Section 4i.<sup>42</sup>

Third, McMahan is alleged to have violated Section 9(a)(3) of the Act, which prohibits any person to knowingly make any statement in a document required to be filed under the Act which is false or misleading with respect to any material fact.<sup>43</sup> Further, a person may not knowingly omit any material fact required to be stated in a report or necessary to make the statements therein not misleading.<sup>44</sup> Enforcement contends that McMahan misled Market

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<sup>40</sup> Complaint at ¶¶40-45. See 7 U.S.C. §6i; 17 C.F.R. §§1.31, 18.05.

<sup>41</sup> Complaint at ¶¶40-45.

<sup>42</sup> Division of Enforcement's Prehearing Memorandum, dated December 17, 2008 ("Enforcement's Prehearing Memorandum"), at 15; Enforcement's Post-Hearing Brief at 63.

<sup>43</sup> Complaint at ¶¶46-48; 7 U.S.C. §13(a)(3).

<sup>44</sup> 7 U.S.C. §13(a)(3).

Oversight in its investigation by producing a sham invoice and with other affirmative misrepresentations and omissions.<sup>45</sup>

In sum, Enforcement accuses McMahan of (1) knowingly sending a false report through interstate commerce; (2) producing inadequate books and records in response to Market Oversight's inquiries into the purchase; and (3) misleading Market Oversight in its investigation. The first charge underlies the others; Enforcement contends that McMahan attempted to cover up his false report by producing inadequate records and misleading the investigation.<sup>46</sup> Conspicuously absent, however, is an express charge that McMahan manipulated the futures market.

#### **Manipulation, Motive, And Quantitative Analysis**

Whatever Enforcement's reasoning for not charging McMahan with manipulation, it discusses the issue in detail – presumably to establish McMahan's motivation to commit the violations for which Enforcement does charge him. Although motive is not an element of any of the violations, *scienter* is an element of Counts I (false reporting to the USDA) and III (misleading the Commission in its investigation).<sup>47</sup> Common experience informs us that people rarely *intend* to deceive without a reason (motive). Therefore, “[e]vidence of

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<sup>45</sup> Enforcement's Post-Hearing Brief at 65-66.

<sup>46</sup> *Id.* at 25, 46-49.

<sup>47</sup> 7 U.S.C. §13(a)(2); 7 U.S.C. §13(a)(3).

motive strengthens an inference of intent.”<sup>48</sup> Enforcement suggests that McMahan’s motivation for reporting a sham cattle transaction was the approximately \$105,000 that he gained as a result of his false report.<sup>49</sup> Thus, Enforcement is trying to prove that he knowingly reported a sham transaction for the purposes of impacting the settlement price of the CME index for personal financial gain – which clearly meets the definition of manipulation.<sup>50</sup>

Enforcement’s manipulation (motive) evidence betrays a lack of understanding of quantitative analysis. Nothing meaningful can be inferred

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<sup>48</sup> *Reddy v. CFTC*, 191 F.3d 109,119 (2d Cir. 1999).

<sup>49</sup> See Enforcement’s Post-Hearing Brief at 93.

<sup>50</sup> See 1 Timothy Snider, Regulation of the Commodities Futures and Options Markets, §12.12, 12-25-31 (2d ed. 1995) (stating that “[a] manipulative act constitutes any act that is inherently capable of causing an artificial price.”). As Professor Pirrong has explained:

[A] major type of manipulation involves some sort of fraud. For instance, a trader can spread a false rumor that causes prices to move in a way that benefits his position; “pump and dump” schemes are one variety of this. *As another example, a trader can misreport the prices of transactions when price reports are used to determine the settlement price of a derivatives contract.* As yet another example, a trader may engage in a wash trade that gives a misleading impression of actual buying or selling interest in a market.

Craig Pirrong, *Energy Market Manipulation: Definition, Diagnosis, and Deterrence*, 31 *Energy L. J.* 5 (2010) (emphasis added).

from the fact that – in this one instance – McMahan’s sales report profited his futures positions.

McMahan has been in the cattle business since the 1980s and had been providing reports of direct sales to the USDA for years.<sup>51</sup> He transacted in cattle almost every day and regularly held futures positions both to hedge and speculate.<sup>52</sup> So let us suppose for a moment that McMahan has always been an honest trader – that he has never submitted false reports or manipulated the market in any way.

Lacking special knowledge, approximately 50 percent of McMahan’s reports are likely to move the market higher from wherever the market happened to be, and 50 percent of his reports should move it lower.<sup>53</sup> Moreover, we can assume for purposes of this hypothetical that McMahan’s futures position is net long approximately half the time and net short the other half.<sup>54</sup> This simple chart demonstrates the conclusions that can be drawn from our uncontroversial assumptions.

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<sup>51</sup> Czerwien Tr. at 345-46. *See* McMahan Tr. at 52-53, 131-33.

<sup>52</sup> McMahan Tr. at 18, 31-37, 134-138.

<sup>53</sup> We simplify somewhat since it is possible that a McMahan report could be precisely at the index’s weighted price average. However, this is unlikely to occur often and does not alter our analysis.

<sup>54</sup> Here we simplify as well. *See supra* note 53. Moreover, we assume that McMahan is long half of the time for purposes of illustration only; our conclusion that McMahan’s *honest* price reports are as likely to help as hurt  
(continued..)

<b>McMahan Trades</b>	McMahan is net long 50%	McMahan is net short 50%
McMahan reports above market 50%	<b>McMahan gains 25%</b>	McMahan loses 25%
McMahan reports below market 50%	McMahan loses 25%	<b>McMahan gains 25%</b>

Thus, assuming McMahan's complete honesty, 50 percent of his reports (25+25) would "directly" move the market to his financial benefit. To be absolutely clear, it is perfectly natural for traders' reports to move markets in a direction that benefits them on a regular basis. Indeed, the surprising thing would be if 50 percent of McMahan's reports did *not* move the market in a direction that benefitted him.

A likely error of any superficial analysis is to conflate loss with honesty and gain with manipulation. But the fact that prices move over time is precisely why futures markets exist;<sup>55</sup> and as the hypothetical above demonstrates, gains from these markets are to be expected about half the time

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his futures position is not dependent on whether and to what extent he is long or short.

<sup>55</sup> A premise of the economics literature on futures markets (dating back at least to Alfred Marshall, Industry and Trade (1919)) is that hedging demand exists because of the potential for price fluctuations to have substantial effects on the profits of producers and users (*e.g.*, flour mills).

with honest trading.<sup>56</sup> It should therefore be obvious that no inference of manipulation can be drawn from the simple fact that McMahan gained – even as a direct result of his report moving the market to his benefit.<sup>57</sup> Thus – particularly given the informal nature of direct reporting – using a single instance of profits in futures market to target traders for investigation or charges would lead to the prosecution of traders based purely on a coincidence.

Proper statistical and economic methodology requires more than one data point.<sup>58</sup> More specifically, it requires conclusions that rest on numerical

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<sup>56</sup> Cf. *In re JCC, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,080 at 41,576 n.23 (CFTC May 12, 1994) (*stating* “[b]ecause futures markets are a zero-sum game, a trending market will produce both winners and losers. Profits derive from being on the right side of a trending market; at best, a difficult matter to predict.”).

<sup>57</sup> As an aside, we note that personal financial gain is not an element of manipulation – or of false reporting. See 7 U.S.C. §13(a)(2). Nor should it be. Suppose a dishonest trader learned the futures position of a rival firm. He might well falsely report in such a way so as to take a small loss himself while substantially injuring his rival. Cf. Markus K. Brunnermeier & Lasse Heje Pedersen, *Predatory Trading*, 60 *J. of Finance* 1825-63 (2005). This suggests another reason for not relying too heavily on futures profits as a screen in determining whether to investigate or charge a trader.

<sup>58</sup> Damodar N. Gujarati, and Dawn C. Porter, Basic Econometrics 835, Appendix A (5th ed. 2009).

As the sample size increases, and provided we are using a consistent estimation procedure, our estimates will be closer to the truth, and less dispersed around it, so that discrepancies that are undetectable with small samples will lead to rejection in large samples. Large sample sizes are like greater resolving power on a telescope; features that are not visible from a

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discrepancies between two samples: a normative, baseline sample<sup>59</sup> and a sample arising from a party's activity.<sup>60</sup>

Therefore, reliable evidence in support of Enforcement's manipulation theory would require analysis of multiple reports and corresponding futures positions, showing a statistically significant deviation from a pattern of honest reports or a pattern of dishonest ones. For instance, if Enforcement established that the average cattleman experienced gains in the futures market as a result of their own reports approximately 50 percent of the time, and that McMahan gained 70 percent of the time – well, that would constitute statistical evidence that McMahan was falsely reporting.<sup>61</sup> Or perhaps if McMahan had a

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distance become more and more sharply delineated as  
the magnification is turned up.

<sup>59</sup> By “normative,” we do not mean “ideal.” Rather, we means some measure of actual conditions with which, in the absence of the complained of acts, expected party-specific behavior should correlate.

<sup>60</sup> See Athanasios Papoulis, Probability & Statistics 3-4, 9-12 (1990). When this occurs, the Court will generally concern itself with six issues: (1) the manner in which the baseline sample was compiled, (2) the appropriateness of the baseline sample, (3) the manner in which a party's sample was compiled and quantified, (4) the manner in which the expert compared samples, (5) the results, and (6) whether and how the expert accounts for chance. *In re Gorski*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,742 at 48,499 (CFTC August 23, 1999).

<sup>61</sup> For example, consider the canonical coin-flip. If one flips a fair coin four times, the chances of its coming up heads three or more times (*i.e.*, 75 percent of the time) is 5/16, or roughly 31 percent. In contrast, if one were to flip a fair coin 16 times, the chances of observing heads on 75 percent or more of the

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history of reporting large trades only after he had taken large futures positions and the market was moving against him. There are endless possibilities. But what they all have in common is multiple data points – a prerequisite for a valid statistical analysis of any one particular data point.<sup>62</sup>

Nevertheless, Enforcement insists that McMahan's gain in this one instance constitutes reliable evidence of McMahan's motive to manipulate the futures market.<sup>63</sup> A final example may help to cement why this reasoning is flawed. Suppose that for the last 100 reports in a row, McMahan had lost money as a direct result of his report. That is, when he reported a transaction above the market, he happened to be net short, and when he reported below the market, he happened to be net long. Further suppose that those 100

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flips would be only about 2.5 percent and if one were to flip a coin 36 times, the probability of observing 75 percent or more heads would be less than 1 in 500. Rephrasing slightly, if one observed a coin coming up heads 27 out of 36 times, one would be confident that the coin is not fair, but one would be substantially less confident if one observed a coin coming up with three heads out of four flips. It follows that, even if an agent is not acting strategically to affect an outcome (in McMahan's case, change a settlement price), large percentage differences from the expected outcome will occur regularly in looking at individual observations, while those same percentage changes are highly unlikely to occur when looking at an average taken over large samples. See Gujarati and Porter, *supra* note 58 at 835, Appendix A.

<sup>62</sup> Pirrong, *supra* note 50 at 9 (“Historical data on historical price relations, analyzed rigorously and properly, can provide extremely powerful evidence of manipulative distortions.”).

<sup>63</sup> Enforcement's Post-Hearing Brief at 93-94.

reports had an aggregate negative impact on his futures positions of \$10,000,000. Now he reports the 101st time – the report at issue here – and he moves the market in a direction where he gains \$105,000. McMahan would remain at a net loss – of \$9,895,000.

In the above example, Enforcement's theory – that a single gain supports an inference of manipulation – leads to the implausible conclusion that McMahan was honest enough to make reports that injured his futures positions 100 times in a row at a cost of \$10,000,000, and yet dishonest on the 101st report only.<sup>64</sup> And while it is astronomically unlikely that McMahan lost on his last 100 trades, the point is that we simply have no baseline data on McMahan's past reports and futures positions by which to evaluate any one instance of his conduct.<sup>65</sup> For example, McMahan might well have lost exactly \$105,000 on the trade immediately prior to the one at issue, as a direct result

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<sup>64</sup> Perhaps Enforcement would disagree, since it is comfortable assuming that McMahan's conduct was an instance of "isolated opportunism." *Id.* at 96.

<sup>65</sup> At the time, the USDA did not keep records of individual direct reports, and McMahan did not keep records either. Czerwien Tr. at 351; McMahan Tr. at 60. Thus, Enforcement argues, it was impossible to adduce statistical analysis of his trading history. *Id.* at 94-96. However, this does not change the fact that examining only one data point of potentially hundreds is statistically improper, and it certainly does not permit the Court to assume away the issue. When a party simply cannot prove an essential fact, the law accounts for this through the burden of proof. When a fact must be proved but proof is currently impossible, the burden of proof resolves the issue. *Burnet v. Houston*, 283 U.S. 223, 228 (1931); *Coca-Cola Bottling Co. v. Wood*, 123 S.W.2d 514, 516 (Ark. 1939) ("The verdict was possible only by permitting surmise and conjecture to supply facts incapable of proof. This was error."); Richard A. Posner, The Problems of Jurisprudence 204 (paperback ed. 1993).

of his report moving the index in the opposite direction of his futures positions.<sup>66</sup> Thus, the fact that McMahan gained \$105,000 as a direct result of this particular report must be taken for what it is – one completely out-of-context data point of possibly hundreds – rendering it both statistically insignificant and unreliable as evidence.

Worse, we cannot even be sure that McMahan actually benefitted from the report when all interests are considered. While the amount gained by McMahan in his own accounts is undisputed,<sup>67</sup> it turns out that his wife and possibly other family members also held futures positions that were affected by his report.<sup>68</sup> Their gains or losses are not in evidence.<sup>69</sup> In theory then,

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<sup>66</sup> Indeed, it was apparently not unusual for McMahan to lose \$90,000 or more in the futures market. See McMahan Tr. at 137-38.

<sup>67</sup> Tr. at 471; Respondent's Post-Hearing Brief at 4.

<sup>68</sup> Harper Tr. at 388-89.

<sup>69</sup> When apprised of this defect, Enforcement conceded that the futures positions of McMahan's "wife, mother-in-law and friends arguable would be relevant" and that the record was devoid of any evidence as to their positions. Enforcement's Post-Hearing Brief at 96-97. Nonetheless, it equivocates by seeking to justify this gap in the record; it does so by suggesting that the futures positions of McMahan's wife and other family members are not properly "aggregated" for purposes of determining whether McMahan exceeded speculative position limits in violation of 7 U.S.C. §6a(a). *Id.* at 97 (citing *In re Bielfeldt*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,923 (CFTC Dec. 2, 2004)). So what? McMahan was not charged with violating trading limits, nor was his family. The relevant issue here is whether McMahan would regard himself as benefitting as a direct result of his report moving the index price. The impact that his report would have on the futures positions of his wife and family would presumably enter into that assessment.

McMahan's immediate family might well have *lost* money as a direct result of his report.<sup>70</sup>

In sum, Enforcement has engaged in two types of data mining:<sup>71</sup> first, by addressing only a single gain while presenting negligible evidence of McMahan's long trading history; and second, by acknowledging that McMahan's immediate family had positions in the futures market but presenting no evidence whether they gained or lost as a result of McMahan's report. We are left, unfortunately, not knowing whether the McMahan family gained at all, or whether the presented gain of \$105,000 constitutes anything other than a normal, statistically insignificant occurrence.

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<sup>70</sup> Though Enforcement agrees that the futures positions of McMahan's wife and family are not in evidence, it nevertheless expresses its willingness to provide the information – and makes an offer of proof to that effect. Enforcement's Post-Hearing Brief at 96-97, n.25. The record is closed and will not be reopened. Tr. at 616-17. Under Rule 10.69, a party seeking to reopen must show that (1) the evidence is relevant and material; *and* (2) reasonable grounds exist to explain the failure to adduce the evidence at the time of hearing. 17 C.F.R. §10.69; *In re U.S. Securities Corp.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶31,494 at 63,570 (CFTC Oct. 7, 2009). No reasonable grounds exist for Enforcement's failure to produce the family's futures positions earlier.

<sup>71</sup> "Data mining" is a term synonymous with "data fishing," "data dredging" and "data snooping." Each refers to the misuse of statistical techniques in a manner that engenders bias; that is, inaccurate and misleading results. The cause of such statistical bias is usually much more complex than it is here, where we deal not with sampling or modeling errors but rather with an attempt to extrapolate statistical significance from an obviously insufficient population of one. *See generally* Ryan Sullivan, Allan Timmermann and Halbert White, *Data-Snooping, Technical Trading Rule Performance, and the Bootstrap*, J. of Finance 54, 1647-1691 (1999).

Beyond McMahan's gain of \$105,000 as a consequence of his report, Enforcement presents other evidence in support of its manipulation theory. This evidence comes in three parts: (1) McMahan held the largest net-long position in October feeder cattle futures among traders with open positions;<sup>72</sup> (2) McMahan's reported number of cattle purchased was relatively large,<sup>73</sup> and the largest that Stephen Harper, McMahan's employee, remembers purchasing;<sup>74</sup> and (3) McMahan's reported price of \$118 per hundredweight was also relatively high.<sup>75</sup> Although these circumstances may raise suspicions sufficient to warrant further investigation,<sup>76</sup> they fall short as reliable proof for the same reasons as discussed above.<sup>77</sup>

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<sup>72</sup> Enforcement's Post-Hearing Brief at 3; DX-27-3; DX-27-4; McMahan Tr. at 208.

<sup>73</sup> Czerwien Written Testimony at ¶14.

<sup>74</sup> Harper Tr. at 421.

<sup>75</sup> Czerwien Written Testimony at ¶14.

<sup>76</sup> There is some evidence that Market Oversight uses a combination of a trader's futures position and unusual price reports to determine which trades to investigate. See Kokontis Tr. at 517-18.

<sup>77</sup> As the Commission has stated:

The Division must prove the allegations of a complaint by a preponderance of the evidence. This requires that the Division establish more than a suspicious set of circumstances. In a case such as this one, which requires the trier of fact to draw inferences from conduct arising out of complex economic relationships, the Division must present evidence that is sufficiently unambiguous and reliable

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The problem is that Enforcement presents none of McMahan's other trades or futures positions for context. For instance, the fact that McMahan held the largest net-long futures position on a week when his report moved the market in his direction might seem suspicious. But what if McMahan regularly held the largest futures position – short or long – simply because he was such a large trader? Then the fact that he held such a large net-long position in this one instance would be inconsequential. And sure enough, McMahan stated that not only had he held large positions in the past, but that this particular position – for 270 contracts – was well below his position limit of 400.<sup>78</sup> Clearly then, no negative inferences can be drawn from McMahan's large futures

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to form a persuasive basis for drawing the inferences necessary to find liability.

*In re Bielfeldt*, [2003-2004 Transfer Binder] ¶29,923 at 56,800.

<sup>78</sup> McMahan Tr. at 208; Kokontis Tr. at 569. Market Oversight's Kokontis stated that during the underlying investigation, McMahan had informed him "[t]hat he had a bigger position in the past, bigger than the October '04 position." Kokontis Tr. at 569.

Kokontis's testimony on this point reveals Market Oversight's indifference. When asked by McMahan's counsel whether Market Oversight had verified McMahan's statement about his prior large trading, Kokontis responded "probably" but he didn't remember the result. *Id.* He then explained that he was "not particularly" likely to remember whether McMahan's statements on this subject panned out because "[i]t was not a particularly relevant point. It didn't matter to me whether he had been in the market larger in the past or not." *Id.* at 570.

position in this one instance, when the evidence provides no guidance as to how unusual it was.

McMahan's report of a relatively large number of cattle might also seem suspicious.<sup>79</sup> And yet, no one disputes that McMahan was a large trader.<sup>80</sup> For the same reasons that a large trader would naturally have large futures positions, a large trader must – by definition – often report large transactions.

Enforcement comes closest to statistical relevance when it argues that the trade was the largest that Harper remembers.<sup>81</sup> However, Harper's testimony on this point is confusing. His exact statement is "I've never bought that much cattle in that much before."<sup>82</sup> Enforcement interprets this as meaning that "[t]his is the largest amount of cattle that Harper recalls ever bringing in."<sup>83</sup> And yet, Enforcement also elicited credible testimony that McMahan had bought a load of 5,000 to 6,000 steers in Marlin, Texas, just a

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<sup>79</sup> *But see* Czerwien Written Testimony at ¶14 ("The 1800 reported number of head purchased was somewhat large, but not unusual.").

<sup>80</sup> Complaint ¶6 ("At all relevant times, McMahan has been a reportable trader in the feeder cattle futures contract and has maintained a feeder cattle hedge exemption with the CME in connection with hedging his cash market."); McMahan Tr. at 36, 83. McMahan's transactions spanned the border. He was one of the larger American buyers in Mexico. Czerwien Tr. at 352.

<sup>81</sup> Harper Tr. at 421.

<sup>82</sup> *Id.*

<sup>83</sup> Enforcement's Post-Hearing Brief at 78.

few years earlier.<sup>84</sup> Given that seemingly inconsistent fact, it is possible that Harper may have been referring only to Bovina; saying, in effect, that he had never before purchased so many cattle from Bovina.<sup>85</sup> Or perhaps Harper had simply not been employed with McMahan long enough to have experienced larger deals.<sup>86</sup> The fact remains the only other transaction addressed at the hearing is for three times as many cattle as the report at issue here.<sup>87</sup>

The same problems arise with respect to McMahan's reported price, which was apparently the highest for direct sales that week<sup>88</sup> – though not for

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<sup>84</sup> McMahan Tr. at 72; Testimony of Kenneth Gladney ("Gladney Tr.") at 380 ("[I]t seemed like it was two or three years before 2004"). Gladney was Czerwien's supervisor at the USDA. Czerwien Tr. at 344.

<sup>85</sup> Harper's complete statement lends some support to this alternative interpretation:

Normally when – to be honest, I've never bought that much cattle in that much before. But I don't recall that's what *they* send me when we purchase cattle from *them*. They always send me – every time that I can remember *them* selling us cattle directly from *them*, *they* have sent me an invoice like the one that we paid off of.

Harper Tr. at 421 (emphasis added). The "they" and "them" appear to refer to Bovina specifically.

<sup>86</sup> At the time of the questioned transaction (October 2004), McMahan had been in the cattle business for two decades. McMahan Tr. at 131-33. Harper had only been working for McMahan for two years. Harper Tr. at 380.

<sup>87</sup> McMahan Tr. at 72.

<sup>88</sup> DX-1.

sales at auctions.<sup>89</sup> We do not have any information regarding McMahan's purchase prices at other times. Once again, this prevents meaningful analysis.

For instance, suppose that we had multiple data points, and that we could statistically demonstrate that McMahan's reports were on average closest to that of the CME index and with the least variation. Under Enforcement's implied theory that a report of a price relatively far from the average supports an inference of false reporting, McMahan could well be – on average – the most honest cattleman in history. Absent context, we can draw no meaningful conclusions from McMahan's relatively high reported price in this one instance.<sup>90</sup>

Moreover, even if we were to assume that a high price in a single instance supported an inference of false reporting, here there are contrary facts to overcome such an inference. First, several witnesses credibly testified that McMahan was buying cattle with an unusual motivation. Rather than simply wanting to buy low and sell high – the standard formula for success in any business – McMahan was expressly purchasing cattle to accrue feed expenses

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<sup>89</sup> Czerwien Tr. at 366; Czerwien Written Testimony at ¶14.

<sup>90</sup> The USDA has the discretion to exclude reported trades that appear to be outliers. Gladney Tr. at 494. Far from excluding the report, Czerwien compared McMahan's reported price with other reported prices and found it to be "right in line." Czerwien Tr. at 358. His superior, Gladney, concurred. Gladney Tr. at 491-92. With the USDA on record as interpreting McMahan's reported price as "right in line," we struggle to see how Enforcement reasonably draws a negative inference.

for tax purposes.<sup>91</sup> Though neither side specifically addresses the issue, it seems likely that the expected tax benefit exceeded the cost to McMahan of paying a relatively high price for the steers.<sup>92</sup> Since McMahan was relatively more interested in accumulating feed expenses than he was in the price, this might accurately be reflected by the moderately higher purchase price that he reported.<sup>93</sup>

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<sup>91</sup> McMahan Tr. at 138-39; Harper Tr. 423-24; Testimony of William Gail Morris ("Morris Tr.") at 300-01. During the relevant period, Morris was the General Manager of Bovina. Morris Tr. at 273-74. Enforcement does not challenge any of the testimony regarding McMahan's 2004 tax circumstances.

<sup>92</sup> McMahan could realize tax savings of \$300,000-\$400,000 if he could successfully accrue sufficient feed expense. McMahan Tr. at 138-39. This is three or more times the amount of the futures market gain at issue. Even after acquiring the feed expenses, McMahan's taxable income in 2004 was "just under" \$1,000,000. Harper Tr. at 424.

<sup>93</sup> One might ask why McMahan's ulterior tax motivation might raise the price that he would have to pay. First, it is helpful to consider that "feeder cattle" – from McMahan's tax perspective – was not a homogenous product. The subset of feeder cattle that McMahan demanded was feeder cattle with particularly high accumulated feed costs. It is natural to pay a premium when you want goods with very specific features. And McMahan was motivated to buy these particular feeders because the tax benefit (at least in theory) outweighed the potentially higher cost in the cash market.

Moreover, purchasing a large number of cattle can – of itself – increase the price above the market average. When a large trader in any market seeks to make a large purchase quickly, he may reasonably ignore offers for small amounts of the product – even if offered at a cheaper price. See Andrew N. Kleit, *Index Manipulation, the CFTC, and the Inanity of DiPlacido*, AEI Center for Regulatory and Market Studies Working Paper 09-06 at 19-22 (Feb. 2009). For instance, suppose a nearby small farmer happened to learn McMahan was in the market for feeder cattle and offered him "Frank" – a single feeder steer – for a bit under market price. It would be perfectly reasonable for McMahan to decline this offer – the time involved in putting together 1800 separate deals for

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In sum, McMahan is a large trader, who in one instance happened to purchase a large number of cattle at a relatively high price while holding a large future position. It is hardly unusual for large traders to make large purchases and hold large futures positions. Moreover, a trader looking to purchase a large number of cattle for tax purposes is likely to take a higher price relative to others. Further, assuming McMahan's complete honesty, approximately 50 percent of his reports should directly benefit his futures position – thus, no negative inference can be drawn from the fact that this one report did so.

As we lack the context necessary to interpret Enforcement's single data point, we conclude that it has failed to demonstrate that McMahan had a motive to falsely report. This does not necessarily mean that McMahan had no financial or other motive to falsely report. But we are bound by what inferences can be drawn from the evidentiary record; we are not in the business of determining ontological truth.<sup>94</sup> The flimsiness of the evidence only

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individual steers is simply prohibitive. Enforcement argues that McMahan's purchase was the largest reported that week; indeed, many of the other reported purchases were for 250 or fewer cattle. DX-1. Clearly then, it is legitimate for McMahan to want to avoid a multitude of separate deals, when he could make a single deal for 1800 – even if he paid a slightly higher price.

<sup>94</sup> A judicial fact-finding is the soul of compromise. There is no doubt that adversarial proceedings are searches for truth. However, the mechanism is imperfect in a number of respects. First, knowledge comes at a price. Mirjan Damaska, *Truth in Adjudication*, 49 *Hastings L.J.* 289, 301 (1998). In addition,  
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means that we must approach the case from the perspective that McMahan had no financial motive to make a false report.

This does not, however, doom Enforcement's case. Motive is not an element of any of the counts brought against McMahan.<sup>95</sup> It simply colors the analysis; if McMahan had no motive to manipulate the market, it is harder to reasonably conclude that he falsely reported with *scienter*. We examine that concept next.

### **Scienter And Recklessness – The Reckless State Of Commission Case Law**

*Scienter*, however, is a subjective inquiry. It turns on the defendant's actual state of mind. See 8 Louis Loss & Joel Seligman, Securities Regulation 3676 (3d ed. 2004). Thus, although we may consider the objective unreasonableness of the defendant's conduct to raise an inference of *scienter*, the ultimate

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unbounded fact finding would compromise other values such as preserving constitutional norms and confidences. Posner, *supra* note 65 at 207. Thus, various aspects of a legal proceeding, such as rules of discovery and evidence, balance the truth-searching aspects with the costs involved. *Id.*; Damaska at 301. In addition, adjudications are bound by an evidentiary record (and, sometimes, noticeable facts), that is generally developed by self-interested parties, rather than all available facts that might inform the process. *Cf.* 5 U.S.C. §556(d); 17 C.F.R. §10.69. See, e.g., *In re Clark*, ¶27,370 at 46,693; *Fager v. Nadell*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,351 at 46,598 (CFTC May 7, 1998); *In re Elliott*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,000 (CFTC Feb. 3, 1998). The development of the record depends a great deal on the foresight, knowledge and skill of the advocates as well as that of the decisional tribunal.

<sup>95</sup> See 7 U.S.C. §§6i, 13(a)(2), 13(a)(3).

question is whether the defendant knew his or her statements were false, or was consciously reckless as to their truth or falsity.<sup>96</sup>

This definition of *scienter* is well established, and it is the same almost everywhere. The Supreme Court<sup>97</sup> and every circuit court<sup>98</sup> understands that

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<sup>96</sup> *Gebhart v. S.E.C.*, 595 F.3d 1034, 1042 (9th Cir. 2010) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976)).

<sup>97</sup> *Hochfelder*, 425 U.S. at 193 n.12 (holding that “the term ‘*scienter*’ refers to a mental state embracing intent to deceive, manipulate, or defraud.”) In *Hochfelder*, the Supreme Court notes that “[i]n certain areas of the law recklessness is sufficient for purposes of imposing liability for some act.” *Id.* But even here, it imports a notion of “intentional conduct.” *Id.* See *Sanders v. John Nuveen & Co., Inc.* 554 F.2d 790, 793 (7th Cir. 1977) (describing the *Hochfelder* recklessness standard “as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.”) (citation and internal quotation marks omitted and emphasis added).

<sup>98</sup> All thirteen circuits agree. *Scienter* is determined by a respondent’s state of mind:

**First Circuit:** “*Scienter* is defined as ‘a mental state embracing intent to deceive, manipulate, or defraud.’” *Ezra Charitable Trust v. Tyco Intern., Ltd.*, 466 F.3d 1, 6 (1st Cir. 2006);

**Second Circuit:** “The Supreme Court has defined *scienter* as ‘a mental state embracing intent to deceive, manipulate, or defraud.’” *South Cherry Street, LLC v. Hennessie Group, LLC*, 573 F.3d 98, 109 (2nd Cir. 2009);

**Third Circuit:** “We have previously defined ‘*scienter*’ in the context of securities fraud as ‘a mental state embracing intent to deceive, manipulate or defraud, or, at a minimum, highly unreasonable (conduct), involving not merely simple, or even excusable negligence, but an extreme departure from the standards of ordinary care, ... which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.’” *In re Alparma Inc. Securities Litigation*, 372 F.3d 137, 148 (3rd Cir. 2004);

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**Fourth Circuit:** “As defined by the Supreme Court, ‘*scienter* refers to a mental state embracing intent to deceive, manipulate or defraud.’” *Svezzese v. Duratek, Inc.*, 67 Fed. Appx. 169, 173 (4th Cir. 2003);

**Fifth Circuit:** “We have defined *scienter* as an ‘intent to deceive, manipulate, or defraud....’” *R2 Investments LDC v. Phillips*, 401 F.3d 638, 643 (5th Cir. 2005);

**Sixth Circuit:** “[T]he Supreme Court defined *scienter* as ‘a mental state embracing intent to deceive, manipulate, or defraud.’” *Robert N. Clemens Trust v. Morgan Stanley DW, Inc.*, 485 F.3d 840, 847 (6th Cir. 2007);

**Seventh Circuit:** “[L]iability requires proof of the defendant’s “*scienter*,” which is to say proof that he either knew the statement was false or was reckless in disregarding a substantial risk that it was false. A popular definition of recklessness in this context is ‘an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 704 (7th Cir. 2008) (citations omitted);

**Eighth Circuit:** “[S]*cienter* may be demonstrated by severe recklessness involving ‘highly unreasonable omissions or misrepresentations’ amounting to ‘an extreme departure from the standards of ordinary care, and that presents a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.’” *Kushner v. Beverly Enterprises, Inc.*, 317 F.3d 820, 828 (8th Cir. 2003) (citing *K & S P’ship v. Cont’l Bank, N.A.*, 952 F.2d 971, 978 (8th Cir. 1991));

**Ninth Circuit:** “[I]n the securities fraud context, *scienter* requires ‘deliberate recklessness,’ which we defined as conduct reflecting ‘some degree of intentional or conscious misconduct.’” *Gebhart*, 595 F.3d at 1041 (citing *In re Silicon Graphics Inc. Securities Litigation*, 183 F.3d 970, 977 (9th Cir. 1999));

**Tenth Circuit:** “The term ‘*scienter*’ has been defined by the Supreme Court of the United States as ‘a mental state embracing intent to deceive, manipulate, or defraud.’ The Supreme Court has further elaborated on the meaning of the term by stating: ‘The words ‘manipulative or deceptive’ used in conjunction with ‘device or contrivance’ strongly suggest that §10(b) was intended to proscribe knowing or intentional misconduct.’” *City of Philadelphia*  
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*scienter* is a state of mind, or in other words *subjective* – that is, intent, knowledge, or a subjective recklessness that rises to the level of intent.<sup>99</sup>

However, we say that *scienter* is understood to be subjective “*almost everywhere*,” because on this issue the Commission appears to be somewhere else. But where, it is hard to say. The Commission started in the same place as the rest of the legal world; in *Squadrito*, the Commission held that

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*v. Fleming Companies, Inc.*, 264 F.3d 1245, 1258 (10th Cir. 2001) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976));

**Eleventh Circuit:** “[E]very circuit to address the issue had held that recklessness can serve as *an actionable state of mind* under §10(b) and Rule 10b-5, including our own. *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1282 (11th Cir. 1999) (emphasis added);

**D.C. Circuit:** “We hold that recklessness is sufficient to satisfy section 4b’s *scienter* requirement. A reckless action, as the First Circuit said in reaching the same result, “is one that departs so far from the standards of ordinary care that it is very difficult to believe the [actor] was not aware of what he was doing.” *Drexel Burnham Lambert Inc. v. Commodity Futures Trading Com’n*, 850 F.2d 742, 748 (D.C. Cir. 1988) (bracket in the original and quoting *First Commodity Corp v. Commodity Futures Trading Com’n*, 676 F. 2d 1, 7 (1st Cir. 1982));

**Federal Circuit:** “The VA’s past interpretation of ‘willful misconduct’ as well as the limited legislative history of §§105 and 1110, support, at least inferentially, our interpretation that in defining the disability for purpose of the exclusion, Congress intended an element of *scienter*, so as to distinguish between willful and involuntary causative acts. *Allen v. Principi*, 237 F.3d 1368, 1378 (Fed Cir. 2001) (emphasis added).

<sup>99</sup> See generally Restatement (Second) of Torts §526 (1977) (permitting *scienter* to be established by showing either knowledge or conscious recklessness).

recklessness (like knowledge) is a state of mind: “[A] finding of good faith bars a finding of recklessness.”<sup>100</sup> Since then, it has been wandering.

***Do v. Lind-Waldock – The Demise Of Scienter***

In *Do v. Lind-Waldock & Co.*, the undisputed facts are as follows. A customer (Do) telephoned her broker (Lind-Waldock) to open a new British Pound futures position in her account.<sup>101</sup> The broker transmitted the order to the exchange floor for execution.<sup>102</sup> “[F]ive to six minutes” later, the customer called again to cancel the order.<sup>103</sup> Assuming that the order had already been filled, the broker advised the customer that it was “too late to cancel” and therefore declined to accept the cancellation order.<sup>104</sup> As it turned out, the broker had been mistaken. The Commission reasoned:

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<sup>100</sup> *In re Squadrito*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,262 at 38,828 (CFTC Mar. 27, 1992) (citations omitted). *Accord Goldstein v. MCI WorldCom*, 340 F.3d 238, 246 (5th Cir. 2003); *Novak v. Kasaks*, 216 F.3d 300, 312 (2nd Cir. 2000) (*holding* that “[b]y reckless disregard for the truth, we mean ‘conscious recklessness’- i.e., a state of mind *approximating actual intent*, and *not merely a heightened form of negligence*.”) (emphasis in the original); *S.E.C. v. Infinity Group Co.*, 212 F.3d 180, 192-93 (3rd Cir. 2000); *cf. Restatement (Second) of Torts* §526 cmt. d (“The fact that the misrepresentation is one that a man of ordinary care and intelligence in the maker’s situation would have recognized as false is not enough to impose liability.”).

<sup>101</sup> *Do v. Lind-Waldock & Co.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,516 at 43,320 (CFTC Sept. 27, 1995).

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at 43,320-21.

<sup>104</sup> *Id.* at 43,320.

If Lind-Waldock's employee had checked on the status of Do's order at the time of complainant's call, the employee would have learned that it had not been executed. In fact, because of unusual volatility in the market for the British Pound futures contract, a CME circuit breaker rule had been triggered, restricting the sale of such contracts for fifteen minutes. As a result, Do's sell order was not executed until 11:20, eight minutes after she instructed Lind-Waldock to enter a cancellation order. Shortly thereafter, Do liquidated the position, suffering an out-of-pocket loss of \$9,250.<sup>105</sup>

Do sued for damages in reparations under the fraud provisions of the Act.<sup>106</sup> In defense, Lind-Waldock argued that there was no proof of *scienter* "because, at best, the record supports an inference that its employee made a good faith error in advising complainant that it was too late to cancel her order."<sup>107</sup> The Commission accepted that the mistake was made in good faith.<sup>108</sup> Under existing Commission case law, that should have been sufficient for Lind-Waldock to prevail.<sup>109</sup> But it wasn't. Without so much as a mention of

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<sup>105</sup> *Id.* (note omitted).

<sup>106</sup> *Id.* See 7 U.S.C. §6b.

<sup>107</sup> *Do*, [1994-1996 Transfer Binder] ¶26,516 at 43,321.

<sup>108</sup> "For purposes of this decision, we assume that the record establishes . . . the employee's good faith belief that, in ordinary circumstances, the order could not be canceled five to six minutes after being given...." *Id.*

<sup>109</sup> Remember *Squadrito*. "[A] finding of good faith bars a finding of recklessness." [1990-1992 Transfer Binder] ¶25,262 at 38,828 (citations omitted).

*Squadrito*,<sup>110</sup> the Commission rooted Lind-Waldock's liability in a newly minted *objective* standard of "recklessness."<sup>111</sup>

The Commission concluded that Lind-Waldock's employee acted with the *scienter* necessary to support a fraud charge "in at least failing to ascertain the status of Do's order prior to advising her that it was 'too late to cancel'"<sup>112</sup> and in failing to transmit the order to the exchange.<sup>113</sup> The Commission concluded that these acts constituted "[r]eckless inattention."<sup>114</sup> Clearly, this new standard is wholly objective. The Commission further concluded that "[w]hat Lind-Waldock's employee actually believed is irrelevant; what matters is

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<sup>110</sup> This omission is an example of the Commission's weak jurisprudential skills. See *Schurz Communication, Inc. v. FCC*, 982 F.2d 1043, 1053 (7th Cir. 1992) (Posner, J.) ("The Commission's [FCC's] treatment of precedent was also cavalier. An administrative agency is no more straight jacketed by precedent than a court is. It can reject its previous decisions. But it must explain why it is doing so."). We have noted other examples in the past. See, e.g., *In re Sklena*, [Current Transfer Binder] Comm. Fut., L. Rep. (CCH) ¶31,425 at 63,239 n.10 (CFTC Sept. 30, 2009) (discussing the Commission's "fractured jurisprudence"); *Vargas v. FX Solutions, LLC*, [Current Transfer Binder] Comm. Fut., L. Rep. (CCH) ¶31,360 at 62,885 & n.151 (CFTC June 1, 2009).

<sup>111</sup> As we shall see shortly, this standard as applied in *Do*, appears a misnomer. The Commission's analysis suggests that it was in fact imposing strict liability. See *infra* notes 116-126 and accompanying text.

<sup>112</sup> *Do*, [1994-1996 Transfer Binder] ¶26,516 at 43,321.

<sup>113</sup> *Id.* at 43,321-22. Of course, if the Lind-Waldock broker ascertained that the cancellation order could not be executed, this second "breach" would result in a duty to engage in an act of futility.

<sup>114</sup> *Id.* at 43,321 (internal quotation marks omitted).

whether the employee was in a position to inquire into the actual status of complainant's order, or to take other suitable action, and failed to do so.”<sup>115</sup>

Broadly, there are three levels of culpability – *scienter* (defined once again as intent, knowledge, or subjective recklessness approaching intent), negligence, and strict liability (or stated differently, non-culpability). Obviously, “objective” recklessness in which good faith is irrelevant is not *scienter*. We now examine whether the standard articulated in *Do* even rises to negligence.

We have previously defined negligence as failure to use “reasonable care.”<sup>116</sup> As applied to the facts in *Do*, the Commission’s recklessness standard appears easier to meet than that of negligence. Consider the analytically most precise standard for negligence – the famous “Hand Formula,”<sup>117</sup> – which

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<sup>115</sup> *Id.*

<sup>116</sup> *Corbett v. Friedman*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,799 at 61,667 n.44 (CFTC Feb. 28, 2008); *Smith v. Betty*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,605 at 60,792 n.27 (CFTC Aug. 15, 2007). This is a common definition of the term. See, e.g., *McCarty v. Pheasant Run, Inc.*, 826 F.2d 1554, 1557 (7th Cir. 1987). Another, lengthier formulation of the same standard defines negligence “as the lack of due care under the circumstances; or the failure to do what a reasonable and prudent man would ordinarily have done under the circumstances of the situation; or doing what such a person under the existing circumstances would not have done.” *Tiller v. Atlantic Coast Line R. Co.*, 318 U.S. 54, 67 (1943).

<sup>117</sup> In *United States v. Carroll Towing Co.*, Judge Learned Hand explained:

Since there are occasions when every vessel will break from her moorings, and since, if she does, she becomes a menace to those about her; the owner’s

(continued..)

translates into economic terms the conventional legal test for negligence. One must determine whether the burden of precaution is less than the magnitude of the injury/loss, multiplied by the probability of occurrence (Burden < Loss \* Probability).<sup>118</sup> Only when the burden is less should the precaution be taken. Negligence is defined as merely the failure to take precautions that would generate greater benefits in avoiding injury than the precautions would cost.<sup>119</sup>

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(..continued)

duty, as in other similar situations, to provide against resulting injuries is a function of three variables: (1) the probability that she will break away; (2) the gravity of the resulting injury, if she does; (3) the burden of adequate precautions. Possibly it serves to bring this notion into relief to state it in algebraic terms: if the probability be called P; the injury, L; and the burden, B; liability depends upon whether B is less than L multiplied by P: *i.e.*, whether B less than PL.

159 F.2d 169, 173 (2d Cir.1947).

Although *Carroll Towing* is an admiralty case, the “Hand Formula” has been widely applied to other areas of the law. See *McCarty*, 826 F.2d at 1556-57 (collecting cases); *United States Fidelity & Guaranty Co. v. Jadranska Slobodna Plovidba*, 683 F.2d 1022, 1026 (7th Cir. 1982) (stating that “the [Hand] formula is a valuable aid to clear thinking about the factors that are relevant to a judgment of negligence and about the relationship among those factors”); Richard A. Posner, Economic Analysis of Law 163-67 (4th ed. 1992).

<sup>118</sup> Or as Learned Hand put it, (B<PL). The product of this multiplication, or “discounting,” is what economists call an expected cost. *McCarty*, 826 F.2d 1554 at 1556.

<sup>119</sup> *Id.* at 1557.

When we apply this standard to the facts in *Do*, it could not be clearer that Lind-Waldock's inaction was entirely reasonable, and therefore not negligent. First, the loss to the customer if a broker fails to transmit an untimely but executable order, can be substantial – but not necessarily so.<sup>120</sup> *Do* suffered damages of \$9,500.<sup>121</sup>

With respect to the probability of damages, *Do*'s British Pound order had not been executed because “a CME circuit breaker rule had been triggered, restricting the sale of such contracts for fifteen minutes.”<sup>122</sup> The Commission acknowledged that the circuit breaker had never before been triggered “in 20 years of foreign currency trading on the CME....”<sup>123</sup> And more generally, the Commission accepted Lind-Waldock's assertion that there is “virtually no chance of canceling a market order to sell British Pound futures five to six

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<sup>120</sup> Of course, in any given case, the loss could be larger or smaller. Indeed, the failure to execute an order could frequently benefit a customer. For instance, this would have been the case if the market had moved in favor of *Do*'s uncanceled order to sell four British Pounds. On average, the loss is likely to be zero. See *JCC, Inc.*, [1992-1994 Transfer Binder] ¶26,080 at 41,576 n.23 (stating that “[b]ecause futures markets are a zero-sum game, a trending market will produce both winners and losers. Profits derive from being on the right side of a trending market; at best, a difficult matter to predict.”).

<sup>121</sup> *Do*, [1994-1996 Transfer Binder] ¶26,516 at 43,320.

<sup>122</sup> *Id.*

<sup>123</sup> And this is with respect to *any* currency, not just the British Pound! *Id.* at 43,320 n.3.

minutes after it [is] given.”<sup>124</sup> Thus, the probability of injury admittedly approached zero.

As to the burden of precaution, the Commission specified the ways in which Lind-Waldock could have prevented the damage that occurred. It could routinely check on the status of all untimely cancelation orders and/or forward them to the exchange.<sup>125</sup> The burden of doing this – while small for each order – would likely be considerable as we aggregate the countless untimely orders that are likely to be received in the normal course of business.

Therefore, the uncontested facts in *Do* show that the burden of precaution dramatically exceeds the magnitude of loss times its probability; in other words,  $B > PL$ . The “reasonable and prudent” broker will not adopt a practice of undertaking to inquire about or transmit untimely orders that he knows have “virtually no chance” of execution. The burden to him (which will be passed on in the fees that he charges his customers) simply exceeds the benefit of avoiding the *de minimis* possibility of injury in any given case. The prudent broker will do precisely what the Lind-Waldock broker did: he will advise the customer that it is “too late to cancel.”

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<sup>124</sup> *Id.* at 43,321.

<sup>125</sup> *Id.* at 43,321-22.

We reach the inescapable conclusion that the Commission in *Do* eviscerates *scienter* and replaces it with a rule of strict liability,<sup>126</sup> and without ever mentioning its own contrary precedent – or the fact that no other court in the country permits *scienter* to be found absent at least subjective recklessness. In so doing, it punishes efficient and reasonable conduct. Worse, no reasonable broker would follow the rule; instead, they will simply assume the risk of liability for damages in the once in a lifetime event that an order can be cancelled so long after being placed. This result harms the very industry the Commission’s regulations are designed to promote, as well as – by raising transaction costs – the customers the Commission is obligated to protect.

### ***In re Staryk – Scienter’s Return***

Yet just two years after the *scienter* requirement (as known to the rest of the world) was banished in *Do*, it was repatriated in *Staryk*.<sup>127</sup> In *Staryk*, the Commission once again<sup>128</sup> held that subjective good faith is sufficient to

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<sup>126</sup> “The principal difference between liability for negligence and strict liability is that the latter imposes liability for those mistakes that could not be avoided by the exercise of due care – mistakes, in other words, the costs of which fall short of the costs of preventing them.” *USA Group Loan Services, Inc. v. Riley*, 82 F.3d 708, 713 (7th Cir. 1996). See Posner, *supra* note 117 at 175.

<sup>127</sup> *In re Staryk*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997).

<sup>128</sup> Remember – once more – *Squadrito*.

preclude a finding of scienter.<sup>129</sup> In that options fraud case,<sup>130</sup> the Commission vacated and remanded the part of the Administrative Law Judge's decision<sup>131</sup> that granted summary disposition in favor of Enforcement on the issue of the respondent broker's *scienter*.<sup>132</sup> In so doing, it held that "[w]hile the deceptive nature of Staryk's solicitations was determined according to an objective standard, his intent in making those representations is a subjective question."<sup>133</sup> And that since "[a] defending party's 'intent and knowledge are particularly within his personal comprehension,'"<sup>134</sup> "[the respondent] was entitled to an oral hearing on the issue of his state of mind."<sup>135</sup>

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<sup>129</sup> *Staryk*, [1996-1998 Transfer Binder] ¶27,206 at 45,811. Although it did not bother to refer to *Squadrito*, its conclusion was essentially the same. "[A] finding of good faith bars a finding of recklessness." [1990-1992 Transfer Binder] ¶25,262 at 38,828 (citations omitted).

<sup>130</sup> See 7 U.S.C. §6c(b).

<sup>131</sup> *In re Staryk*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,701 at 43,932-33 (CFTC June 5, 1996).

<sup>132</sup> *Staryk*, [1996-1998 Transfer Binder] ¶27,206 at 45,803, 11, 13.

<sup>133</sup> *Id.* at 45,811.

<sup>134</sup> *Id.* (citing to *CFTC v. Savage*, 611 F.2d 270, 282 (9th Cir. 1979)).

<sup>135</sup> *Id.* at 45,811. Compare *Gebhart*, 595 F.3d at 1042 n.11. In granting summary disposition in favor of Enforcement, the Administrative Law Judge made two *scienter* findings. He found not only intent, but also objective recklessness. *Staryk*, [1994-1996 Transfer Binder] ¶26,701 at 43,932-33. In doing so, the judge specifically relied on *Do. Id.* at 43,927 n.77. Yet, in its remand order, the Commission vacated both the Court's *subjective* intent finding and *objective* recklessness finding on the basis of Staryk's testimony of his *subjective* state of mind. *Staryk*, [1996-1998 Transfer Binder] ¶27,206 at 5,811.

The Commission did not attempt to reconcile its holding in *Staryk* with its holding in *Do*; indeed, it once again does not even acknowledge a conflict.<sup>136</sup> And unfortunately, the confusion does not end there.

***In re R&W – Elemental Confusion***

In a still later case, *R&W*, the Commission appears to go in a yet another direction.<sup>137</sup> The respondents in *R&W* sold electronic futures trading systems that were supposedly guaranteed to generate a profit.<sup>138</sup> Among other violations, the Commission held that the respondents fraudulently omitted to inform its customers that their performance claims for the systems were based on “simulations” rather than actual trading.<sup>139</sup> The respondents’ defense was that they lacked the requisite *scienter* because they “believed that there was no material difference between an actual trading account and R&W’s simulated account.”<sup>140</sup> The Commission rejected this argument, holding that “professions of ignorance by [the respondents], *even if believable*, would constitute a reckless disregard for the legal significance of the omitted fact and of their

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<sup>136</sup> The remand order does not cite to *Do* or discuss the judge’s findings in support of objective recklessness. *See supra* note 110.

<sup>137</sup> *In re R&W Technical Services, Ltd.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,582 (CFTC Mar. 16, 1999).

<sup>138</sup> *Id.* at 47,728.

<sup>139</sup> *Id.* at 47,743. *See* 7 U.S.C. §6b.

<sup>140</sup> *R&W*, [1998-1999 Transfer Binder] ¶27,582 at 47,743.

duties under the Act.”<sup>141</sup> Thus, the Commission chose not to apply the subjective, “mental state” view of *scienter* that it had embraced in *Squadrito* and once again in *Saryk*. Instead, it appears to have shifted back to an objective standard<sup>142</sup> – but one with a different spin than *Do*.

In *R&W*, objective recklessness morphs into the heretofore distinct legal element of materiality. Here is the Commission’s entire discussion of the standard.

[P]rofessions of ignorance by R&W and Reagan, even if believable, would constitute a reckless disregard for the legal significance of the omitted fact and of their duties under the Act. Despite respondents’ asserted personal beliefs as to the efficacy of their product, the weight of opinion supports the principle that simulated results convey less reliable information than actual results about the predictive power of a trading system. Their omission of a demonstrably material fact left investors without a key piece of data with which to evaluate their purchase decisions and future investment choices. R&W and Reagan’s willingness to conceal crucial information from their customers and to allow them to base their investment decisions upon inaccurate information is a significant departure from ordinary standards of care. These factors alone — even assuming that R&W and Reagan lacked the specific intent to harm their customers — support a finding of recklessness.<sup>143</sup>

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<sup>141</sup> *Id.* at 47,743 (emphasis added).

<sup>142</sup> In its discussion of *scienter*, the Commission cites to *Do*; there is no mention of *Squadrito* or *Saryk*. *Id.*

<sup>143</sup> *Id.* (citation omitted).

Nothing is left of *scienter*; if a respondent omits a “demonstrably material fact” he does so recklessly. Period.<sup>144</sup> To add to this confusion, the Commission equates believable ignorance that there was no material difference between actual and simulated trading results with a “willingness to conceal crucial information”<sup>145</sup> and *ipse dixit* declares this to be negligence (“a *significant* departure from ordinary standards of care”).<sup>146</sup> So *recklessness is* the *omission of a material fact*, because *believable ignorance is willful concealment* which *is* an act of *negligence*. And whatever that means, it satisfies the *scienter* requirement. We are left dumbfounded.

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<sup>144</sup> There can be no question that materiality is an element of fraud. And that appears to be where the Commission lost track; in *R&W* it first discusses the materiality element of fraud separately, before going on to discuss it a second time in the context of *scienter*. *Id.* at 47,741-43.

<sup>145</sup> As the Commission notes: “[a] statement or omitted fact is ‘material’ if a reasonable investor would have considered the information important in making a decision to invest.” *Id.* at 47,741. If the respondents do not believe a piece of information is material – that is, important to investors – how can the failure to disclose it be regarded as the intentional concealment of “crucial” information? Compare *Sundstrand Corp. v. Sun Chemical Corp.* 553 F.2d 1033, 1047 (7th Cir. 1977) (*stating* “even if constructive knowledge of the danger to Sundstrand of omitting certain facts is imputed to Meers, an omission caused because Meers genuinely forgot about these facts would not be actionable, even if such an omission derived from inexcusable neglect.”).

<sup>146</sup> *Id.* at 47,741 (emphasis added). Negligence involves a *significant* departure from reasonable care, while (at least everywhere but the Commission) recklessness involves an *extreme* one. See *Infinity Group Co.*, 212 F.3d at 192 (The court defines recklessness as “[h]ighly unreasonable (conduct), involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.”) (citations omitted).

### **Conclusion – A Different Rule For Every Day**

In sum, in addressing recklessness in the context of *scienter*, the Commission in one breath held that “[a] finding of good faith bars a finding of recklessness,”<sup>147</sup> while in the next breath held the opposite (“What Lind-Waldock’s employee actually believed is irrelevant...”).<sup>148</sup> It then moved back to a subjective standard – ruling that *scienter* could only be established at trial, because it was purely subjective and a state of mind.<sup>149</sup> And the last word on the subject mixes the concepts of recklessness, materiality, subjectivity, objectivity and negligence in a manner that is incoherent.<sup>150</sup> Moreover, whenever it strays from a purely subjective standard, its test for recklessness looks remarkably like strict liability.<sup>151</sup> And not one of these cases expressly overrules – or even acknowledges – the others’ conflicting precedent.

Clearly defined law – no matter how bad – has the minimal benefit of allowing litigants to know the rules of the game and act accordingly.

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<sup>147</sup> *Squadrito*, [1990-1992 Transfer Binder] ¶25,262 at 38,828.

<sup>148</sup> *Do*, [1994-1996 Transfer Binder] ¶26,516 at 43,321.

<sup>149</sup> *Staryk*, [1996-1998 Transfer Binder] ¶27,206 at 45,811.

<sup>150</sup> *R&W*, [1998-1999 Transfer Binder] ¶27,582 at 47,743.

<sup>151</sup> *See supra* notes 116-126, 143-146 and accompanying text.

Hopelessly muddled rules, however, offer nothing but unbounded agency discretion – something that amounts to no law at all. In another context, the Commission has observed that “[t]he law does not permit an agency to grant to one person the right to do that which it denies to another similarly situated. There may not be a rule for Monday, and another for a Tuesday, a rule of general application, but denied outright in a specific case.”<sup>152</sup> By having a different rule regarding *scienter* for every day of the week, the Commission has failed to heed this bedrock principle of jurisprudence.<sup>153</sup>

Although obliged to follow Commission precedent,<sup>154</sup> we quite candidly have no idea how to reconcile the Commission’s conflicting and confusing holdings on *scienter*.<sup>155</sup> However, we do know that the Federal courts

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<sup>152</sup> *In re Horn*, [1990–1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,836 at 36,939 (CFTC Apr. 18, 1990) (*citing with approval Frozen Foods Express, Inc. v. United States*, 535 F.2d 877, 880 (5th Cir.1976) (*quoting Mary Carter Paint v. FTC*, 333 F.2d 654, 660 (5th Cir. 1965)).

<sup>153</sup> *Squadrito* was decided on a *Friday* (March 27, 1992), *Do* on *Wednesday* (September 27, 1995), *Staryk* on *Thursday* (December 18, 1997), and *R&W* on a *Tuesday* (March 16, 1999). If this case is appealed, we hope the Commission’s decision is not issued on a Monday. Further, we note that the odds of four cases with distinct precedent being issued on four different days out of a possible five day work week is only 19.2 percent. Absent an understanding of statistical reasoning, we might be inclined to believe that the Commission intended this distribution. See *supra* notes 51-95 and accompanying text.

<sup>154</sup> *In re Trillion Japan Co. Ltd.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,082 at 41,589 (CFTC May 23, 1994).

<sup>155</sup> The Commission has recognized that a decision-maker “must be prepared to explain its failure to reach a similar conclusion in situations that are apparently comparable.” *Horn*, [1990-1992 Transfer Binder] ¶24,836 at (continued..)

uniformly hold that *scienter* – including recklessness – is subjective, a mental state, and wholly distinct from negligence and strict liability.<sup>156</sup> Thus, if the Commission decision in this case is appealed, the Fifth Circuit (the circuit with likely jurisdiction),<sup>157</sup> as well as any other circuit, would use the subjective definition of recklessness. Given the conflicting Commission precedent and the unanimity in the Federal courts, we choose to follow the Commission in *Staryk* and *Squadrito*. We hold that *scienter* is determined subjectively via an examination of a respondent's state of mind. To meet its burden on the counts alleging violations of Section 9(a)(2) and Section 9a)(3) of the Act,<sup>158</sup> Enforcement must therefore demonstrate that McMahan falsely reported with intent, knowledge, or a subjective recklessness that rises to the level of intent.

We now consider whether and to what extent Enforcement has proved the charges it has leveled against McMahan.

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(..continued)

36,939. Should this case be appealed, we ask that the Commission clarify this area of its case law.

<sup>156</sup> See *supra* notes 96-99 and accompanying text.

<sup>157</sup> See 7 U.S.C §§9, 15.

<sup>158</sup> 7 U.S.C. §13(a)(2); 7 U.S.C. §13(a)(3). See *supra* note 4.

**McMahan's Violations: False And Misleading Reporting To The USDA  
Affecting The Price Of Feeder Cattle**

In its first Count of the Complaint, Enforcement accuses McMahan of violating Section 9(a)(2) of the Act:

“It shall be a felony for...: Any person . . . knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce....”<sup>159</sup>

To establish the violation requires proof of three elements: (1) a respondent must have knowingly delivered or caused to be delivered market reports or market information through interstate commerce;<sup>160</sup> (2) the information must have been false, misleading, or knowingly inaccurate; and (3) the report must concern market information or conditions of a type that generally affects or tends to affect the price of a commodity in interstate commerce.<sup>161</sup> There is no dispute over the third element – direct reports of

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<sup>159</sup> 7 USC §13(a)(2). See Complaint at ¶¶37-39.

<sup>160</sup> Arguably, the first element should be divided into two. Though often overlooked, “through interstate commerce” is certainly distinct from “knowingly delivered,” and just as necessary to prove. See generally, *In re Wright*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,412 at 54,768-71 (CFTC Feb. 25, 2003).

<sup>161</sup> See *In re Soybean Futures Litigation*, 892 F. Supp. 1025, 1044 (N.D. Ill. 1995).

feeder cattle do generally affect the price of a commodity in interstate commerce – and so we will focus on the first and second.

### **The Interstate Commerce Requirement**

Initially, there was no dispute over the interstate commerce requirement. Indeed, from the earliest filings through Enforcement's Post-Hearing Brief, there was no discussion of it at all. Enforcement just assumed it away, asserting – but not otherwise developing or supporting – that McMahan had intentionally sent a market report through interstate commerce.<sup>162</sup> McMahan waited until his post-hearing response to address the issue but then did so at length.<sup>163</sup> It is potentially a game changer; if the interstate commerce element is not met, McMahan cannot be found liable under Section 9(a)(2) of the Act.<sup>164</sup>

Enforcement must establish each and every element of a violation.<sup>165</sup> McMahan argues that Enforcement has not proven the interstate commerce

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<sup>162</sup> See, e.g., Enforcement's Post-Hearing Brief at 59.

<sup>163</sup> Respondent's Post-Hearing Brief at 29-32, 58-59. Enforcement then responded, also at length. See Division of Enforcement's Post-Hearing Reply Brief, dated September 18, 2009 ("Enforcement's Post-Hearing Reply"), at 1-9.

<sup>164</sup> There is no reason to suspect that the element of interstate commerce is any less necessary to establish than the other elements of a violation. See *Wright*, [2003-2004 Transfer Binder] ¶29,412 at 54,768-71.

<sup>165</sup> This burden extends to all issues relating to liability and sanctions. *In re First Financial Trading, Inc.*, [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,089 at 53,710 (CFTC July 8, 2002). See 5 U.S.C. §556 (stating that "[e]xcept as otherwise provided by statute, the proponent of a rule or order has the burden of proof."); *Director, Office of Workers' Compensation Programs, Dept of Labor v. Greenwich Collieries*, 512 U.S. 267, 278-79 (1994). Enforcement  
(continued..)

requirement.<sup>166</sup> Were this true, Enforcement would have failed to establish the violation.<sup>167</sup> Enforcement cannot simply allege violations of the Act, present no evidence of certain elements, and then rely on the court to fill in the gaps through a combination of guesswork and judicial notice.<sup>168</sup> However, while we

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(..continued)

must prove all elements by the “preponderance of the evidence.” *Bielfeldt*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. ¶29,923 at 56,800.

<sup>166</sup> “[Enforcement] has failed to prove or even allege facts to support a conclusion that the [sic] Mr. McMahan’s report to USDA took place “through interstate commerce.” Respondent’s Post-Hearing Brief at 31.

<sup>167</sup> In a seminal case, the Eighth Circuit Court of Appeals considered whether a USDA judicial officer had erred in finding that certain persons had violated the Packers and Stockyards Act. *See Bruhn's Freezer Meats of Chicago, Inc. v. USDA*, 438 F.2d 1332, 1339 (8th Cir. 1971). The court found that “[a]n additional element must be proved . . . namely that petitioners’ manufacturing or processing activities were performed on meats or meat food products ‘for sale or shipment in commerce.’” *Id.* at 1338-39. Thus, if Congress prescribes or proscribes activity that occurs in interstate commerce, an agency seeking to prove a violation of the statute through engagement in the activity must prove that the violative conduct occurred in interstate commerce or in a manner that is considered by law as the equivalent of interstate commerce. *See Wright*, [2003-2004 Transfer Binder] ¶29,412 at 54,768-71.

<sup>168</sup> Indeed, Rule 56 of the Federal Rules of Civil Procedure may serve as guidance. It “...mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial.” *See Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). Obviously, our decision here is based on a record after full hearing, not on a summary disposition motion. Nonetheless the theme runs true.

agree that Enforcement did not actively litigate the issue,<sup>169</sup> we believe that it has nevertheless managed to establish facts sufficient to support its conclusion that McMahan's report satisfies the interstate commerce element.

McMahan argues that "there is no dispute that the communication at issue on October 21, 2004 was an intrastate telephone call placed by Mr. McMahan from his office in Austin, Texas to Mr. Czerwien in his office in Amarillo, Texas."<sup>170</sup> We agree. However, our inquiry does not end there; we must still determine whether the intrastate communication satisfies the interstate commerce element.

Cases interpreting similar statutes have turned on detailed examinations of the language preceding the term "interstate commerce."<sup>171</sup> For instance, some statutes refer to transmitting "in"<sup>172</sup> interstate commerce, while some use

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<sup>169</sup> And this is nothing new; Enforcement has previously ignored the interstate commerce element. See *Wright*, [2003-2004 Transfer Binder] ¶29,412 at 54,770.

<sup>170</sup> Respondent's Post-Hearing Brief at 58-59.

<sup>171</sup> "Congress uses different modifiers to the word 'commerce' in the design and enactment of its statutes." *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001).

<sup>172</sup> "In commerce' . . . [is] understood to have a more limited reach." *Circuit City Stores*, 532 U.S. at 115, 121. Courts have repeatedly held that the *in* commerce formulation requires that the communication actually cross a state or national border. See, e.g., *United States v. Lewis*, 554 F.3d 208, 212-14 (1st Cir. 2009); *United States v. Schaefer*, 501 F.3d 1197, 1200-02 (10th Cir. 2007); *Smith v. Ayres*, 845 F.2d 1360, 1366 (5th Cir. 1988).

the broader term “affecting,”<sup>173</sup> while still others use the phrase “use of any means or instrumentality of.”<sup>174</sup> Of these, “affecting” and “use of any means or instrumentality” are clearly broader than “in”; and courts have routinely followed this plain language interpretation.<sup>175</sup>

Here, the statute uses the word “through.”<sup>176</sup> We agree with McMahan that “through” is closer to “in,” than “affecting” or “use of any means or instrumentality,” and that it requires a relatively narrow application of the statute.<sup>177</sup> If there were nothing more, we would agree with McMahan’s conclusion that his intrastate telephone call does not satisfy the interstate commerce element of the violation.

However, McMahan ignores the language immediately preceding the word “through,” which reads in part that “[i]t shall be a felony for...: Any person to . . . knowingly to deliver *or cause to be delivered* for transmission through . . .

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<sup>173</sup> “The phrase ‘affecting commerce’ indicates Congress’ intent to regulate to the outer limits of its authority under the Commerce Clause.” *Circuit City Stores*, 532 U.S. at 115.

<sup>174</sup> *Dupuy v. Dupuy*, 511 F.2d 641, 644 (5th Cir. 1975) (*holding* that intrastate use of the telephone may confer federal jurisdiction over a private action when the violation alleged prohibits “use of any means or instrumentality of interstate commerce”).

<sup>175</sup> See *United States v. Wadford*, 331 Fed. Appx. 198, 204 (4th Cir. 2009).

<sup>176</sup> 7 U.S.C. §13(a)(2).

<sup>177</sup> Respondent’s Post-Hearing Brief at 31-32.

interstate commerce....”<sup>178</sup> Thus, it is not only a violation to *directly* deliver it through interstate commerce, but also a felony to “cause it to be delivered” through interstate commerce.<sup>179</sup> The additional language obviously broadens our interpretation.<sup>180</sup> In sum, the issue is whether Enforcement has sufficiently alleged and proved facts establishing that McMahan intentionally caused his report to be delivered through interstate commerce.

A detailed discussion of proximate cause is unnecessary to show that McMahan did indeed cause his report to be delivered through interstate commerce. Though an intrastate phone call, McMahan was contacting an employee of the “US”DA.<sup>181</sup> And a reasonable person would predict that information provided to the USDA is not going to remain within some state’s borders – even Texas’s. Sure enough (and as usual) the USDA published the Texas Weekly Direct Feeder Summary<sup>182</sup> – including the transaction by

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<sup>178</sup> 7 U.S.C. §13(a)(2) (emphasis added).

<sup>179</sup> *Id.*

<sup>180</sup> In *Bruhn’s*, the court found that post-sale transportation is incidental to a purchase or sale for purposes of determining whether the transaction constitutes interstate commerce. Specifically, when it is understood by the purchaser and seller that the good is to be promptly transported across state lines after the sale, then the sale itself is as much a part of interstate commerce as if it occurred by the seller shipping the good across state lines to the purchaser. See *Bruhn’s*, 438 F.2d. at 1339-40.

<sup>181</sup> Joint Chronology at ¶7.

<sup>182</sup> Kass Written Testimony at ¶8.

McMahan.<sup>183</sup> The CME (not located in Texas) then included these reported sales (as usual) in calculating the value of the CME Feeder Cattle Index.<sup>184</sup> Trouble arose when another cattleman, Thomas Pritchard of Idaho (also not in Texas), complained to Paul Peterson at the CME about what he perceived as a likely invalid report.<sup>185</sup> Obviously, McMahan's report to the USDA did not remain confined to Texas. At the time McMahan submitted the report, he knew that the USDA used the information from his reports to improve the market; indeed, that was McMahan's professed motivation for serving as a direct reporter.<sup>186</sup> Similarly, McMahan knew that his reports were routinely used at the CME.<sup>187</sup> Much testimony was devoted to the single instance when they were not.<sup>188</sup> Clearly then, McMahan's report to a federal agency for the express purpose of dissemination to other market participants located throughout the United States "cause[d] [it] to be delivered for transmission through . . . interstate commerce."<sup>189</sup>

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<sup>183</sup> *Id.*

<sup>184</sup> *Id.* at ¶4.

<sup>185</sup> Pritchard Written Testimony at ¶¶1, 3.

<sup>186</sup> McMahan Tr. at 54.

<sup>187</sup> *Id.* at 72-77.

<sup>188</sup> *Id.*

<sup>189</sup> 7 USC §13(a)(2).

We hold find that Enforcement has established the interstate commerce element of Section 9(a)(2).

### **False Reporting – The All-Steer Deal**

The second element of Count I has been the focus of this case. It requires Enforcement to prove that “the information must have been false, misleading, or knowingly inaccurate.”<sup>190</sup> Enforcement brings its charges in the alternative. First, it argues that the reported deal for all steers was a sham.<sup>191</sup> Second, Enforcement argues that if there was an all-steer deal, McMahan’s report of it was still knowingly misleading because none of the cattle met the weight requirements of the Feeder Cattle Index.<sup>192</sup> We first consider Enforcement’s argument that the all-steer deal was a fabrication.

Enforcement presents a reasonable case for false reporting; anyone would be suspicious when a cattleman does not end up with the cattle he has

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<sup>190</sup> *Id.* The provision is badly written. The “or” in “false, misleading, ‘or’ knowingly inaccurate,” leaves the reader with the impression that the report need not be intentionally false or misleading. However, as the Fifth Circuit has held, this would be unconstitutionally overbroad for lack of adequate *mens rea*, i.e., it would criminalize the innocent act of delivering a report not known to be false or misleading.” *U.S. v. Valencia*, 394 F.3d 352, 353 (5th Cir. 2004). Thus, the falsity of any reported information must be known, and *scienter* is without question an element of false reporting.

<sup>191</sup> Enforcement’s Post-Hearing Brief at 25-27.

<sup>192</sup> *Id.* at 27-29.

reported purchasing.<sup>193</sup> At trial and in their post-hearing briefs, each side attempted to establish a timeline to substantiate their respective stories. This was particularly important for McMahan; he had to establish a legitimate manner by which he reported purchasing certain cattle and yet ended up getting others.<sup>194</sup> Unfortunately, McMahan's explanation of the circumstances surrounding the all-steer deal is somewhat convoluted.

Enforcement attempts to push McMahan's story past convoluted to incredible. McMahan responds both by supporting his story and attempting to expose flaws in Enforcement's analysis. We use the same framework: first, we recount McMahan's story; second, we discuss its apparent inconsistencies; and third, we examine support for McMahan's story along with flaws in Enforcement's case – before concluding whether Enforcement has established that the all-steer deal was a sham.

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<sup>193</sup> It is doubly suspicious when the cattleman's report results in moving the futures market to the benefit of his position in the futures market – at least superficially. However, and as discussed at length, we will not consider McMahan's futures profits as evidence of his motive. A single data point does not statistics make. See notes 51-95 and accompanying text.

<sup>194</sup> Of course, the ultimate burden of proof lies with Enforcement. However, since Enforcement established that McMahan reported purchasing cattle of which he did not ultimately take ownership, the burden logically shifts to McMahan to the extent that he provide an explanation for the apparently inaccurate report. Cf. *Fields v. Cayman Associates, Ltd.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,688 at 30,929 (CFTC Jan. 2, 1985) (“Thus, when a respondent is confronted with *prima facie* evidence that he traded excessively, he must be prepared to articulate a reasonable justification for his trading.”).

*McMahan's Story*

In 2004, McMahan was having what may have been his most profitable year ever.<sup>195</sup> By October, he had over a \$1,000,000 in profit and was looking at a tax bill of between \$300,000 and \$400,000.<sup>196</sup> McMahan's fiscal year ends in December, and he operates on an accrual basis.<sup>197</sup> This provided him with the opportunity to generate current expenses that could reduce his tax bill. After talking with his controller, Stephen Harper, McMahan decided that the best way to accomplish this was to buy and hold cattle.<sup>198</sup> In that way, they could generate feed expenses while fattening the cattle for later sale.<sup>199</sup>

At some point between October 15 and October 21, 2004, McMahan contacted Gail Morris, the manager of Bovina.<sup>200</sup> In a telephone call, McMahan explained his situation and said that he had approximately \$1,500,000 to spend – his total line of credit – and wanted to accumulate \$1,000,000 in feed expenses.<sup>201</sup> McMahan specified his preference for “steers” because they

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<sup>195</sup> McMahan Tr. at 135.

<sup>196</sup> *Id.* at 138-39; Harper Tr. at 424.

<sup>197</sup> *Id.* at 139, 194-95.

<sup>198</sup> *Id.* at 139.

<sup>199</sup> *Id.*

<sup>200</sup> Joint Chronology at ¶5. McMahan and Morris each also own a 10 percent stake in Bovina. Complaint ¶8; Answer ¶8; McMahan Tr. at 20, 141; Morris Tr. at 274, 298.

<sup>201</sup> Joint Chronology at ¶5; McMahan Tr. at 68, 123.

accumulate feed expense the fastest.<sup>202</sup> Morris responded that there were some steers that would serve McMahan's tax purposes.<sup>203</sup>

Also that week, McMahan told someone at the USDA (probably Czerwien) that he had found some feeder cattle in which he was possibly interested, and that he was going out to look at them the next day.<sup>204</sup> On Thursday, October 21, Czerwien called McMahan to ask if he had made any purchases that week.<sup>205</sup> McMahan responded by making the report at issue; he informed Czerwien that he had purchased approximately 1800 feeder steers, weighing an average of 725 pounds, and at a cost of \$118.00 per hundredweight.<sup>206</sup>

Czerwien discussed the report with his supervisor, Gladney; they concluded that the price was a bit high, but within the range of prices being reported elsewhere.<sup>207</sup> Similarly, they concluded that the number of head was somewhat large, but not unusually so.<sup>208</sup> As such, they accepted the report

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<sup>202</sup> McMahan Tr. at 142-43.

<sup>203</sup> *Id.* at 144.

<sup>204</sup> Joint Chronology at ¶3.

<sup>205</sup> *Id.* at ¶7.

<sup>206</sup> *Id.* at ¶7; McMahan Tr. at 63. As discussed, the 1800 steers came in two groups: one of approximately 930 steers weighing an average of 900 pounds, and one of approximately 870 steers weighing an average 525 pounds. See *supra* note 25 and accompanying text. These different weight groups were not mentioned to Czerwien. Czerwien Written Testimony at ¶13.

<sup>207</sup> Czerwien Written Testimony at ¶14.

<sup>208</sup> *Id.*

and included it in the Texas Weekly Direct Feeder Summary, published on October 22, 2004.<sup>209</sup> The Chicago Mercantile Exchange then published the CME Feeder Cattle Index for October 25 using these data and included McMahan's reported purchase.<sup>210</sup>

Meanwhile, McMahan informed Harper of this initial, all-steer deal.<sup>211</sup> Harper did not immediately act on this knowledge; that is, he did not do any of the necessary paperwork to formalize the deal.<sup>212</sup> For the moment, it remained simply an oral agreement between Morris and McMahan.

On Monday, October 25, this oral agreement was altered.<sup>213</sup> Morris informed McMahan that the lighter steers were not ideal for accruing feed costs, at least in part because they were to be put to pasture, rather than staying at a feed lot.<sup>214</sup> Morris therefore suggested that McMahan replace the

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<sup>209</sup> *Id.* at ¶¶12, 14; Kass Written Testimony at ¶8.

<sup>210</sup> DX-3; Kass Written Testimony at ¶8.

<sup>211</sup> Harper Tr. at 391-92.

<sup>212</sup> It is unclear when Harper learned of the all-steer deal. McMahan suggests that may have been by Friday, October 22. Respondent's Memorandum With Respect To Issue No. Three, filed December 14, 2009 ("Respondent's Issue Three Memo"), at 1; Harper Tr. at 392. The next week, Harper sought an invoice for the deal. Respondent's Issue Three Memo at 2; Harper Tr. at 406-07.

<sup>213</sup> This date is an estimate. "Mr. Morris could have suggested changing the transaction on October 25 or 26. We picked the date most likely." Respondent's Issue Three Memo at 3. *See* McMahan Tr. at 171-72, 176-77.

<sup>214</sup> Morris Tr. at 304-05.

lighter steers with heifers.<sup>215</sup> McMahan agreed; heifers were substituted for the lighter steers, and the final transaction was for 930 heavier steers and 1825 heifers.<sup>216</sup>

Morris then informed his employee – Rhonda Field – of the combined steer and heifers deal.<sup>217</sup> He had not previously mentioned the all-steer deal and never did end up mentioning it, as it was now moot.<sup>218</sup> Meanwhile, McMahan had not informed Harper of the changed deal – and didn’t for some time.<sup>219</sup> Thus, on behalf of McMahan, Harper called Field on Monday, October 25, to ask for an invoice for the all-steer deal – the only deal he knew about.<sup>220</sup> Field, who knew only of the combined steer and heifer deal, refused to provide it.<sup>221</sup>

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<sup>215</sup> *Id.* at 305-06.

<sup>216</sup> *See supra* note 28 and accompanying text.

<sup>217</sup> Morris Tr. at 305. Field was the Bovina office manager and bookkeeper. Testimony of Rhonda Field (“Field Tr.”) at 216.

<sup>218</sup> Respondent’s Issue Three Memo at 1-2.

<sup>219</sup> Harper Tr. at 403.

<sup>220</sup> Respondent’s Issue Three Memo at 1-2. The invoice is dated October 26. DX-12-3. Field testified that on the day of the initial request, Morris was not in the office. Field Tr. at 256-57. It was the next day, when Morris was back, that Field asked Morris whether to send the invoice (and then did so). *Id.* Thus, the initial request must have been made at least a day before the 26th – the date on the invoice. McMahan suggests it was on October 25. Respondent’s Issue Three Memo at 2.

<sup>221</sup> Field Tr. at 224. Moreover, when she asked Morris about sending the invoice, he initially told her not to send it because “[t]hose are not the actual  
(continued..)

On Tuesday, October 26, Harper called Field a second time, again requesting the invoice.<sup>222</sup> Field asked Morris what to do, and Morris told her to send it.<sup>223</sup> Field did so.<sup>224</sup> Later that day, after receiving the invoice from Field, Harper called her back and asked for a more detailed version that specified “steers.”<sup>225</sup> Also on October 26, Ken Lovett of the CME contacted McMahan to confirm the reported all-steer deal; McMahan confirmed it.<sup>226</sup> On the morning of Wednesday, October 27, Field faxed the more detailed invoice.<sup>227</sup> On receipt,

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(..continued)

cattle that we wound up selling to [McMahan].” Morris Tr. at 279. Also, Field agreed with Enforcement’s attorney’s characterization of the conversation – that Morris told Field: “Don’t send the invoice.” Field Tr. at 224.

<sup>222</sup> Field Tr. at 224-25. Field agreed with Enforcement’s characterization that Harper called more than once requesting an all-steer invoice. *See also* Harper Tr. at 409-10.

<sup>223</sup> Specifically, Morris told Field to “[s]end the thing. I don’t know what he’s doing. It doesn’t mean a thing.” Field Tr. at 226.

<sup>224</sup> Field Tr. at 225. The invoice she sent had limited information. It specified 1750 “head” (not identifying the sex), averaging 705 pounds (not including total weight), at \$118.00 per hundredweight. DX-12-3.

<sup>225</sup> Harper Tr. at 409, 417. Field does not remember Harper asking for a revised invoice, nor does she recall her preparation and faxing of the revised invoice. Field Tr. at 246. However, she acknowledged that two invoices exist, and did not question their authenticity.

<sup>226</sup> Joint Chronology at ¶11; McMahan Tr. at 179.

<sup>227</sup> Field believes she faxed the more detailed invoice on October 26, on the basis that it is dated October 26, 2004. DX-9-18; Field Tr. at 243. Certainly her belief is reasonable. However, Field also remembers calling at approximately the same time she faxed the invoice. The closest match in the phone records – where a fax and phone call to McMahan are in close proximity  
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Harper put a check to Bovina (c/o Field) in the overnight mail.<sup>228</sup>

Also that Wednesday (presumably after receiving the amended invoice specifying steers) or possibly the next day, Thursday, October 28, Harper learned that the deal had changed.<sup>229</sup> He then asked Field to select heifers to meet the specifications of the changed deal.<sup>230</sup> Likely that same day, Field faxed Harper an inventory sheet (the cattle list) containing the cattle for the steer and heifer transaction.<sup>231</sup> On Thursday, Field received the check.<sup>232</sup>

The revised deal was never reported – not the fact that the initial deal had changed,<sup>233</sup> nor the distinct and separately reportable fact that McMahan

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– is on the morning of October 27. Field impliedly agreed that it was possible she called on the 27th. Field Tr. at 243.

<sup>228</sup> Joint Chronology at ¶14.

<sup>229</sup> Respondent's Issue Three Memo at 2. Harper is not sure of the exact date when he learned of the change. Harper Tr. at 402-04.

<sup>230</sup> Field Tr. at 222.

<sup>231</sup> Harper Tr. at 402-04. Harper believes he first saw the cattle list some time after Wednesday, October 27, but that it could possibly have arrived earlier without his having seen it. *Id.* at 402-03. The timing of his knowledge is important; if he knew the deal had changed before requesting the amended invoice specifying steers, then his (and McMahan's) story becomes less consistent.

<sup>232</sup> Joint Chronology at ¶15; Field Tr. at 248.

<sup>233</sup> McMahan Tr. at 177.

had acquired heifers.<sup>234</sup> McMahan argues that it was not his practice to report changed deals.<sup>235</sup> Moreover, the USDA had no requirement that direct reporters tell them if a deal changed.<sup>236</sup>

This factual account is meant to explain the series of miscommunications that supports McMahan's version of events. In sum, McMahan asserts the following: (1) McMahan had an oral deal with Morris for all steers;<sup>237</sup> (2) this deal was properly reported to the USDA;<sup>238</sup> (3) the oral all-steer deal subsequently changed to an oral deal for steers and heifers;<sup>239</sup> (4) due to a series of miscommunications, an invoice was requested for the old deal;<sup>240</sup> and (5) any conflicting testimony from Field is due to these miscommunications.<sup>241</sup>

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<sup>234</sup> *Id.* at 183.

<sup>235</sup> McMahan Tr. at 177-78.

<sup>236</sup> *Id.*; *Delay*, 2006 U.S. Dist. LEXIS 85068, at \*24.

<sup>237</sup> McMahan Tr. at 67.

<sup>238</sup> Joint Chronology at ¶7; McMahan Tr. at 63.

<sup>239</sup> McMahan Tr. at 67, 171-72; Morris Tr. at 304-305.

<sup>240</sup> *See generally* Respondent's Issue Three Memo.

<sup>241</sup> *Id.* at 3.

*McMahan's Inconsistencies*

Some time before McMahan struck the initial, all-steer deal, he told Czerwien<sup>242</sup> that he had “found a string of feeder cattle” in which he was interested, and that he “was going out the next day . . . to look at them....”<sup>243</sup> At hearing, responding to an unrelated question, McMahan stated that he had never seen the 1800 feeder steers he allegedly purchased.<sup>244</sup> Given everything that followed, this appears suspicious. It might imply premeditation; that is, McMahan may have been setting the stage for his false report. If nothing else, we can conclude that from the outset that McMahan was apparently saying or implying actions that failed to occur.

A more serious inconsistency occurs with respect to McMahan’s estimate of the date on which the deal changed from all steers to both steers and heifers. Although McMahan need not establish the exact date on which the deal changed, he certainly must establish that *some* date (or dates) is reasonable given the facts about which we are sure. If no date for the changed

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<sup>242</sup> Or someone else at the USDA. Joint Chronology at ¶3.

<sup>243</sup> *Id.*

<sup>244</sup> The testimony here is somewhat confused, but McMahan is at least sure that he did not see the steers before he purchased them. McMahan Tr. at 158. Since McMahan purchased the steers on the telephone, his testimony amounts to an admission that he did not see them until *after* the purchase (if at all). *Id.* at 143-44.

deal appears consistent with the facts, then doubt is cast on McMahan's veracity.

At trial, McMahan attempted to establish that the deal had changed only after Harper requested the all-steer invoice.<sup>245</sup> Everything else equal, this would support the plausibility of McMahan's story. It is much more believable that Harper was requesting an invoice for a current deal that later changed, than that Harper was requesting an invoice for a defunct deal due to a series of miscommunications.

More specifically, the Respondent's Post-Hearing Brief suggests that McMahan's best estimate is October 28.<sup>246</sup> Strangely, the pages of transcript cited as a reference reveal no support – at all – for that date.<sup>247</sup> The transcript instead appears to support McMahan's best guess as being October 26, though even this much is unclear.<sup>248</sup> However, either date is consistent with McMahan's opinion that the deal changed after Harper requested the all-steer invoice on October 25.<sup>249</sup>

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<sup>245</sup> See McMahan Tr. at 121-25; Harper Tr. at 402-04.

<sup>246</sup> Respondent's Post-Hearing Brief at 18-19.

<sup>247</sup> See Respondent's Post-Hearing Brief at 19 (*citing* McMahan Tr. at 175-76.) It is unclear if "28" is a typo, or if it cites to the wrong part of the transcript in support.

<sup>248</sup> See McMahan Tr. at 175-76.

<sup>249</sup> Although McMahan attempted to establish the mostly likely date on which the deal changed, he also testified that he simply have no idea. See, e.g., *id.* at (continued..)

These dates are also reasonable given that it is undisputed that Ken Lovett of the CME called on October 26 to inquire about the validity of the all-steer deal.<sup>250</sup> As previously discussed, McMahan responded that he had bought the cattle.<sup>251</sup> If the deal did not change until after McMahan spoke to Lovett on October 26, at that time McMahan would have known only that he had bought the cattle and was expecting the paperwork to be finalized shortly.

However, the facts strongly suggest that the deal changed prior to Harper requesting the all-steer invoice. Of primary importance is Field's testimony that she prepared the cattle list for the combined steer and heifer deal between October 22 and 25.<sup>252</sup> This is clearly inconsistent with McMahan's testimony – if, perhaps, only by a day.<sup>253</sup> And yet, given other facts, that day matters very much.

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122, 142-49, 175-78. He is confident that it must have been after he reported the all-steer deal – but then, any other conclusion would be inculpatory. McMahan Tr. at 117. He says he believes that the deal changed only after the all-steer invoice was obtained from Bovina – but he is not even sure of that. *Id.* at 116-17.

<sup>250</sup> Joint Chronology at ¶11; RX-1-16.

<sup>251</sup> McMahan Tr. at 179.

<sup>252</sup> Field Tr. at 222-23.

<sup>253</sup> Field estimates that October 25 is the latest she might have prepared the cattle list, while McMahan's earliest estimate at trial was October 26. We note that in McMahan's supplemental brief, he states that October 25 is the most likely date the deal was changed. Respondent's Issue Three Memo at 3 (and  
(continued..)

McMahan argues that Field's memory is poor; certainly, it is possible that Field is misremembering the dates. As she stated during trial, "[i]t's been nearly five years, sir."<sup>254</sup> And so, we momentarily discount her testimony with respect to the precise dates and instead examine a related issue: the sequence in which Field became aware of the two deals. In other words, it is certainly possible for Field to remember which of two events happened first, even if she does not remember the exact date of either.

Sure enough, Field testified unambiguously that she knew of the combined steer and heifer deal before learning of the all-steer deal.<sup>255</sup> Moreover, substantial portions of her testimony are incomprehensible absent this fact being true. For instance, Field distinctly remembers her initial refusal to prepare the all-steer invoice was on the ground that "we didn't sell him those cattle."<sup>256</sup> Thus, she not only claims to have already known of the combined

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(..continued)

attached Respondent's Timeline) However, the reference he provides to the transcript includes no mention of the 25th – only the 26th. *Compare id.* at 1, *with McMahan Tr.* at 176-77.

<sup>254</sup> Field Tr. at 243. None of the witnesses had particularly good memories of the specifics. For instance, McMahan at one point testified that he was not even sure of the month the deal changed. "Early November, end of October, early November." McMahan Tr. at 122.

<sup>255</sup> Field Tr. at 252-53.

<sup>256</sup> *Id.*; Field's testimony on this point is supported by Morris. Morris also claimed that he initially refused to provide the invoice on the grounds that "[t]hose are not the actually cattle that we wound up selling to S&R." Morris  
(continued..)

steer and heifer deal, but remembers decisions she made at the time that were expressly based on – and consistent with – that knowledge. She also remembers Morris, her employer, telling her not to prepare the invoice on the same grounds – that McMahan had not purchased only steers.<sup>257</sup> In sum, there is a difference between not remembering something – like a specific date – and *affirmatively* remembering an internally consistent series of events that did not actually happen. We find it very unlikely that Field has done the latter here.<sup>258</sup>

Given our conclusion that Field knew of the combined steer and heifer deal before learning of the all-steer deal, certain facts become apparent. First, we note that Harper believes that he contacted Field to request the all-steer invoice “[p]rior to October 26th.”<sup>259</sup> If Field already knew of the combined steer and heifer deal when Harper initially called, then obviously the deal must have

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(..continued)

Tr. at 279. It is clear then that the deal must have already changed at the time Harper was requesting the invoice.

<sup>257</sup> Field Tr. at 224. Although corroborated by Morris, this portion of Field’s testimony would be even stronger had she recounted the conversation with Morris in her own words. Instead, she responded to the Enforcement attorney’s representation of the conversation with “Yes, sir.” *Id.*

<sup>258</sup> The alternative, of course, is that Field is lying. However, she has no motive to lie, neither party suggests that she did, and we agree that she has been truthful.

<sup>259</sup> Harper Tr. at 392.

changed on or before October 25 – consistent with Field’s estimate of when she prepared the combined steer and heifer cattle list.<sup>260</sup>

Second, this means that when Lovett called on October 26 to confirm the all-steer deal, McMahan knew that he was no longer acquiring 1800 steers; the deal had changed – perhaps just the day before.<sup>261</sup> Nevertheless, McMahan answered simply that he had bought them – a response that was therefore questionable, at best.<sup>262</sup> Absent some intent to conceal his actions, we are hard-pressed to imagine why McMahan would answer merely that he had bought the steers, rather than explain the circumstances of the changed deal.<sup>263</sup> However, this does not necessarily mean that there was no initial deal; McMahan could have simply believed that the change – though genuine – *seemed* suspicious and have wanted to avoid further questions.<sup>264</sup>

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<sup>260</sup> And inconsistent with McMahan’s. Clearly, his best estimate(s) as to the date the deal changed – October 26 and 28 – are both wrong.

<sup>261</sup> Compare Respondent’s Issue Three Memo at 3, *with* Joint Chronology at ¶11.

<sup>262</sup> Joint Chronology at ¶11; McMahan Tr. at 179.

<sup>263</sup> Indeed, McMahan testified that deals are often made orally and with no paperwork, at least initially. McMahan Tr. at 146-47. If this is common practice in the cattle industry, we wonder why – absent fraud – McMahan should be motivated to conceal the fact that the oral deal had changed.

<sup>264</sup> This is his excuse for not volunteering information or documents concerning the changed deal, when Market Oversight questioned him about his report. *See id.* at 120.

Third, as McMahan's deal for both steers and heifers was made prior to Harper requesting the all-steer invoice, Harper was requesting an invoice for a defunct deal. Of course, McMahan explains the series of miscommunications that led to the request for a defunct invoice in the Respondent's Issue Three Memo and concludes that Harper did not know the deal was defunct when he requested the invoice.<sup>265</sup> But this sits uncomfortably as a factual argument in the alternative, since at trial, McMahan (unsuccessfully) attempted to establish that the deal had changed only after Harper requested the all-steer invoice.<sup>266</sup>

Harper agrees that he had no knowledge of the combined steer and heifer deal while he was requesting the invoice for the all-steer deal.<sup>267</sup> However, he hedges; he does not rule out the possibility that he might have received the steers and heifers cattle list before requesting the all-steer invoice, and just not have looked at it.<sup>268</sup>

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<sup>265</sup> See Respondent's Issue Three Memo at 1-3.

<sup>266</sup> See McMahan Tr. at 121-25; Harper Tr. at 402-04. See Respondent's Issue Three Memo at 1 ("Respondent does not agree that Ms. Field is necessarily correct in her recollection that she was aware of the revised heifer/steer deal when Mr. Harper first asked for an invoice.... Nevertheless, in this Memorandum and the accompanying timeline, we assume that she was correct.").

<sup>267</sup> See Harper Tr. at 402-03. Of course, should Harper have testified otherwise, it would mean he had knowingly requested an invoice with no legitimate business purpose - which would strongly suggest that there had been no initial deal.

<sup>268</sup> *Id.* This serves only to add to the oddity of McMahan's story. Given the small size of McMahan's staff (Harper and two or three other employees) and  
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Field's testimony, however, implies otherwise. Field testified not only that she knew of the combined steer and heifer deal before the deal for all steers, but that it was *Harper* who told her to prepare the steer and heifer cattle list.<sup>269</sup> As Field remembers preparing the cattle list on October 22 or 25,<sup>270</sup> Harper must have known of the combined steer and heifer deal before he requested the all-steer invoice – in direct contradiction to his testimony.<sup>271</sup>

We see no reason not to accept Field's testimony in full.<sup>272</sup> While she admitted her memory was imprecise on certain issues, she appeared confident

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Harper's responsibilities ("I'll do checks, record entries in the books, deposit checks, reconcile accounts"), it seems implausible that he would not know of the existence of the paperwork sitting in his office for the steers and heifer deal. Harper Tr. at 381, 384.

<sup>269</sup> Field Tr. at 222. Morris also says that he told Field to prepare the combined steer and heifer cattle list. Morris Tr. at 304-06. This does not necessarily contradict Field's testimony; both Harper and Morris may have told her to prepare the combined steer and heifer cattle list. Unfortunately, neither party explored this possible contradiction.

<sup>270</sup> Field Tr. at 222.

<sup>271</sup> See Harper Tr. at 402-04.

<sup>272</sup> Field's veracity was unquestioned. Indeed, she was testifying against McMahan – a part-owner of the company that employs her. Thus, if anything, she was testifying against her own interest – a factor which boosts her credibility. See John Henry Wigmore, Evidence in Trials at Common Law §§ 945, 948-49, 966 (1970). Though we agree Field did not remember everything perfectly, she was quite candid about what she did not remember. That behavior strengthens our opinion that Field accurately remembered the facts about which she expressed confidence.

that she had heard of the combined steer and heifer deal from Harper.<sup>273</sup> It therefore seems likely that Harper knowingly requested an invoice for a defunct deal – or a non-existent one.<sup>274</sup> As Harper’s testimony appears to be inaccurate – knowingly or not – we find it difficult to credit McMahan’s explanation of a series of miscommunications. This logic appears to lead inexorably to the conclusion that there was no initial, all-steer deal.

### *McMahan’s Support*

And yet, there are facts that support McMahan’s story as well. Foremost among them is testimony from Morris, manager of Bovina and business associate of McMahan. Morris gave clear testimony that there was an initial, all-steer deal.<sup>275</sup> Moreover, he testified that he was the one to suggest the

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<sup>273</sup> “Steve Harper told me to pick them out....” Field Tr. at 222.

<sup>274</sup> Compare Harper Tr. at 402, with Field Tr. at 222. Other aspects of Harper’s testimony were also troublesome. For instance, Harper requested the all-steer invoice multiple times; he wanted to make sure it said “steers” and that it included the total weight. This was apparently important for his records. Harper Tr. at 408-49. And yet, it is undisputed that at some point, Harper learned that the all-steer deal had been changed to a steer and heifer deal. However, Harper did not go back and get a new invoice. *Id.* at 418-19. It seems unreasonable to work so hard at getting the details right for record-keeping purposes with respect to the all-steer deal, but not with respect to the deal for steers and heifers. When asked, Harper had no satisfactory explanation for his failure to seek an invoice for the changed deal. *Id.* at 419-20 (“[I]t’s not something I thought about.”).

<sup>275</sup> Morris Tr. at 299 (“I sold them and he bought them.”).

change to steers and heifers, on the grounds that the heifers would be better suited to meet McMahan's tax purposes.<sup>276</sup>

These two assertions are key to McMahan's defense. If Morris is credible, his testimony is powerful evidence that there was a legitimate deal for all steers. Fundamentally, the issue is not whether the parties can reconstruct the timing of the initial deal, but simply whether the deal occurred. And there can be no more direct evidence on that issue than Morris's testimony – that is, the testimony of the other party to the oral agreement.<sup>277</sup> As such, we concluded the hearing by directing the parties to provide thorough credibility assessments of Morris in their post-hearing briefs.<sup>278</sup>

Enforcement's credibility assessment was less than convincing.<sup>279</sup> Enforcement does not expressly accuse Morris of lying under oath – instead it says things like “[Enforcement] believes that Morris's testimony supporting McMahan's story that the two had an initial all-steer deal is a story that Morris

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<sup>276</sup> *Id.* at 304-05.

<sup>277</sup> *In re Rosenberg*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,992 at 37,643 (CFTC Jan. 25, 1991) (“To succeed in such a circumstantial approach, however, the Division must do more than present suspicious circumstances raising the possibility of knowing wrongdoing. It must establish that the existence of these factual elements is ‘more probable than their nonexistence.’”) (citation omitted).

<sup>278</sup> Tr. at 611.

<sup>279</sup> Enforcement's Post-Hearing Brief at 70-75.

simply went along with and is not credible.”<sup>280</sup> This politely stated conclusion is only tepidly supported. Enforcement argues, in effect, that Morris had known McMahan a long time, that they had a business relationship, and that Morris would not want to be known as a “rat” for cooperating with the government.<sup>281</sup>

We find these reasons insufficient to damage Morris’s credibility. At the trial, Enforcement elicited no evidence as to the nature of Morris’s personal relationship with McMahan;<sup>282</sup> perhaps Morris has had an undying enmity toward McMahan for the last 20 years.<sup>283</sup> Simply knowing someone for a long time – absent some context about the personal relationship – is hardly persuasive evidence supporting an inference that a witness lied under oath.

Similarly, the fact that the two have a business relationship is unpersuasive. No evidence was presented that Morris’s business would be significantly impacted if McMahan was found liable.<sup>284</sup> Nor was any evidence

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<sup>280</sup> *Id.* at 71.

<sup>281</sup> *See Id.* at 70-75.

<sup>282</sup> Enforcement concedes this. *Id.* at 71.

<sup>283</sup> After all, “[f]amiliarity breeds contempt.” Mark Twain, Notebooks (1935).

<sup>284</sup> The business relationship consists of the fact that both Morris and McMahan are 10 percent co-owners of Bovina, and that McMahan has purchased cattle from Bovina and fed them there. Enforcement’s Post-Hearing Brief at 71; Harper Tr. at 385, 387. However, we have no evidence as to the value of McMahan’s interest in Bovina, whether his interest was passive or active, or the nature and extent of his interaction with Morris regarding the

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presented to support a contention that Morris's business relationship with McMahan might encourage Morris to lie under oath. Instead, Enforcement simply states that a business relationship exists and concludes that this fact creates some sort of negative inference. By itself, it does not.

Finally, Enforcement's assertion that Morris likely did not want to be known as a "rat" for cooperating with the government has no factual support in the record.<sup>285</sup> It is supported with citations to cases in which floor brokers expressly discuss their discomfort with testifying against other floor brokers.<sup>286</sup> The flawed logic appears to leap from: (a) some other people in a different business context have perceived "reputational harm" in being known as having cooperated with the government,<sup>287</sup> to (b) Morris was similarly motivated and therefore lied under oath about the existence of an initial deal.

Clearly, as there is no factual support for the contention that the witness in *this* case was worried about appearing as a small rodent in the eyes of his

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affairs of the company. We also have no evidence to suggest the extent of the commercial dealings between McMahan's cattle business and Bovina – other than that they may have been small. See Harper Tr. at 387 ("We only occasionally buy cattle from Bovina Feeders.").

<sup>285</sup> Enforcement's Post-Hearing Brief at 71-72.

<sup>286</sup> *In re Zuccarelli*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,784 at 48,739 n.50 (CFTC Oct. 1, 1999); *In re Barcal*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,637 at 41,561 (May 5, 1994).

<sup>287</sup> Enforcement's Post-Hearing Brief at 71-72.

fellow cattlemen, we cannot credit Enforcement's assertion. Indeed, the opposite conclusion might just as easily be drawn; after all, Morris would be understandably concerned with a perception that he is associated with a trader accused of fraud. He might well be more motivated to distance himself from McMahan than to expose himself to charges of perjury<sup>288</sup> by falsely testifying that he was the one to suggest a change to the trade that Enforcement believes is fraudulent.

Enforcement also argues that Morris's testimony is suspect because "[he] was frequently put in a position where his testimony was corrected after being refreshed or was impeached."<sup>289</sup> Certainly, to the extent that Morris's memory was flawed or his testimony was successfully impeached, we could conclude that his credibility had suffered. Enforcement suggests that Morris's mistakes support its theory that there never was an initial all-steer deal.<sup>290</sup>

However, Enforcement does not explain *why* Morris's mistakes support its theory that there was no initial all-steer deal. While Enforcement provides examples of mistakes, it avoids analysis of them; it simply asserts that Morris's mistakes equal no initial deal.<sup>291</sup> Also, Enforcement seems to conflate the

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<sup>288</sup> 18 U.S.C. §1621.

<sup>289</sup> Enforcement Post-Hearing Brief at 72.

<sup>290</sup> *Id.* at 75.

<sup>291</sup> *Id.*

concept of refreshed recollection with that of impeachment;<sup>292</sup> while either might damage a witness's credibility, they do so in different ways and for different reasons.<sup>293</sup>

At trial, Morris occasionally required his recollection to be refreshed. Enforcement characterizes its first example of Morris's poor memory as "trivial" – presumably to contrast it with later, less-trivial examples.<sup>294</sup> However, the other examples do not seem much different. For instance, Enforcement says that Morris's testimony is problematic as to his role in drafting his March 2005 letter to the Commission.<sup>295</sup> Morris initially testified that the information came

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<sup>292</sup> *Id.* Refreshing the memory: The act of a witness who consults his documents, memoranda, or books, to bring more distinctly to his recollection the details of past events or transactions, concerning which he is testifying. Black's Law Dictionary 1152 (5th ed. 1979);

Impeachment of witness: To call in question the veracity of a witness, by means of evidence adduced for such purpose, or the adducing of proof that a witness is unworthy of belief. In general . . . a witness may be impeached with respect to prior inconsistent statements, contradiction of facts, bias or character. Black's Law Dictionary 678 (5th ed. 1979).

<sup>293</sup> For instance, if Morris's memory is flawed on a particular issue, we might still credit the remainder of his testimony. If Morris is shown to have lied about a particular issue (through impeachment), then all of his testimony is in doubt.

<sup>294</sup> Enforcement's Post-Hearing Brief at 72. We will not address the self-described trivial example.

<sup>295</sup> Enforcement's Post-Hearing Brief at 72. The letter describes the number of head and prices for the initial all-steer deal. DX-10-2.

from rough calculations that he and McMahan went over together.<sup>296</sup> After refreshing Morris's recollection with his investigative testimony from April 2007, Morris amended his testimony to say that the information came from McMahan.<sup>297</sup>

Even assuming that this mistake was material, we are not even sure it is a mistake. It is not inconsistent to say that the information was (1) a rough calculation, (2) that Morris and McMahan went over together, *and* (3) that the information came from McMahan.<sup>298</sup>

Another Enforcement example is that Morris called the \$1.65 price in the aforementioned letter "just average penciling."<sup>299</sup> Enforcement then states that "Morris admitted, 'Yes sir,' in response to the very next question, 'Did McMahan come up with that number.'"<sup>300</sup> We are unsure why Enforcement would style this an admission; once again, the two statements are not necessarily incompatible. If McMahan did the "average penciling," then Morris's statements are totally consistent.

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<sup>296</sup> Morris Tr. at 288.

<sup>297</sup> *Id.* at 289.

<sup>298</sup> Indeed, Morris initially responded that he did not think that the information came from McMahan; but *before* his recollection was refreshed, he went on to say that "possibly it could have." Morris Tr. at 288-89.

<sup>299</sup> Enforcement's Post-Hearing Brief at 73; Morris Tr. at 290.

<sup>300</sup> *Id.*

There is more in this vein. Morris testified that a scribbled calculation he had done for Enforcement at his deposition did not include an adjustment for cattle that had died.<sup>301</sup> After being taken through the page line by line, Morris agreed that the calculation did in fact include the adjustment.<sup>302</sup> In essence, Enforcement is accusing Morris of incorrectly interpreting calculations he had scribbled in pencil on an unlined paper a couple years earlier.

In sum, though Morris made minor mistakes while testifying, he immediately corrected them when his recollection was refreshed. We are unsure why Enforcement mentions these mistakes at all. None were intentional; indeed, Enforcement does not even suggest this. And it is perfectly reasonable for Morris to have forgotten minor details while remembering the major points that (1) there was an initial deal, and (2) the deal changed after Morris suggested the substitution of heifers.

With respect to impeachment, Enforcement simply refers back to the examples provided, calls them impeachment, and concludes that they support its theory that there never was an initial all-steer deal.<sup>303</sup> This does not help Enforcement's case. Morris's mistaken testimony was either (1) honest and as a result of poor memory (in which case no negative credibility inference can be

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<sup>301</sup> *Id.* at 74; Morris Tr. at 312.

<sup>302</sup> Morris Tr. at 316.

<sup>303</sup> Enforcement's Post-Hearing Brief at 75.

drawn regarding the ultimate issue),<sup>304</sup> or (2) intentionally dishonest – which is not alleged with respect to any specific portion of Morris’s mistaken testimony. Thus, the result is the same whatever Morris’s mistakes are labeled; Enforcement has failed to establish a flaw in Morris’s credibility.

While McMahan attempts to support Morris’s credibility in various ways,<sup>305</sup> a detailed discussion thereof is unnecessary given our conclusion that Enforcement has failed to discredit Morris. Absent a reason to doubt his testimony, we need not consider attempts to bolster it; we find Morris’s testimony as to the existence of the all-steer deal to be truthful and accurate.<sup>306</sup>

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<sup>304</sup> Enforcement certainly does not suggest that Morris’s memory was so poor that he forgot that there was no all-steer deal.

<sup>305</sup> Respondent’s Post-Hearing Brief at 33-35. In essence, McMahan argues that Morris’s testimony was credible because it was (1) internally consistent; (2) consistent with prior statements; (3) congruous with other, reliable evidence; and (4) in harmony with the proven surrounding circumstances. *Udiskey v. Commodity Resource Corp.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,599 at 47,848 n.68 (CFTC Apr. 2, 1999) (setting forth framework for assessing witness credibility).

<sup>306</sup> Not all of Morris’s testimony exculpates McMahan. As we shall see, Morris’s testimony supports Enforcement’s alternative theory of liability under Section 9(a)(2) – that is, assuming there was an all-steer deal, McMahan misrepresented it. See *infra* note 360 and accompanying text. This gives us more reason to credit Morris’s candor.

There are other facts supporting McMahan's story beyond Morris's testimony. First, McMahan had a history of honest reporting;<sup>307</sup> despite having voluntarily reported for many years, he had never been investigated or accused of any impropriety.<sup>308</sup> Indeed, the USDA has a system by which it checks for suspicious reports.<sup>309</sup> Not only was no prior report of McMahan's ever doubted by that system, *but even this one was not considered suspicious*;<sup>310</sup> it only became an issue because another cattleman complained.<sup>311</sup> Moreover, although Market Oversight also monitors the cattle markets on a continuous basis for suspicious transactions,<sup>312</sup> it has never questioned any of McMahan's

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<sup>307</sup> Gladney Tr. at 489 (stating that he had "always found [McMahan's] reporting to be reliable and honest").

<sup>308</sup> *Id.* at 480-81.

The Court: So he had reported hundreds of times and you never had any question?

Gladney: No.

*Id.* at 481.

<sup>309</sup> *Id.* at 491-92; Czerwien Tr. at 345-46.

<sup>310</sup> Gladney Tr. at 491-92.

<sup>311</sup> See Pritchard Written Testimony.

<sup>312</sup> Kokontis explained that he supervised a team of economists:

Their job, and therefore my job, is to monitor all of these markets on a continuous basis, look for anomaly prices, review the daily large trader positions that come into the Commission under regulation for possible clues to what might be causes of or

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other trades.<sup>313</sup>

Second, given McMahan's apparent history of honest reporting, it appears strange that he would pick this particular moment to submit a false report.<sup>314</sup> It is uncontested that McMahan was having perhaps his most profitable year ever.<sup>315</sup> Enforcement does not suggest that he had debts, needed the money for some reason, or even that his projected loss – absent his allegedly false report – was of unusual size. On the contrary, McMahan testified without rebuttal that losses of this size in the futures market were not all that unusual for him.<sup>316</sup> It seems odd then that McMahan should risk his reputation, his business, and even incarceration.<sup>317</sup>

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associations of large trader positions and price anomalies. And whenever we see a problem, I'll look into it more deeply and it goes from there.

Kokontis Tr. at 517-18.

<sup>313</sup> *Id.* at 558-60.

<sup>314</sup> “[Enforcement’s] theory of the case is that this is a case of isolated opportunism as opposed to a pattern of activity.” Enforcement’s Post-Hearing Brief at 96.

<sup>315</sup> McMahan Tr. at 135.

<sup>316</sup> *Id.* at 137-38.

<sup>317</sup> Charges under Sections 9(a)(2) and 9(a)(3) may be brought criminally and may result in a felony conviction punishable by imprisonment for up to 10 years and a fine of up to \$1,000,000. 7 U.S.C. §13(a)

Third, Field testified that she was told to pick out steers and heifers that would get close to a certain, very specific, dollar amount – \$1,455,855.00<sup>318</sup> She did so, and the steers and heifers she picked totaled 1,456,954.21.<sup>319</sup> McMahan was left owing Bovina approximately a thousand dollars.<sup>320</sup> While these facts are undisputed, the parties argue about the reason for this discrepancy. McMahan contends that Field was asked to target a specific dollar amount because that was the amount of the initial all-steer deal, and that the \$1,099.21 discrepancy occurred because Morris did not have groups of cattle on hand that would precisely equal the agreed amount.<sup>321</sup> This seems reasonable. If there had been only a single transaction for steers and heifers, Field would not have been asked to target such a precise, pre-existing sum, and there would have been no discrepancy showing a small amount at the end of the transaction. McMahan would simply have written a check for the full amount of the steer and heifer deal.<sup>322</sup>

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<sup>318</sup> Field Tr. at 220-22, 250; DX-21.

<sup>319</sup> DX-21.

<sup>320</sup> *Id.*, Field Tr. at 220-22.

<sup>321</sup> Respondent's Post-Hearing Brief at 20.

<sup>322</sup> It is possible that McMahan sent a check for slightly less than the combined steer and heifer deal on purpose, so as to later use it as proof that there was an initial deal. However, we believe this theory accords McMahan an unlikely degree of foresight. We conclude that the existence of two distinct amounts is objectively strong support for the existence of two distinct deals.

*Enforcement Has Not Proven That The All-Steer Deal Was A Sham*

[I]t is an embarrassment to the law when judges base decisions of consequence on conjectures.<sup>323</sup>

We summarize the facts as follows: (1) McMahan has a convoluted story to explain how he reported certain cattle but ended up with others;<sup>324</sup> (2) Enforcement's motive evidence in support of a false report is lacking;<sup>325</sup> (3) the only parties to the alleged initial deal have testified consistently that it occurred;<sup>326</sup> (4) Morris appears truthful, and we credit his testimony;<sup>327</sup> (5) Field also appears truthful, and we credit her testimony;<sup>328</sup> and (6) Field's memory of events is incompatible with the timeline that McMahan sought to establish.<sup>329</sup>

The mix of evidence as to the existence of an all-steer deal is perplexing. While McMahan and Harper's testimony is undoubtedly self-interested,<sup>330</sup> we

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<sup>323</sup> *U.S. v. Chambers* 473 F.3d 724, 726 (7th Cir. 2007).

<sup>324</sup> *See supra* notes 200-274 and accompanying text.

<sup>325</sup> *See supra* notes 47-94 and accompanying text.

<sup>326</sup> *See supra* notes 275-276 and accompanying text.

<sup>327</sup> *See supra* notes 279-306 and accompanying text.

<sup>328</sup> *See supra* notes 269-274 and accompanying text.

<sup>329</sup> *See id.*

<sup>330</sup> In such circumstances, the Court runs the risk of crediting the testimony of "plausible liars." *Carr v. Cigna Securities, Inc.*, 95 F.3d 544, 547 (7th Cir. 1996) (Posner, C.J.).

find no good reason to doubt the testimony of Morris or Field. Although the testimonies of Morris and Field do not directly contradict each other, they certainly lead to opposite conclusions on the ultimate issue of whether there was an initial all-steer deal.<sup>331</sup> When we juggle about McMahan's convoluted story, the conflicting credible testimony and the lack of circumstantial motive and pattern evidence, nothing falls firmly in hand – we conclude simply that it's a toss-up as to whether there was an initial deal for 1800 steers.

Since the evidence is in equipoise, we fall back on “using burden of proof as a placeholder for the missing knowledge.”<sup>332</sup> The burden of proof on all material issues lies with Enforcement, and it must make these showings “by a

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<sup>331</sup> The Court is not obligated to find one side or the other to be more credible. Indeed, there may be occasions when two witnesses or groups of witnesses may be equally credible or incredible. Under those circumstances, we need only find that Enforcement has failed to establish its version of the facts with requisite certainty. See *Webster v. Refco, Inc.*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,578 at 47,669 n.46 (CFTC Feb. 1, 1999); *Ackerman v. Medical College of Ohio Hosp.*, 680 N.E.2d 1309, 1311 (Ohio Ct. App. 1996) (unreported op.); *Guiberson v. United States*, Case No. 76-34-C2, 1978 WL 1250, at \*5 (D. Kan. Dec. 13, 1978). In other words, a tie in credibility goes to the respondent.

<sup>332</sup> Posner, *supra* note 65 at 217. As Judge Posner has noted that “[t]he function of burden of proof in achieving formal [as opposed to substantive] accuracy is to allow a court to reach a definitive result in a case where it may not have the faintest idea whether the defendant wronged the plaintiff, and if so how seriously.” *Id.* at 216-17 (1990). The Commission has stated that “[i]f, upon any issue in the case, the evidence appears to be equally balanced, or if it cannot be said upon which side it weighs heavier, then plaintiff has not met his or her burden of proof.” *In re Scheck*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,072, at 45,123 n.8 (CFTC June 4, 1997) (quoting *Smith v. United States*, 726 F.2d 428 430 (8th Cir. 1984) (citation omitted)).

preponderance of the evidence.”<sup>333</sup> This it has not done, and we therefore conclude that Enforcement has failed to demonstrate that McMahan violated Section 9(a)(2) by intentionally reporting a sham all-steer deal. Although this is distinct from an affirmative finding of fact that the initial deal occurred, we approach the remainder of this case as if it did.

### **Misleading Reporting – (Mis)averaging**

Enforcement argues in the alternative that if there was an initial all-steer deal, McMahan – in reporting it – averaged the weights of two groups of non-conforming steers so as to intentionally mislead the USDA as to the nature of the cattle.<sup>334</sup> The elements necessary for Enforcement to establish a fraudulent report remain the same: (1) a respondent must have knowingly delivered or caused to be delivered market reports or market information through interstate commerce; (2) the information must have been false, misleading, or knowingly inaccurate; and (3) the report must concern market information or conditions of a type that generally affects or tends to affect the price of a commodity in interstate commerce.<sup>335</sup>

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<sup>333</sup> *Bielfeldt*, [2003-2004 Transfer Binder] ¶29,923 at 56,800. This burden extends to issues of credibility. *See Guiberson*, 1978 WL 1250, at \*5; *Ackerman*, 680 N.E.2d at 1311.

<sup>334</sup> Enforcement’s Post-Hearing Brief at 27-29, 55. Enforcement believes he did so in furtherance of its unproven theory that McMahan sought to manipulate the Feeder Cattle Index. *See supra* notes 47-94 and accompanying text.

<sup>335</sup> *See supra* notes 159-161 and accompanying text.

We have discussed the first and third elements at length with respect to the all-steer deal; those discussions apply equally here.<sup>336</sup> So once again, it is the second element at issue; Enforcement must demonstrate that McMahan intentionally, knowingly, or recklessly made a misleading report.

Enforcement presents a strong and apparently straightforward case; an experienced cattleman reported buying 1800 steers weighing an average of 725 pounds when none of the steers actually weighed close to that amount. Although the issue is slightly more complicated than Enforcement presents it, we agree with its conclusion. By averaging the weights of two sets of non-conforming steers and reporting them as a single set of 725 pound feeder steers, McMahan knowingly made a misleading report.<sup>337</sup>

*(Mis)averaging – The Facts*

On some day during the week of October 14-21, 2004, McMahan called the USDA to say that he had found some feeder cattle in which he was possibly interested, and that he was going out to look at them the next day.<sup>338</sup> On Thursday, October 21, Czerwien called McMahan to ask if he had made any

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<sup>336</sup> See *supra* notes 161-189 and accompanying text.

<sup>337</sup> We note that the manner in which McMahan reported the steers provides additional support for Morris's and his testimony that there was in fact an initial all-steer deal. If the deal was entirely fabricated, as Enforcement believes, why wouldn't the counterparties construct it so that the cattle neatly conformed to the Cattle Feeder Index?

<sup>338</sup> Joint Chronology at ¶3.

purchases that week.<sup>339</sup> McMahan responded by making the report at issue; he informed Czerwien that he had purchased approximately 1800 feeder steers, weighing an average of 725 pounds, and at a cost of \$118.00 per hundredweight.<sup>340</sup>

McMahan left out a key detail; he neglected to mention that none of the steers weighed close to 725 pounds.<sup>341</sup> Rather, McMahan had actually purchased two sets of steers with distinct average weights; one averaged 525 pounds while the other averaged 900 pounds.<sup>342</sup> For his report, McMahan combined the groups and took the average of the total, thereby reaching the reported number.

*McMahan Intentionally Misled The USDA In Reporting The All-Steer Deal*

We begin our analysis by noting that McMahan did correctly calculate the average weight of steers he purchased. That is, McMahan purchased an approximately equal number of 525 pound steers and 900 pound steers, and the average of those two groups was – without question – about 725 pounds.

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<sup>339</sup> *Id.* at ¶7.

<sup>340</sup> *Id.*; McMahan Tr. at 63.

<sup>341</sup> McMahan Tr. at 66; Czerwien Written Testimony at ¶16. At trial, McMahan conceded that the cattle he purchased were not of the proper weight to be included in the Feeder Cattle Index. McMahan Tr. at 68. However, he quibbled by arguing that there might have been some outliers that fell within the specified weight range. *Id.* at 157. Even if potential outliers were relevant, there is no evidence that any such outlier steers existed.

<sup>342</sup> DX-10-2; McMahan Tr. at 202.

McMahan's report with respect to average weight was therefore literally true. However, it is certainly possible to mislead while stating the literal truth.<sup>343</sup> After all, using statistics to lie or mislead is hardly new.<sup>344</sup>

In order to assess whether a representation is misleading, it is first necessary to determine what representation is being made.<sup>345</sup> The key is not so much the words used but the message that is conveyed.<sup>346</sup> A statement should not be considered deceptive or misleading merely because it could be

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<sup>343</sup> *E.g. Staryk*, [1996-1998 Transfer Binder] ¶27,206 at 45,811 (*holding* that a respondent need not make a fraudulent statement explicitly, and that words may be misleading in context); *In re First National Trading Corp.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,142 at 41,788 n.20 (CFTC July 20, 1994) (*recognizing* that "the 'standard' sales pitch . . . that options offered a 'predefined limited risk with unlimited profit potential' – is literally true. However, when recited repeatedly as a sales inducement . . . the representation inflates the likelihood of profit while minimizing the risk of loss, although the amount at risk was fixed."). *See also McMahan & Co. v. Warehouse Entertainment, Inc.*, 900 F.2d 576, 579 (2nd Cir. 1990); *Swickard v. A.G. Edwards & Sons*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,522 at 30,275 (CFTC Mar. 7 1985).

<sup>344</sup> We turn to Mark Twain again. *See supra* note 283. He wrote in Chapters from My Autobiography, published in the *North American Review*, No. DCXVIII., July 5, 1907. "Figures often beguile me, particularly when I have the arranging of them myself; in which case the remark attributed to Disraeli would often apply with justice and force: "There are three kinds of lies: lies, damned lies, and statistics."

<sup>345</sup> *Staryk*, [1994-1996 Transfer Binder] ¶26,701 at 43,924.

<sup>346</sup> *Id.*

unreasonably misunderstood by its intended audience.<sup>347</sup> Rather, the court should focus on the common understanding of the communication.<sup>348</sup>

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<sup>347</sup> See *Johnson v. Don Charles & Co.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,986 at 37,624 (CFTC Jan. 16, 1991). In this reparations case, the Commission held that a reasonable customer would not interpret the AP's general statements as a materially deceptive description of risk. Thus, it held that even if the record should establish that the complainants subjectively understood the statements as a (fraudulent) guarantee against loss, their fraudulent inducement claim would fail. *Id.*

<sup>348</sup> "A company cannot be liable for every possible reading of its claims, no matter how farfetched. We therefore require that the consumer interpretation in any particular case be reasonable." *Hammond v. Smith Barney, Harris Upham & Co.*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,657 n. 12 (CFTC Mar. 1, 1990) (quoting with approval *In re International Harvester Co.*, 104 F.T.C. 949, 1057 (1984)).

For a sample of the rich literature bearing on this issue, and on the nature and operation of commercial information markets generally, see Larry E. Ribstein, *Private Ordering and the Securities Laws: The Case of General Partnerships*, 42 CaseW.Res.L.Rev.1 (1992); Jacob Jacoby, The Comprehension and Miscomprehension of Print Communications (1987); Frank H. Easterbrook and Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va.L.Rev. 669 (1984); Tim S. Campbell, Financial Institutions, Markets, and Economic Activity (1982); Richard Schmalensee, *Comments on Beales, Craswell and Salop*, 24 J. Law & Econ. 541 (1981); J. Howard Beales, Richard Craswell and Steven C. Salop, *The Efficient Regulation of Consumer Information*, 24 J. Law & Econ. 491 (1981); Jacob Jacoby, The Miscomprehension of Television Communications (1980); Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 Harv.L.Rev. 661 (1977); Jean-Jacques Lambin, *Advertising, Competition and Market Conduct in Oligopoly Over Time in Contributions to Economic Analysis* (1976); Russell L. Ackoff, *Advertising Research at Anheuser-Busch, Inc. 1963-1968*, 16 Sloan Management Rev. 1 (1975); George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 Amer.Econ.Rev. 132 (1973); Michael R. Darby and Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J. Law & Econ. 67 (1973); George J. Stigler, *The Economics of Information in The Organization of Industry* (1968); Lester G. Telser, *Advertising and Competition*, 72 J. Political Econ. 537 (1964).

Enforcement suggests that although McMahan's report was literally true, he actually conveyed the false message that he had purchased 1800 steers that all weighed approximately 725 pounds.<sup>349</sup> We agree; indeed, we consider the conclusion indisputable. The USDA believed McMahan had reported purchasing not approximately 900 light steers and 900 heavy steers, but 1800 "seven-weight"<sup>350</sup> steers.<sup>351</sup> And we consider the USDA's misunderstanding reasonable in light of industry practices. Indeed, Czerwien expressed astonishment that McMahan's report could be interpreted any other way: he "had never in heard in [his] entire life of anybody averaging" such a split load of cattle.<sup>352</sup>

However, to be liable, McMahan must have been intentionally, knowingly, or recklessly misleading. To determine McMahan's *scienter*,<sup>353</sup> we will first examine McMahan's experience to determine whether it is likely that he understood the USDA's standards and definitions. Second, we will contrast

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<sup>349</sup> Enforcement's Post-Hearing Brief at 27-29. McMahan's report was included in the portion of the CME Feeder Cattle Index for steers weighing between 700 and 749 pounds. Cook Written Testimony at ¶19.

<sup>350</sup> McMahan Tr. at 29.

<sup>351</sup> Cook Written Testimony at ¶19.

<sup>352</sup> Czerwien Tr. at 369.

<sup>353</sup> See *supra* notes 96-158 and accompanying text.

the language in McMahan's report with his understanding of the information conveyed to cattle professionals by that language.

According to McMahan's testimony, he had been in the industry for decades, made direct reports for years, and had frequently taken large positions in the cattle futures market.<sup>354</sup> Indeed, as discussed, he had a substantial long futures position when he made the report at issue.<sup>355</sup> Thus, there can be no doubt that McMahan was an experienced cattleman with knowledge of the futures market for feeder cattle.

Further, McMahan habitually reported to the USDA everything that he had purchased that week.<sup>356</sup> However, when he was "busy" he would just list the ones that fit in the index.<sup>357</sup> Clearly then, McMahan knew enough to distinguish between cattle that would and would not qualify for inclusion. The evidence therefore supports a finding of fact that McMahan was well aware of the USDA's standards and definitions.<sup>358</sup>

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<sup>354</sup> McMahan Tr. at 18, 35-36, 52-53.

<sup>355</sup> *Id.* at 78-79; DX-35-2.

<sup>356</sup> *See* Tr. at 369-70.

<sup>357</sup> Czerwien Testimony at ¶20.

<sup>358</sup> *Id.* ("McMahan appeared to be knowledgeable about the specifications for the CME Feeder Cattle Index"). McMahan's expert knowledge of the nature and composition of the Feeder Cattle Index is confirmed by his testimony. McMahan Tr. at 45-53.

We now examine the language of McMahan's report. First, and as discussed, McMahan reported that his 1800 steers averaged 725 pounds.<sup>359</sup> The key word here is "average." Enforcement elicited testimony from the USDA, Market Oversight, and even Morris that *no one* in the industry averages cattle of substantially different weights.<sup>360</sup>

Indeed, this is just common sense. Weight is obviously a critical factor in determining the price of cattle; calves, feeder cattle, and finished steers are about as different as cattle can be.<sup>361</sup> Thus, if one were to freely average cattle of vastly different weights, no one in the industry would have any idea what they were buying; a cattleman expecting a delivery of feeder steers (say, averaging 725 pounds) might receive an equal number of 100 pound calves and 1,350 pound finished steers. In sum, the USDA, Market Oversight, Morris, and common sense all say that industry practice is to have cattle grouped by

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<sup>359</sup> McMahan Tr. at 63.

<sup>360</sup> Czerwien Tr. at 369; Kokontis Tr. at 550-51. Morris testified that the proper way to report the all-steer deal was "900 head weighing approximately 900 pounds and 875 head weighing approximately [525 pounds]." Morris Tr. at 297.

Indeed, Czerwien testified that in the past McMahan had followed the industry practice of reporting split loads separately. Czerwien Written Testimony at ¶13 ("[I]n the past [McMahan] had repeatedly reported mixed or split loads with separate prices for different weights and/or grades, etc."). McMahan denies this. McMahan Tr. at 68-70. However, we credit Czerwien's testimony over McMahan's.

<sup>361</sup> McMahan Tr. at 22-25.

weight, narrowly distributed around the average; we therefore find it highly unlikely that an experienced cattleman like McMahan could honestly believe otherwise.<sup>362</sup>

Moreover, McMahan specifically identified the cattle in his report to the USDA as “feeder cattle” – not once but twice.<sup>363</sup> The term has meaning. For purposes of the “Feeder Cattle Index,” feeder cattle are defined as young steers between 700 and 849 pounds of grade 1 muscling and a medium to medium-large frame.<sup>364</sup> Once again, there can be no doubt that McMahan knew this. Czerwien testified that:

[McMahan] appeared to be knowledgeable about the specifications for the CME Feeder Cattle Index. From time to time, Mr. McMahan would explain that he was “busy” and tell me that he would only give details in “the Index cattle,” and then would proceed to report his purchases of feeder steers in weights that fit within the Index.<sup>365</sup>

Thus, having concluded that McMahan clearly misrepresented the steers’ weight – and with knowledge that his reported average would improperly qualify the steers for the “Feeder Cattle Index” – it is reasonable to further

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<sup>362</sup> Indeed, McMahan does not attempt to explain why or how he got the wrong idea about the proper way to report a split load. He simply stated “[t]hat’s the way I had always done it.” McMahan Tr. at 154-55. *See supra* note 360.

<sup>363</sup> The first time was in a call to Czerwien (or someone at the USDA) sometime before his report. Joint Chronology at ¶3. The second was during the report at issue. *Id.* at ¶7.

<sup>364</sup> Cook Written Testimony at ¶5; Cook Tr. at 443-44; DX-38-1.

<sup>365</sup> Czerwien Written Testimony at ¶20.

conclude that McMahan's characterization of the steers as "feeder cattle" would support the misleading nature of his report.

In fact, McMahan's report mischaracterized his purchase as "feeder cattle" under his *own* definition. At trial, McMahan defined feeder cattle as simply "an animal that goes to the feedlot. It doesn't matter whether he weighs 400 pounds or weighs 1,000 pounds. If they're sent to a feedlot, they're called feeder cattle."<sup>366</sup> And yet McMahan also testified that some (and perhaps most or all) of the 525 pound steers at issue here were on pasture when McMahan bought them and kept on pasture afterwards.<sup>367</sup> Indeed, this is apparently normal; McMahan agreed at trial that throughout the industry, the majority of five-weight steers are not kept at feedlots.<sup>368</sup> It appears, therefore, that McMahan *must* have been lying to the USDA when he described his (entire) purchase as "feeder cattle"; the description conflicts with not only the index definition but his own.

We conclude that McMahan averaged the weights of two groups of non-conforming steers in his report so as to mislead the USDA (and therefore, predictably, the CME and others in the cattle industry) into reasonably believing that they met the conditions for inclusion in the CME's Feeder Cattle

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<sup>366</sup> McMahan Tr. at 27.

<sup>367</sup> *Id.* at 189, 196-97.

<sup>368</sup> *Id.* at 28.

Index. This belief was reinforced by McMahan falsely describing the steers as “feeder cattle.” And although we can’t read McMahan’s mind, the circumstantial evidence is overwhelming that McMahan misled the USDA with *scienter*.<sup>369</sup> As an experienced cattleman, he knew the USDA and others in the cattle industry would interpret his report as implying that McMahan had purchased approximately 1800 feeder steers – as defined by the USDA – that all weighed at or near 725 pounds. Accordingly, we hold that despite a lack of motive evidence, Enforcement has clearly satisfied its burden that McMahan’s report to the USDA violated Section 9(a)(2).

### **McMahan’s Violations: Misleading Market Oversight**

In Count III of the Complaint,<sup>370</sup> Enforcement charges McMahan with violating Section 9(a)(3) of the Act, which, in relevant part, prohibits:

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<sup>369</sup> Making a finding as to a respondent’s mental state does not require us to read the respondent’s mind, or to accept self-serving, but implausible, denials of culpable knowledge. And it is a good thing that we need not do so. See Posner, *supra* note 65 at 177 (“[W]e cannot peer into people’s minds, at least not with the clumsy tools of legal procedure.”). Since a respondent (or, for that matter, anybody else) rarely confesses to engaging in intentional wrongdoing, such a finding often results from inferences drawn from circumstantial evidence. *Herman & McLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983) (“[T]he proof of *scienter* required in fraud cases is often a matter of inference from circumstantial evidence.”). *Accord JCC, Inc.*, [1992-1994 Transfer Binder] ¶26,080 at 41,579; *see also In re Kolter*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,262 at 42,198 (CFTC Nov. 8, 1994) (*finding* that an unsupported denial of fraudulent intent is insufficient to defeat a motion for summary disposition as “[circumstantial] facts establish *scienter*, and [the respondent] has submitted no controverting evidence”).

<sup>370</sup> We have not forgotten Count II, a relatively less complex books and records violation. The facts we present and analyze in addressing Count III provide a  
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Any person knowingly to make, or cause to be made . . . any statement in any . . . report, or document required to be filed under this Act or any rule or regulation thereunder . . . which statement was false or misleading with respect to any material fact, or knowingly to omit any material fact required to be stated therein or necessary to make the statements therein not misleading.<sup>371</sup>

Enforcement must establish four elements: (1) that the subject knowingly made or caused to be made a statement; (2) in a report or a document required to be filed under the Act or regulations; (3) concerning a material fact; (4) that was false or misleading or knowingly omitted information required to be reported or necessary to make the statements made not misleading.<sup>372</sup>

Enforcement accuses McMahan of multiple violations of Section 9(a)(3).<sup>373</sup> Unfortunately, despite noting in its Complaint that “each and every instance in which McMahan made false or misleading statements, or omitted

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necessary background to our analysis of Count II; this is why they appear out of the order in which the Complaint happened to label them.

<sup>371</sup> 7 U.S.C. §13(a)(3). See Complaint at ¶¶46-48.

<sup>372</sup> An analogous federal statute is the general false statement statute, which applies to any person within the jurisdiction of a federal agency who “knowingly and willfully (1) falsifies, conceals, or covers up by any trick, scheme, or device, a material fact; (2) makes any materially false, fictitious, or fraudulent statement or representation; or (3) makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry....” 18 U.S.C. §1001. This statute “protect[s] the authorized functions of governmental departments and agencies from the perversion which might result from . . . deceptive practices....” *US v. Gilliland*, 312 U.S. 86, 93 (1941).

<sup>373</sup> See Complaint at ¶47.

information necessary to make the statements not misleading is a *distinct violation*,”<sup>374</sup> it never expressly identifies or lists them.<sup>375</sup> Instead, it simply presents the facts and leaves us to organize them.

This oversight creates problems. It is one thing for us to determine the merits of a series of distinctly alleged violations; it is quite another to determine what *might* constitute an allegation of fraud and then affirm or deny our own suggestion. For example, the overarching fraud of which Enforcement accuses McMahan is that of omission. Enforcement says that despite numerous opportunities, he knowingly failed to correct the misleading impression that he had completed the purchase of 1800 steers. Does each opportunity to correct the misleading impression constitute a distinct omission and therefore a

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<sup>374</sup> *Id.* at ¶48 (emphasis added).

<sup>375</sup> In the Complaint, Enforcement merely states that McMahan violated Section 9(a)(3). See Complaint at ¶47. In Enforcement’s Prehearing Memorandum, it goes further by stating the following with respect to McMahan’s fraudulent actions: (1) McMahan omitted mentioning that the all-steer transaction had changed; and (2) McMahan delivered false or misleading responses to the second and sixth questions asked during the investigation by Market Oversight. Enforcement’s Prehearing Memorandum at 17-18. In its Post-Hearing Brief, Enforcement’s factual discussion of Count III is particularly concise. It states simply that McMahan “had a duty to disclose material information being sought by the CFTC” and then refers us back to its discussion of Count II regarding McMahan’s violation of Section 4i. See Enforcement’s Post-Hearing Brief at 68. Enforcement’s Post-Hearing Reply is no more detailed; it again simply refers us to its discussion in Count II. Enforcement’s Post-Hearing Reply at 24-25.

distinct violation? If so, how many of these opportunities were there?<sup>376</sup> Are some of McMahan's apparently affirmative misrepresentations blended into the overarching theme of omission? Enforcement has not briefed these issues.

Left with little choice, we determine that Enforcement has alleged the following "distinct," affirmative misrepresentations: (1) McMahan produced a sham invoice;<sup>377</sup> (2) McMahan lied to or misled the Commission in his answer to question 2 of Market Oversight's December 28 letter;<sup>378</sup> and (3) McMahan lied to or misled the Commission in his answer to question 6 of the December 28 letter.<sup>379</sup> We further determine that Enforcement has alleged two misrepresentations by reason of omission: that (4) the invoice was impliedly misleading because McMahan omitted the fact that he had improperly averaged two groups of non-conforming steers to reach his reported "average" weight;<sup>380</sup> and (5) the copy of the bill of sale draft was impliedly misleading because

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<sup>376</sup> One might think we could simply count them. Unfortunately not. For instance, what happens when McMahan gives a two-part answer to a single question, and Enforcement alleges that both parts are misleading? See DX-8-2; Enforcement's Post-Hearing Brief at 65.

<sup>377</sup> Enforcement's Post-Hearing Brief at 65.

<sup>378</sup> *Id.*

<sup>379</sup> *Id.* at 66.

<sup>380</sup> *Id.* at 64.

McMahan omitted the fact that the payment was for a changed deal for steers and heifers.<sup>381</sup>

With respect to McMahan's express misrepresentations, the parties largely agree on the law;<sup>382</sup> it is clear that express misrepresentations (like the production of a sham invoice) are violations of Section 9(a)(3).<sup>383</sup> The dispute over these will be resolved primarily on our interpretation of the facts – whether the invoice was in fact a sham document and whether McMahan's answers were in fact misleading.<sup>384</sup>

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<sup>381</sup> *Id.*

<sup>382</sup> *See generally, id.* at 66-68; Respondent's Post-Hearing Brief at 48-53.

<sup>383</sup> Section 4i of the Act provides the Commission with the authority to impose reporting requirements for large traders in futures contracts. 7 U.S.C. §6i. *See also, FDIC v. Shearson Lehman Hutton, Inc.*, [1992-1994 Transfer Binder] (CCH) Comm. Fut. L. Rep. ¶25,674 at 40,231 n.16 (CFTC Apr. 12, 1993). Meanwhile, Section 9(a)(3) prohibits individuals from intentionally providing false or misleading information in those reports. 7 U.S.C. §13(a)(3).

<sup>384</sup> McMahan contends that statements may be misleading – even intentionally misleading – so long as they are “literally true.” Respondent's Post-Hearing Brief at 48-52. *See infra* notes 425-430 and accompanying text. This argument doesn't pass the laugh test, given the very clear and contrary language of Section 9(a)(3) (“false or misleading with respect to any material fact, or knowingly to omit any material fact required to be stated therein or necessary to make the statements therein not misleading”). *See New York Currency Research Corp. v. CFTC*, 180 F.3d 83 89 (2d Cir. 1999) (“The plain meaning of that language ordinarily informs our understanding of a statutory or regulatory term.... It appears that the Commission – based on a reading of its prior decisions – acknowledges this basic principle of statutory construction.”) (citations omitted).

Fortunately for McMahan, he makes this argument in the alternative. He does not admit that his answers were intentionally misleading. Respondent's  
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Conversely, whether McMahan violated the Act through omission is primarily a question of law. There is no dispute over the facts – the parties agree that McMahan omitted the information with *scienter*.<sup>385</sup> The issue is simply whether McMahan had a legal duty to disclose – that is in this case, whether his omissions resulted in any of his answers and documents he did produce becoming impliedly misleading.

### **Market Oversight's Investigation**

The events that form the basis of these charges begin with Market Oversight's letter to McMahan on November 5, 2004,<sup>386</sup> asking him to provide information on all transactions of physical cattle during October of 2004.<sup>387</sup> On November 10, McMahan spoke with Market Oversight over the phone, and

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Post-Hearing Brief at 48-52. Rather, he argues simply that in response to unclear questions, his answers were accurate – if perhaps ambiguous. *Id.* On a related note, McMahan has admitted that he sought to avoid further investigation by trying not to mention the changed deal. “Mr. McMahan’s motive for negotiating the scope of the document request, and responding literally and not volunteering information in response to [Market Oversight’s] questions, was his hope to avoid further investigation arising from the change to the reported transaction.” *Id.* at 47-48. *See infra* notes 457-459 and accompanying text. This is not, of course, equivalent to an admission that he supplied intentionally misleading answers to any particular question.

<sup>385</sup> *See* Enforcement’s Post-Hearing Brief at 64; Respondent’s Post-Hearing Brief at 47-48.

<sup>386</sup> DX-4-3.

<sup>387</sup> Joint Chronology at ¶18; DX-4-3.

expressed his opinion that the document request was burdensome.<sup>388</sup> Market Oversight proposed that the request could be narrowed to information regarding solely the transaction for 1800 steers, but specifically mentioned it might still require the additional information concerning all October transactions.<sup>389</sup>

On November 22, McMahan responded with some information that he routinely prepared for his bank,<sup>390</sup> as well as an invoice and a copy of the bill of sale draft.<sup>391</sup> On November 24, Market Oversight wrote McMahan thanking him for it.

Although not a direct and complete answer to my questions, your reply goes far in helping us understand the context of your transaction of 1800 steers.... [W]e will evaluate the information . . . to determine what further information we need. While that evaluation is in progress, it is not necessary for you to provide further information.... As our evaluation continues, we will advise you of what additional information we need.<sup>392</sup>

On December 28, Market Oversight faxed McMahan another letter asking six questions.<sup>393</sup> During a telephone call on January 10, 2005, McMahan

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<sup>388</sup> Joint Chronology at ¶22. See DX-5-3; DX-16-1.

<sup>389</sup> DX-5-3.

<sup>390</sup> *Id.*; Joint Chronology at ¶25.

<sup>391</sup> Joint Chronology at ¶25; DX-9.

<sup>392</sup> DX-6-2.

<sup>393</sup> Joint Chronology at ¶28; DX-7-3.

asked if he could respond over the phone; he was told that he could not.<sup>394</sup> McMahan then dictated his response to Harper, who faxed it to Market Oversight on January 12, 2005.<sup>395</sup> There was no further relevant communication between Market Oversight and McMahan until this case was filed.<sup>396</sup>

**Enforcement Failed To Prove That McMahan Produced A Sham Invoice**

Enforcement's first allegation of a Section 9(a)(3) violation is that McMahan produced a sham invoice.<sup>397</sup> It theorizes that the invoice is false because it represents a sham transaction – one that never occurred.<sup>398</sup> We have of course already concluded that Enforcement failed to sufficiently prove that this initial all-steer deal was a sham.<sup>399</sup>

For the purposes of this allegation, the circumstances under which the invoice was created do not matter.<sup>400</sup> Obviously, an invoice is not fraudulent

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<sup>394</sup> Kokontis Tr. at 546; McMahan Tr. at 112; DX-18-1.

<sup>395</sup> Joint Chronology at ¶31; McMahan Tr. at 112; DX-8-2.

<sup>396</sup> See Joint Chronology at ¶¶31-33.

<sup>397</sup> Enforcement's Post-Hearing Brief at 65.

<sup>398</sup> *Id.*

<sup>399</sup> See *supra* notes 190-333 and accompanying text.

<sup>400</sup> An invoice is defined as “[a] written account, or itemized statement of merchandise shipped or sent to a purchaser, consignee, factor, etc., with the quantity, value or prices and charges annexed, and may be as appropriate to a  
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simply because the purchaser requests it, or because it is created some days after the transaction, or even because it reflects a transaction that had already changed at the time the invoice is produced. So long as the underlying transaction is legitimate, an invoice that reflects it accurately is not a sham document. Accordingly, we hold that Enforcement has failed to prove that McMahan produced a sham invoice.

**Enforcement Failed To Prove That McMahan Knowingly Misled Market Oversight By Simply Answering That He Was Provided An Invoice With The Weight On It**

Enforcement's second charge under Section 9(a)(3) is that McMahan lied or was otherwise misleading in his response to the second of six questions<sup>401</sup> in Market Oversight's letter to McMahan dated December 28, 2004.<sup>402</sup> That question asks:

Did you move the feeder cattle from that location? If so, were they moved to another feedlot? If the feeders were moved, please provide information on the trucking and any other particulars related to the movement to the new location (vet inspections, scale tickets, trucking firm, etc.). If the feeders were

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consignment or a memorandum shipment as it is to a sale." Black's Law Dictionary 742 (5th ed. 1979).

<sup>401</sup> For context, the first question asked: "Where were the feeders located when you purchased them from Bovina?" DX-7-3. McMahan answered "The feeders were located at Bovina." DX-8-2.

<sup>402</sup> Joint Chronology at ¶28; DX-7-3; Enforcement's Post-Hearing Brief at 51.

not moved, were they weighed? If so, please provide copies of the scale tickets.<sup>403</sup>

McMahan answered:

We did not move the feeder cattle from that general location.<sup>404</sup> Some were moved to wheat pasture in the general vicinity. When we bought the cattle we were provided an invoice which had the weight on it, but we have not received any scale tickets. In the normal course of business, we do not receive them.<sup>405</sup>

Enforcement concentrates on the underlined portion of McMahan's response, arguing that McMahan did not receive the invoice in the normal course of business.<sup>406</sup> It concludes without further analysis that this made McMahan's statement intentionally misleading.<sup>407</sup> We now examine McMahan's answer in the context of the circumstances surrounding the creation of the invoice.

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<sup>403</sup> DX-7-3.

<sup>404</sup> Enforcement also argues that McMahan's response to the question "[d]id you move the feeder cattle from that location?" is misleading, because the question was asked with the understanding that McMahan had taken delivery of the feeder cattle specified in the invoice. Enforcement's Post-Hearing Brief at 65-66. Enforcement does not allege that McMahan expressly lied in his answer; rather, it appears to simply be pointing out another circumstance under which it would have been natural for an honest man to mention the changed deal. As such, this does not constitute an affirmative act and is subsumed under the alleged violation of omission – that McMahan failed in a duty to notify Market Oversight of the changed transaction.

<sup>405</sup> DX-8-2 (emphasis added).

<sup>406</sup> Enforcement's Post-Hearing Brief at 51.

<sup>407</sup> *Id.*

McMahan believes he entered into the all-steer deal with Morris just before he made his report to Czerwien at 8:00 a.m., on October 21, 2004.<sup>408</sup> The all-steer invoice was created and faxed to McMahan on either October 26<sup>409</sup> or October 27.<sup>410</sup> As discussed, the invoice was provided only at the express request of Harper, acting on behalf of McMahan.<sup>411</sup> Indeed, it appears undisputable that had McMahan never asked for the invoice, it would never have existed.

First Field and then Morris initially refused to provide the invoice under the reasoning that it was for cattle other than those actually purchased.<sup>412</sup> When they did eventually provide the invoice, it did not contain the total weight or specify “steers”<sup>413</sup> – it took a second, specific request from Harper to get a “corrected” invoice.<sup>414</sup> And it is important to note that Harper supplied all of these details;<sup>415</sup> Field apparently knew nothing of the number of cattle, their

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<sup>408</sup> Respondent’s Post-Hearing Brief at 12.

<sup>409</sup> Field Tr. at 243.

<sup>410</sup> This date is inferred through the respondent’s questioning of Field. *Id.*

<sup>411</sup> Harper Tr. at 406.

<sup>412</sup> Field Tr. at 226; Morris Tr. at 279.

<sup>413</sup> Field Tr. at 245; Harper Tr. at 409; DX-12-3.

<sup>414</sup> Harper Tr. at 409; DX-11.

<sup>415</sup> Harper Tr. at 406.

total weight, their average weight, or the price, because she had no independent knowledge of the alleged initial all-steer transaction.<sup>416</sup>

Field's knowledge (and lack thereof) is of great importance. As discussed in Enforcement's Section 9(a)(2) charges, we have held that Field knew of the second (steer and heifer) transaction at the time she was asked to prepare an invoice for the first (all steer).<sup>417</sup> This is important, because it establishes the likelihood that Harper knew the all-steer transaction had been novated at the time he requested an invoice for it.<sup>418</sup> Related, it is noteworthy that neither Harper nor McMahan ever requested (or received) an invoice for the second transaction of both steers and heifers.<sup>419</sup>

There is no doubt that McMahan's answer is "literally" true. He was in fact provided an invoice that had the weight on it. And considering the informality of cattle transactions, stating he received the invoice "when we bought the cattle" is not false, *per se*. It may be that invoices are regularly supplied a few days after the agreement;<sup>420</sup> in any case, there appears to be no reason to interpret "when" as meaning "immediately upon."

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<sup>416</sup> Field Tr. at 224.

<sup>417</sup> *Id.* at 224-26.

<sup>418</sup> *See supra* notes 267-274 and accompanying text.

<sup>419</sup> Harper Tr. at 418.

<sup>420</sup> The parties provided no data one way or the other.

However, as we have previously discussed, telling the literal truth is no panacea. A statement can be literally true and yet misleading.<sup>421</sup> Market Oversight may have been reasonably misled in a number of ways by McMahan's response to its second question. Perhaps his response falsely implies that he obtained the invoice before the deal changed to one for steers and heifers. Or perhaps it falsely suggests that the source of the information on the invoice was the seller (Bovina), not the buyer (McMahan). However, we don't need to address what implications are buried within McMahan's statement.<sup>422</sup>

To be liable, McMahan must be found to have misled Market Oversight with *scienter* – intentionally, knowingly, or with a recklessness that approaches

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<sup>421</sup> See *supra* notes 343-348 and accompanying text. “The general definition of ‘misleading’ is a statement that, when viewed in the light of the circumstances under which it was made, creates a false impression of the facts.” Enforcement’s Post-Hearing Reply at 23-24 (citing *Brody v. Transitional Hospitals Corp.*, 280 F.3d 997, 1006 (9th Cir. 2002)).

<sup>422</sup> We note that it would be no easy task to decipher the reasonably implied meaning(s) of McMahan’s answer. Indeed, it might be futile since Enforcement offered no reliable evidence on the issue. In a case such as this, where the implied meaning is unclear, Enforcement would be best advised to introduce expert opinions, copy tests or survey evidence as to the representations reasonably conveyed by a statement. Cf. *In re Staryk*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,515 at 47,385 n.76 (CFTC Dec. 4, 1998) (stating that the surveys should be “methodologically sound; they [should] draw valid samples from the appropriate population, ask appropriate questions in ways that minimize bias, and analyze results correctly”) (citing *In re Thompson Medical Research Co., Inc.*, 104 F.T.C. 648, 789-90 (1984)); *Staryk*, [1994-1996 Transfer Binder] ¶26,701 at 43,926 n.71.

intent.<sup>423</sup> McMahan's *scienter* will be determined by an examination of the context in which he answered Enforcement's questions. This context may best be described as "casual." Market Oversight told McMahan from the outset that it was doing "due diligence" and that "it did not imply McMahan was guilty of any wrongdoing."<sup>424</sup> While this certainly does not permit McMahan to answer untruthfully, it does influence the significance to which McMahan accords Market Oversight's questions and his responses.

McMahan begins his discussion of *scienter* with a quote from a case in which the Supreme Court overturned a conviction for perjury.<sup>425</sup> In *Bronston*, the defendant deliberately misled investigators with an answer that was literally correct but unresponsive – resulting in his questioners drawing incorrect conclusions.<sup>426</sup> The Supreme Court held that the fact finder "should not be permitted to engage in conjecture whether an unresponsive answer, true and complete on its face, was intended to mislead or divert the examiner."<sup>427</sup>

Enforcement argues that *Bronston* is inapposite for a variety of reasons. Most compelling is that "McMahan's obligations under 9(a)(3) are much

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<sup>423</sup> See *supra* notes 96-158 and accompanying text.

<sup>424</sup> DX-4-4.

<sup>425</sup> *Bronston v. United States*, 409 U.S. 352 (1973).

<sup>426</sup> *Id.* at 357.

<sup>427</sup> *Id.* at 359.

broader than the prohibition against perjury under 18 U.S.C. §1621 that [the court in] *Bronston* construed.”<sup>428</sup> We agree. The perjury statute “confines the offense to the witness who ‘willfully . . . states . . . any material matter which he does not believe to be true.’”<sup>429</sup> The Supreme Court goes on to say that “the statute does not make it a criminal act for a witness to willfully state any material matter that *implies* any material matter that he does not believe to be true.”<sup>430</sup>

Meanwhile, Section 9(a)(3) expressly forbids statements that are knowingly made which are “false or misleading with respect to any material fact, or knowingly . . . omit any material fact required to be stated therein or necessary to make the statements therein not misleading.”<sup>431</sup> Thus, there can be no doubt that if McMahan was intentionally misleading, he violated the plain language of the Act – regardless of whether he spoke literal truth.

*Bronston* is not only inapposite but provides a useful contrast. Enforcement argues that “the rationale underlying a perjury prosecution is not present here.”<sup>432</sup>

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<sup>428</sup> Enforcement’s Post-Hearing Reply at 23.

<sup>429</sup> *Bronston*, 409 U.S. at 357; 18 U.S.C. 1621.

<sup>430</sup> *Id.* at 357-358.

<sup>431</sup> 7 U.S.C. §13(a)(3).

<sup>432</sup> Enforcement’s Post-Hearing Reply at 20.

Under the pressures and tensions of interrogation, it is not uncommon for the most earnest witnesses to give answers that are not entirely responsive. Sometimes the witness does not understand the question, or may in an excess of caution or apprehension read too much or too little into it.<sup>433</sup>

Enforcement then goes on to reason that “[t]his is not a case where a deponent is giving verbal responses under the pressures and tension of a deposition. Kokontis was attempting to obtain records and written responses to a set of written questions.”<sup>434</sup>

We agree. Indeed, we are faced with the opposite extreme; far from being a high-pressure interrogation, Market Oversight implied that McMahan was not even under investigation.<sup>435</sup> Accordingly, when McMahan initially offered to answer the questions at issue (nearly three months after the disputed event), he suggested a casual method of response – over the phone and while “on the road.”<sup>436</sup> When he was told that his response must be in writing, his approach remained casual. Rather than carefully study the questions and craft his

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<sup>433</sup> *Bronston*, 409 U.S. at 358.

<sup>434</sup> Enforcement’s Post-Hearing Reply at 20.

<sup>435</sup> “As I mentioned in our phone call Wednesday, this is an effort to conduct due diligence in the market surveillance of the Feeder Cattle contract, and is not meant to imply wrongdoing.” DX-4-4.

<sup>436</sup> “Rock called me this morning wishing to give an oral reply.... I said I needed a written reply, which I invited him to fax.... He said he was on the road but would get an assistant to prepare a reply and send it.” DX-18-1 (Internal CFTC email from Kokontis to staff).

response,<sup>437</sup> he had Harper read him the questions over the phone and write down his answers.<sup>438</sup> Harper expressed that he “thought” he got everything written down correctly.<sup>439</sup> It is in this context that we examine whether there is sufficient evidence of McMahan’s *scienter*.

We conclude that for McMahan to have misled Market Oversight with *scienter*, he must be either a remarkably gifted liar or have planned his response in an extraordinarily devious manner. Either he fabricated the story of the circumstances in which he allegedly replied to provide plausible deniability, or he spontaneously crafted – on the phone and while driving – a statement that was literally true but intentionally misleading. Neither seems particularly likely.

It would be much more interesting if McMahan had made up the story; indeed, we would consider McMahan some sort of evil genius. It would have to go something like this: McMahan had long been conspiring with Harper to respond in a manner that was misleading and yet literally true. The related

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<sup>437</sup> “Later, about 1:45 pm, an assistant called to say the reply was ready but Rock wouldn’t be able to review it until evening.” *Id.*

<sup>438</sup> Harper Tr. at 412; McMahan Tr. at 186-187.

<sup>439</sup> “Attached are Rock’s answers to you [sic] questions of December 28. Since Rock was out of town we had to do this over the phone, but I think I got everything down that he dictated.” DX-8-1 (Fax cover sheet to answers – comment by Harper.)

goal was to create plausible deniability of McMahan's intent to mislead via the fabrication of unusual circumstances surrounding his response.

First, McMahan waited until the last minute to call Market Oversight to create a fiction of being rushed. His offer to answer the questions orally was made in bad faith, as he had predicted that Market Oversight would want his answers solely in writing.<sup>440</sup> He made up the fact that he was out of the office on a trip and currently driving to create the impression that his response was made with limited care. In fact, he did not dictate his response at all, but rather crafted it in person with Harper. Harper then wrote on the cover of the fax that "I *think* I got everything down that he dictated" to further support the notion of a hurried response and to muddy the waters of intent.<sup>441</sup> The typo therein ("[a]ttached are Rock's answers to 'you' questions...") was the *coup de grace*.<sup>442</sup>

And yet. The circumstances in which McMahan responded are not factually contested – though to be fair, there is no logical means by which they could be. Regardless, we find it substantially more likely that McMahan (1) waited until the last minute to respond for the same reason everyone else does

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<sup>440</sup> It had to be in bad faith, because on the telephone there was the serious danger that Market Oversight would follow up on answers it considered incomplete or imprecise. See Respondent's Post-Hearing Brief at 53.

<sup>441</sup> DX-8-1 (emphasis added).

<sup>442</sup> *Id.*

(particularly attorneys) – because he felt he had other priorities; (2) offered to respond orally because he was on the road; (3) dictated his response to Harper because it was more convenient given the looming deadline; and (4) that Harper’s comment on the fax cover sheet was a natural enough addendum given the circumstances. Thus, we conclude that the circumstances of McMahan’s response were accurately portrayed.

However, McMahan may still have the requisite *scienter* if he managed through all of the aforementioned distractions to tell the literal truth, while intentionally misleading Market Oversight into believing that the invoice was provided in the normal course of business. We find this equally unlikely.

First, we note that Market Oversight’s question does not mention the word “invoice” – not once.<sup>443</sup> Thus, McMahan could have provided a thorough answer to the question without mentioning it either. As the comment at issue appears rather minor in the grand scheme of things – “...we were provided an invoice that had the weight on it...” – we find it unlikely that McMahan would bring it up only to deliberately lie about it.<sup>444</sup>

Second, we believe telling the literal truth while deliberately misleading Market Oversight through clever phraseology is no easy task. Doing it under the circumstances McMahan did – having the questions read to him while “on

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<sup>443</sup> DX-7-3.

<sup>444</sup> Indeed, McMahan argues consistently that he did not wish to volunteer information. Respondent’s Post-Hearing Brief at 47-48.

the road” and dictating his responses – would seem to be particularly difficult. We believe it more likely that given the three months that had passed and that McMahan was answering the questions in a casual manner, McMahan was simply hurried and imprecise.

In sum, we find that Enforcement has inadequately supported its allegation that McMahan misled Market Oversight with *scienter* by his simple answer that “we were provided an invoice that had the weight on it.”

**McMahan Knowingly Misled Market Oversight As To His Retention Of The Steers Reported In The All-Steer Deal**

Enforcement’s third allegation of a Section 9(a)(3) violation is that McMahan lied or was otherwise misleading in his response to the sixth question in Market Oversight’s letter to McMahan, dated December 28, 2004.<sup>445</sup> That question asked:

Have you disposed of any amount of ownership or interest in the 1750 feeders in question? If so, please indicate prices, weights, quantities, dates and counterparties.<sup>446</sup>

McMahan responded: “[n]ot to the best of my knowledge.”<sup>447</sup>

This is plainly an odd answer. If anyone had knowledge of what McMahan had done with cattle that McMahan had negotiated to purchase, it was – clearly – McMahan. Nevertheless, McMahan argues that given certain

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<sup>445</sup> Joint Chronology ¶28; DX-7-3; Enforcement’s Post-Hearing Brief at 51.

<sup>446</sup> DX-7-3.

<sup>447</sup> DX-8-2; McMahan Tr. at 114-15.

unusual circumstances, there were a number of questions as to whether he still owned the cattle.<sup>448</sup>

For instance, McMahan argues (we think) in an impossibly convoluted sentence that he might somehow have gained constructive possession, by virtue of the light steers remaining at Bovina for fattening.<sup>449</sup> He suggests that the original agreement to buy the light steers might have given him ownership, despite the fact that it was superseded by a second agreement for steers and heifers.<sup>450</sup> He further contends that the fact that he had not disposed of the heavier steers and heifers for which he had actually paid might somehow be relevant to whether he had disposed of any interest in the distinct deal for all steers.<sup>451</sup> Or at least, these are the issues with which McMahan was apparently wrestling that prompted his answer “[n]ot to the best of my knowledge.”<sup>452</sup>

Although we credit McMahan’s attorneys for making the best of it, all of those issues are far, far from the point. By the terms of Market Oversight’s written question, it does not matter if McMahan retained some interest in the

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<sup>448</sup> Respondent’s Post-Hearing Brief at 52.

<sup>449</sup> *Id.*

<sup>450</sup> *Id.*

<sup>451</sup> *Id.*

<sup>452</sup> DX-8-2; McMahan Tr. at 114-15.

cattle, but whether that interest had diminished from what was initially reported.<sup>453</sup>

By January 12, 2005, McMahan had known for nearly three months that the deal for all steers had changed to one for steers and heifers. In all that time: (1) he had not paid for the light steers; (2) no invoice had been created for the light steers, (3) no further oral agreement had been made regarding the light steers; and (4) no further borrowing had occurred to facilitate the purchase of the light steers. In short, McMahan had engaged in no effort at all to formalize or complete what he alleges was his oral understanding with Morris.<sup>454</sup> Rather, all McMahan ever had was his purported belief that he would have to pay for the light steers at some unspecified future date – contingent upon whether he could afford to do so.<sup>455</sup>

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<sup>453</sup> DX-7-3.

<sup>454</sup> “McMahan said he would take [the light steers].” Morris Tr. at 294.

<sup>455</sup> This contingency is important. McMahan testified that:

[W]e substituted the heifers for the steers because I didn't have enough money on my line of credit to pay for both deals at the same time. And I told him, I said, *'If need to be, I'll – you know, I'll pay for those other steers whenever I can.'* And he said, *'Well, we'[ll] worry about it later.*

McMahan Tr. at 68 (emphasis added). Thus, McMahan had borrowed all he could to finance the purchase of the heavy steers and heifers. He simply did not have the money to purchase the light steers at that time, nor was there any guarantee that he would have the necessary funds in the future.

Market Oversight asked whether McMahan had “disposed” of “any amount of ownership or interest” in the 1750 feeder steers in question. This is a very broad question. Assuming all facts in McMahan’s favor, there remains no doubt that McMahan’s interest in the light steers had changed. He started with 1750 steers. He then substituted heifers for half of those steers, resulting in a purchase of approximately 900 heavy steers and 1800 heifers. It doesn’t take a legal scholar trained in the niceties of property law to recognize that this, of itself, constitutes a clear “disposal of [some] amount of ownership or interest in the 1750 feeders in question.” After all, 900 heavy steers is less than 1750 heavy and light steers. In sum, an alleged contingent and uncertain future “obligation” to pay for light steers is not the same as light steers that have already been paid for (and for which an invoice exists).<sup>456</sup>

Therefore, the correct answer to Market Oversight’s question is “Yes” – accompanied by some explanation. On the contrary, “[n]ot to the best of my knowledge” is actively misleading – not to mention disingenuous. This is not an instance of literal truth, nor did McMahan simply choose to not volunteer information. McMahan is an experienced cattleman. He knew full well that there is a very real difference between 1,750 steers and 900 steers plus 1800 heifers. He also knew that there is a difference between a completed purchase

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<sup>456</sup> And if this were not enough, we note that McMahan never did end up paying for the light steers – and therefore never did end up owning them.

for which an invoice exists and a future contingent and uncertain obligation to purchase if at all possible.

Moreover, in this instance, our conclusion that McMahan intentionally lied to Market Oversight is buttressed by proof of a motive.<sup>457</sup> Indeed, he admitted that he hoped to avoid disclosure of the changed deal because it might “inflare” Market Oversight’s suspicions about the *bona fides* of the all-steer deal.<sup>458</sup> And of course responding truthfully to question six – by informing Market Oversight that his interest in the light steers had changed – would have certainly have opened up the “whole new can of worms” that McMahan wanted to remain tightly sealed.<sup>459</sup>

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<sup>457</sup> “Evidence of motive strengthens an inference of intent.” *Reddy*, 191 F.3d at 119.

<sup>458</sup> In his post-hearing brief, McMahan explained:

What remains is the motive to which Mr. McMahan testified: he was receiving calls from investigators asking him about the reported transaction, telling him that it had affected the close-out price, and telling him that he held the largest net long position as of October 28. He was concerned that if these investigators learned that the transaction had changed after it had been reported, it would only inflame suspicions.

Respondent’s Post-Hearing Brief at 47-48.

<sup>459</sup> McMahan testified:

I thought I read the answers – the questions they had and tried to answer them as truthfully as could and I knew or felt like if I told them this had changed, I already had the CME calling and I told the

(continued..)

We hold that with respect to question six, McMahan misled Market Oversight with *scienter* as to his retention of the steers reported in the initial all-steer deal in violation of Section 9(a)(3) of the Act.<sup>460</sup>

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(..continued)

people I bought the cattle. I had the USDA call or the CFTC calling, and I didn't know what other – I was answering the questions I thought as truthfully as I could and I thought it would open up a whole new can of worms saying, "Oh, by the way, after – you know, after we did all this, the deal changed."

McMahan Tr. at 183. *See id.* at 120.

<sup>460</sup> Section 9(a)(3) has a materiality requirement. 7 U.S.C. §13(a)(3). *See supra* notes 43-44 and accompanying text. Neither party briefed the issue of the materiality of McMahan's challenged statements to Market Oversight. *See* Enforcement's Post-Hearing Reply at 23-25; Respondent's Post-Hearing Brief at 48-53; Enforcement's Post-Hearing Reply at 66-68. We take this to be a concession to the obvious. A fact is "material" if it relates "to a matter which is so substantial and important as to influence [the] party to whom made." Black's Law Dictionary 880 (5th ed. 1979). *See U.S. v. Gaudin*, 515 U.S. 506, 509 (1995). "[T]he question of whether a fact is material is an objective one" *Aboelghar v. R.J. O'Brien Assoc., Inc.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶31,571 at 64,164 (CFTC May 17, 2010) (citation omitted). However, McMahan knew that Market Oversight would regard the fact of his changed interest in the steers to be important – that it would open up a "can of worms." McMahan Tr. at 120, 183. After all, the purpose of Market Oversight's investigation was to examine the *bona fides* of the all-steer deal as it impacted the Cattle Feeder Index. DX-4-4; McMahan Tr. at 87-88. Thus, the materiality of McMahan's misleading statement in response to Market Oversight's specific question is beyond dispute. *Cf. In re Auster*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,274 at 25,344 (CFTC Oct. 4, 1981) (stating that, "one may generally surmise" that any information specifically requested on a Commission registration application is material to the Commission's fitness assessment.").

### **Misleading Omissions**

In addition to prohibiting affirmative misrepresentations, Section 9(a)(3) prohibits certain knowing omissions of material fact in a report or document – those “required to be stated therein or necessary to make” any affirmative statements not misleading.<sup>461</sup> Enforcement charges McMahan with violating Section 9(a)(3) as a consequence of both what he did *and* didn’t say.

The plain language of Section 9(a)(3) appears to set forth a rule for omissions.<sup>462</sup> A “pure omission” – or as McMahan presents it, “not volunteering information”<sup>463</sup> – is generally lawful.<sup>464</sup> It only offends Section 9(a)(3) if the report or document specifically requires the omitted information, and it is knowingly withheld. The second type of omission under Section 9(a)(3) occurs when a respondent fails (with *scienter*) to disclose qualifying information necessary to prevent one of his affirmative statements from being false or misleading.<sup>465</sup> In this regard, Section 9(a)(3) treats omissions in a

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<sup>461</sup> 7 U.S.C. §13(a)(3).

<sup>462</sup> Enforcement’s treatment of the law governing omissions is so meager as to be unhelpful. See Enforcement’s Post-Hearing Brief at 67-68.

<sup>463</sup> Respondent’s Post-Hearing Brief at 47.

<sup>464</sup> The policy reasons why “pure omissions” generally are not unlawful are set forth in *Harris v. Connelly*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,919 at 41,016 n. 25 (CFTC Jan. 3, 1994).

<sup>465</sup> There may be many distinct ways in which to correct an otherwise misleading statement; clearly, each of these cannot count as a separate instance of “omission.” Thus, the violation rests with the affirmative  
(continued..)

manner analogous to that found in the case law governing commodity fraud.<sup>466</sup>

Many of the facts relevant to McMahan's alleged omissions are not contested. McMahan has agreed that he omitted mention of the changed deal with *scienter*;<sup>467</sup> he worried that the changed deal would seem suspicious.<sup>468</sup> However, he argues that he did not have to volunteer anything about the subsequent transaction, and that he accurately answered all of the questions Market Oversight actually asked.<sup>469</sup>

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(..continued)

misstatement. Further, it is important to note that in this second case, the deception is the direct consequence of the affirmative statement – not the omission. The omission is simply the set of qualifying or corrective information that would have rendered the affirmative statement non-misleading. See *Swickard*, [1984-1986 Transfer Binder] ¶22,522 at 30,275.

<sup>466</sup> Under the Commission's anti-fraud provisions, certain omissions may be misleading if the respondent has failed to disclose qualifying information necessary to prevent one of his affirmative statements from being deceptive. *Id.* An omission may also violate the Commission's disclosure rules. If neither of these two conditions are met, an omission is not unlawful. See *Saryk*, [1994-1996 Transfer Binder] ¶26,701 at 43,926, n. 72; *Lehoczky v. Gerald, Inc.*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,441 at 42,923-24 (CFTC June 12, 1995) (*citing Swickard* and *holding* that the failure to disclose that a majority of respondent's customers lost money "standing alone, does not establish a violation of Section 4b").

<sup>467</sup> See Respondent's Post-Hearing Brief at 47-48.

<sup>468</sup> And he believed that the existence of the changed deal was in any event irrelevant to Market Oversight's concern over the legitimacy of the initial deal. *Id.* at 47-48.

<sup>469</sup> *Id.* at 44. In essence, he argues that it was Market Oversight's duty to ask specific questions, and that he cannot be held liable for failing to answer questions that were not asked. *Id.* at 45.

McMahan does not discuss his omission of the steers' true weights. He correspondingly does not expressly admit *scienter*. However, we found earlier that McMahan misled the USDA, the CME, and others with *scienter* by reporting a purchase as 1800 feeders weighing an average of 725 pounds.<sup>470</sup> As we have held that McMahan was misleading with *scienter* in his underlying report, that record supports a finding that any material omissions in subsequent reports on the same subject also were made with *scienter*.

Therefore, it is clear without further discussion that McMahan's omissions satisfy most of the elements of Section 9(a)(3). They were (1) made with *scienter*; (2) material (as the changed deal and the improperly averaged steers were essential elements of the initial report and the subsequent investigation);<sup>471</sup> and (3) relevant to affirmative statements made in reports to Market Oversight.

Adequate analysis of the fourth element, however, necessitates more discussion; the section requires traders to not omit information when its disclosure is affirmatively required or its absence makes other statements misleading.<sup>472</sup> Put another way, McMahan was not obligated to provide any and all information that he thought Market Oversight might value. Rather, his

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<sup>470</sup> See *supra* notes 343-369 and accompanying text.

<sup>471</sup> See *supra* note 460.

<sup>472</sup> See 7 U.S.C. §13(a)(3).

obligation was limited to accurately and completely responding to Market Oversight's requests for information and documents; he was required to volunteer facts only to the extent necessary to make his document production and answers not misleading.

For example, suppose Market Oversight expressly informed a cattle trader that it was investigating to find out whether he had reported a false transaction. It then asked only for documents related to cattle transactions between the hours of 2:59 a.m., and 3:00 a.m., on Sunday, October 10, 2004. The trader, though possessing other documents that would unequivocally prove that he had falsely reported, nevertheless produced nothing. Further, he responds in writing that he did not engage in a fraudulent transaction within that time frame.

Clearly, the trader would have omitted certain facts with *scienter*, and those facts are arguably material, in the sense that they are important and Market Oversight would have liked to know them. However, the purposefully omitted material facts in this hypothetical were *not* requested and *not* necessary to make the trader's response complete and accurate on its face. The trader truthfully had no documents that met the specifications of this hypothetical request, and his response was in no way misleading.

Thus, it is possible for McMahan to have omitted material facts with *scienter*, and yet not be liable for violating Section 9(a)(3). We examine Market Oversight's specific questions and requests for production with this in mind.

**McMahan Knowingly Misled Market Oversight By Omitting To Inform It That (1) The Bill Of Sale Draft That He Produced Was For Cattle Other Than Those That He Reported And (2) None Of The Steers That He Purchased Weighed Close To The Average Stated On The Invoice That He Produced**

The relevant series of interactions between Market Oversight and McMahan begins with a letter sent by Market Oversight to McMahan on November 5, 2004,<sup>473</sup> which asked him to provide information on all transactions of physical cattle during October of 2004.<sup>474</sup> The fact that McMahan changed the deal from all steers to both steers and heifers is clearly relevant to any potential response, as it was a transaction in physical cattle that occurred in October. The omission of such a fact is an excellent example of an omission for which McMahan would be liable under the Act. It would have been a material omission, made with *scienter*, in a required report, of specifically requested information. Moreover, its absence would have made any response misleading.

And yet, Market Oversight withdrew this question.<sup>475</sup> It – not McMahan – suggested the scope of the new request, which was narrowed to solely information regarding the transaction for 1800 steers.<sup>476</sup> Market Oversight

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<sup>473</sup> DX-4; DX-5; DX-6; DX-7; DX-8; DX-9.

<sup>474</sup> Joint Chronology at ¶18; DX-4-3.

<sup>475</sup> The withdrawal was at McMahan's urging; he argued that the request was too burdensome. Joint Chronology at ¶22. See DX-5-3; DX-16-1.

<sup>476</sup> DX-5-3; DX-6-2.

now required (1) all the supportive documentation relating to his report to the USDA of the transaction in the amount of 1800 steers on October 15;<sup>477</sup> and (2) a recent monthly report that he routinely prepared for his banks, covering September and October 2004.<sup>478</sup> McMahan responded by providing the all-steer invoice from Bovina Feeders, a livestock bill of sale draft matching the dollar amount on the invoice, and the requested bank documents.<sup>479</sup>

Market Oversight's revised requests were obviously much narrower. Rather than "information on all transactions of physical cattle in October,"<sup>480</sup> Market Oversight's new request was for "supportive documentation" relating to McMahan's report "for 1800 steers on October 15." By its own terms, non-supportive documentation – like evidence of a changed deal – was not being

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<sup>477</sup> DX-5-3. At this point in its investigation, Market Oversight believed the 1800 steer deal had occurred on October 15.

It was reported in the USDA's report on the 22nd. That we were – would've been absolutely sure of. The date it occurred, a week later, I don't know as I sit here today how certain we were about that at the time. We had some indication that it was on the 15th, apparently.

Testimony of David A. Kass at 512.

<sup>478</sup> *Id.* Market Oversight specifically hedged this narrower option with a statement that suggested that it might at some point still require the additional information concerning all October transactions. DX-6-2. However, Market Oversight never renewed its broader request.

<sup>479</sup> DX-9. The bank documents are not at issue.

<sup>480</sup> DX-4-3.

requested. Also not being requested was information on any transactions *other* than that for the reported 1800 steers on October 15 – such is the difference between “all transactions in October” and “related to your report for 1800 steers” on a specific date.

*Ex ante*, these narrower questions were perfectly reasonable. Market Oversight’s sole interest was in verifying the reported all-steer transaction. Its questions were specifically tailored to do just that, while courteously minimizing the burden on McMahan. However, narrower questions naturally lead to narrower answers. And indeed, Market Oversight got exactly what it asked for: bank statements, and documentation supporting the report for 1800 steers.

Enforcement argues that McMahan nevertheless had a duty not to omit the facts that the deal had changed and that he had improperly averaged five and nine-weight steers.<sup>481</sup> The issue then, is whether the omission of these facts make the documents that McMahan *did* produce – the invoice, bill of sale draft, and the bank statements – impliedly misleading. And they do.

McMahan’s omission of the fact that the deal had changed makes the bill of sale draft impliedly misleading. The bill of sale draft is dated October 27, 2004.<sup>482</sup> As discussed at length, by October 27 the deal had already changed

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<sup>481</sup> Enforcement’s Post-Hearing Brief at 64.

<sup>482</sup> DX-9-17.

from all steers to steers and heifers.<sup>483</sup> Thus, the bill of sale draft was not for a purchase of 1800 steers; it was for a purchase of approximately 900 steers and 1825 heifers.<sup>484</sup> By presenting the bill of sale draft as supportive documentation of his all-steer purchase, and omitting the fact that the money was actually spent on a changed deal, McMahan materially misled Market Oversight.<sup>485</sup>

McMahan's omission of the fact that he had improperly averaged five and nine weight steers makes the invoice impliedly misleading. The invoice says that McMahan purchased 1800 steers averaging 705 pounds.<sup>486</sup> As previously discussed, an "average weight" in the cattle industry implies that the steers all weigh approximately that amount. By producing this invoice in response to a request for "supportive documentation relating to your report to the USDA...," McMahan was again implying that the cattle he purchased were properly reported as steers fitting within the Cattle Feeder Index – steers weighing between 700 and 850 pounds. Absent the material fact that none of the steers

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<sup>483</sup> See *supra* notes 252-272 and accompanying text.

<sup>484</sup> Even given McMahan's slightly different timeline, he certainly knew at the time he produced the bill of sale draft – many weeks later – that the dollars represented therein had not gone toward the reported all-steer deal.

<sup>485</sup> See *supra* note 318-322.

<sup>486</sup> DX-9-18.

weighed close to the reported average,<sup>487</sup> McMahan's invoice was impliedly misleading – despite being literally accurate in the sense that the two distinct groups of cattle, when unreasonably combined into a single group, averaged approximately 705 pounds.

In sum, we hold that McMahan impliedly misled Market Oversight with *scienter* in violation of Section 9(a)(3) by (1) producing the bill of sale draft while omitting the fact that it represented payment for cattle other than those reported and (2) producing the invoice while omitting the fact that none of the steers weighed close to the average indicated.

**McMahan's Violations: Inspection Of Books And Records, Furnishing Of Pertinent Information**

Enforcement's remaining allegation is that McMahan violated Section 4i of the Act,<sup>488</sup> as well as Commission Rules 1.31 and 18.05.<sup>489</sup> Section 4i

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<sup>487</sup> See *supra* notes 25-26, 460.

<sup>488</sup> 7 U.S.C. §6i; Complaint at ¶¶40-45.

<sup>489</sup> 17 C.F.R. §§1.31, 18.05. Rules 1.31 and 18.05 implement Section 4i. See *Reporting Requirements for Contract Markets, Futures Commission Merchants, Members of Exchanges and Large Traders*, 56 Fed. Reg. 45996, 63 (CFTC 1981); *General Regulations; Inspection of Books and Records*, 46 Fed. Reg. 21 (CFTC 1981). Rule 1.31 requires that all books and records required to be kept by the Act or Commission regulations, be provided “to a Commission representative upon the representative's request.” 17 C.F.R. §1.31(a)(2). In 2004, Rule 18.05 provided that “[E]very trader who holds a reportable futures or options position shall keep books and records showing all details concerning all positions . . . and shall upon request furnish to the Commission any pertinent information concerning such positions, transactions or activities.” 17 C.F.R. §18.05. Though the amended rule is not substantively different, we must still use the old rule for our analysis, as “the Commission adheres closely  
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imposes recordkeeping and inspection obligations on “reportable traders” – those holding large futures positions in a commodity.<sup>490</sup> McMahan was among the traders obligated to “keep books and records showing all details concerning . . . all positions and transactions in the cash commodity . . . and . . . upon request furnish to the Commission any pertinent information concerning such positions, transactions or activities....”<sup>491</sup> McMahan allegedly violated Section 4i and Rules 1.31 and 18.05 by (1) failing to produce adequate cash market and other records upon request, and (2) by providing false, misleading, or knowingly inaccurate information.<sup>492</sup>

As with its charges of McMahan’s violations of Section 9(a)(3), Enforcement does not distinctly list each of the alleged violations of Section 4i. Moreover, Enforcement’s allegations appear to differ somewhat between its post-hearing brief and its post-hearing reply.<sup>493</sup> Further muddling the issue, it

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to retroactivity principles.” *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,568.

<sup>490</sup> 7 U.S.C. §6i. It is undisputed that, at all relevant times, McMahan was a reportable trader in the feeder cattle futures contract. Complaint at ¶6; Answer at ¶6.

<sup>491</sup> 17 C.F.R. §18.05.

<sup>492</sup> Enforcement’s Post-Hearing Brief at 66.

<sup>493</sup> For instance, in Enforcement’s Post-Hearing Brief, its discussion of the Section 4i charges includes reference to the sham invoice, Market Oversight’s December 28 letter requesting answers to various questions, and McMahan’s  
(continued..)

combines the presentation of much of the analysis (and even the allegations) for Section 9(a)(3) and Section 4i, making them difficult to distinguish.

For instance, Enforcement appears to expressly allege that McMahan violated Section 4i in part by “providing false, misleading, or knowingly inaccurate information.”<sup>494</sup> And yet, Section 4i is not a fraud provision.<sup>495</sup> Indeed, Enforcement notes that *scienter* – a critical element of fraud – is not an element of Section 4i.<sup>496</sup> We add to Enforcement’s observation that neither Section 4i, nor its implementing Rules 1.31 and 18.05, mention the words “false,” “misleading,” or “knowingly inaccurate” – not once.

Thus, Enforcement’s discussion of Section 4i regarding McMahan’s intent to deceive Market Oversight – and assertions like “McMahan knew why

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two omissions. Enforcement’s Post-Hearing Brief at 62-66. However, Enforcement’s Post-Hearing Reply seems more limited: “[t]he gist of the Commission’s allegations in Count II is that McMahan was required to, and failed to produce the [cattle list] describing the cattle he actually purchased.” Enforcement’s Post-Hearing Reply at 17.

<sup>494</sup> Enforcement’s Post-Hearing Brief at 66.

<sup>495</sup> See 7 U.S.C. §6i.

<sup>496</sup> Enforcement’s Post-Hearing Brief at 63. (“*Scienter* is not an element of a cause of action under Section 4i or Rules 1.31 and 18.05, and nothing in either the statute or regulation implies that intent need be shown.”); Enforcement’s Post-Hearing Reply at 21.

the CFTC was calling” – seem misplaced.<sup>497</sup> Section 4i is no more than a books and records provision; McMahan must simply maintain them and produce them upon request.<sup>498</sup> Whether a record is in some way false or misleading is irrelevant to whether it is maintained and produced. And whether it is intentionally false or “knowingly inaccurate” can only be relevant if *scienter* is – and Enforcement has agreed that it is not.<sup>499</sup> In sum, whether McMahan lied, cheated, stole, mislead, or anything else, is fundamentally irrelevant to whether he has violated a strict liability bookkeeping rule. Our analysis of McMahan’s possible violations of Section 4i is therefore limited solely to whether McMahan produced the documents and information requested.<sup>500</sup>

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<sup>497</sup> See Enforcement’s Post-Hearing Brief at 64. However, McMahan’s *scienter* with respect to his violation of Section 4i may be relevant to determining the level of sanctions. See *U.S. Securities Corp.*, [Current Transfer Binder] ¶31,494 at 63,573 (citing *In re Grossfeld*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,467-68 (CFTC Dec. 10, 1996), *aff’d sub nom. Grossfeld v. CFTC*, 137 F.3d 1300 (11th Cir. 1998)). And yet there is nothing to indicate that Enforcement was discussing intent and knowledge in that context, and Enforcement expressly discusses sanctions in a separate section of its brief. Enforcement’s Post-Hearing Brief at 100-107.

<sup>498</sup> 7 U.S.C. §6i.

<sup>499</sup> Enforcement’s Post-Hearing Brief at 65.

<sup>500</sup> Enforcement does not allege that McMahan failed to properly create or maintain documents – only that he failed to produce them on request. See *id.* at 64-65.

Suppose Market Oversight asks a trader for documents supporting a deal. The only documents that exist are somehow false or misleading. The trader produces the documents. What are Enforcement’s options? Enforcement might allege that the trader violated Section 4i by failing to  
(continued..)

**McMahan Did Not Violate The Commission's Inspection Requirements By Failing To Produce The Cattle List**

In Enforcement's Post-Hearing Reply, it emphasizes McMahan's failure to produce the cattle list as "the gist" of its allegations in Count II.<sup>501</sup> Enforcement suggests that had McMahan produced a copy, Market Oversight would have learned that McMahan had not purchased seven-weight steers and could have asked better follow-up questions.<sup>502</sup> This matches our understanding of Section 4i as it involves simply the failed production of a document.

Proving a violation would appear to be a straightforward task. Enforcement need simply (1) point to a specific request for documents that reasonably includes the cattle list; (2) explain *why* the language of the request reasonably includes the cattle list; and (3) provide some proof that McMahan

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maintain proper records – because the only records that existed were misleading. Or Enforcement might allege a violation of Section 9(a)(3) for the production of false or misleading documents. But Enforcement cannot logically support an allegation that the trader failed to produce the documents requested; if it accepts the fact that no other relevant documents exist, then the trader has – by definition – produced every relevant document.

<sup>501</sup> Enforcement's Post-Hearing Reply at 17. Though the word "gist" at least potentially implies "only" – and Enforcement's choice not to mention any other allegations in its post-hearing reply reinforces this view – we view Enforcement's Post-Hearing Brief as alleging a second distinct violation of Section 4i. We discuss it below.

<sup>502</sup> Enforcement's Post-Hearing Brief at 65.

refused or otherwise failed to produce it. However, Enforcement does not approach the issue in this way; particularly, it never explains why the language of the request reasonably includes the cattle list.<sup>503</sup>

Obviously, this creates problems; once again we are forced to infer some part of Enforcement's case.<sup>504</sup> At best, we can conclude that Enforcement is arguing that the cattle list is responsive by virtue of either (1) containing some of the cattle from the (alleged) initial deal; or (2) being the only document to accurately reflect the cattle McMahan ended up owning. Neither argument supports a violation of Section 4i.

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<sup>503</sup> The closest Enforcement comes to our suggested method of proving a violation of Section 4i is in its post-hearing reply. Enforcement states:

The one responsive document that McMahan did possess – the inventory of cattle that Field had sent (DX-28), and which presumably included the heavy steers from the alleged all-steer deal – is the one document McMahan did not tender. *It is not true*, as McMahan proposes, that the bill of sale and invoice “were the only documents in possession of Mr. McMahan or his companies relating to the transaction of 1800 steers that he had reported to the Department of Agriculture.”

Enforcement's Post-Hearing Reply at 15 (*quoting* Respondent's Post-Hearing Brief at 45) (emphasis in original). Here, at least, Enforcement specifically states that the cattle list was a responsive document and that McMahan did not produce it; additionally, Enforcement properly omits mention of McMahan's intent or knowledge. And yet, Enforcement fails to explain *why* the document was responsive or otherwise provide any analysis – it simply concludes that McMahan's argument is “not true.” *Id.*

<sup>504</sup> See *supra* notes 370-381 and accompanying text.

Market Oversight requested “supportive documentation relating to your report to the USDA of the transaction in the amount of 1800 steers on October 15....”<sup>505</sup> The cattle list, however, (1) was not supportive documentation (if anything, it tended to undermine McMahan’s reported purchase); (2) was documentation for a distinct deal that included heifers; and (3) occurred on a date after that of the initial deal.

We agree with Enforcement that some of the cattle in the second deal were identical to cattle in the first. However, we do not agree that this fact alone somehow makes documentation of the second deal (the cattle list) somehow constitute “supportive documentation” for the first. Similarly, the fact that the cattle list accurately reflected the cattle McMahan ended up owning (the second deal) is simply irrelevant to whether McMahan produced everything for which Market Oversight asked (supportive documentation for the first).

In sum, Market Oversight asked for documents supporting the first deal. The cattle list is a document from the second deal. While there might be some hypothetical argument by which a document for one deal can be supportive documentation for another, Enforcement does not attempt to provide it. Further, Enforcement’s comments regarding McMahan’s knowledge or intent are simply misplaced; as discussed, Section 4i is a simple strict liability books

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<sup>505</sup> DX-5-3.

and records provision. Thus, we find that McMahan did not violate Section 4i by failing to produce the cattle list.<sup>506</sup>

**McMahan Violated The Commission's Production Requirements By Failing To Inform Market Oversight That His Ownership Interest In The Steers Had Changed**

Enforcement also alleges that McMahan violated Section 4i by failing to properly answer the sixth question of Market Oversight's letter dated December 28, 2004.<sup>507</sup> As discussed, that question asked McMahan in part "[h]ave you disposed of any amount of ownership or interest in the 1750 feeders in

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<sup>506</sup> Finally, we note an apparent flaw in the process for requesting documents. We commend Market Oversight for trying to work with McMahan by narrowing its initial request. However, it is clear that Market Oversight was at least somewhat dissatisfied with McMahan's production. Indeed, it specifically stated that "although not a direct and complete answer to my questions...." DX-6-2. Nevertheless, Market Oversight went on to cancel its still-active broader request for documents regarding all transactions in October. *Id.*

Later, after receiving McMahan's answers to the December 28 letter, Market Oversight apparently concluded that McMahan was not responding in good faith. Its instincts were correct, as this opinion explains at length. This was the time to reinstate the initial, broad request for documents. Had Market Oversight done so, one of two things would have occurred. Either McMahan would have satisfied Market Oversight's request by producing the cattle list, or he would have failed to do so – in which case Enforcement would have been able to successfully establish a clear violation of Section 4i.

<sup>507</sup> Enforcement's Post-Hearing Brief at 65. Though quite frankly, given Enforcement's conflation of the factual and analytical development of the alleged Section 9(a)(3) and Section 4i violations, we had to make some assumptions. In theory, Enforcement might be alleging that every violation of Section 9(a)(3) is also a violation of Section 4i. However, and as discussed at length, the Section 4i books and records provision is clearly not equivalent to the Section 9(a)(3) fraud provision. Thus, violation of one does not automatically result in a violation of the other.

question?”<sup>508</sup> and McMahan answer was “[n]ot to the best of my knowledge.”<sup>509</sup> We have already determined that this answer was knowingly false and therefore violated Section 9(a)(3). The issue is whether McMahan’s answer also violates Section 4i – that is, whether McMahan failed to produce information in his possession that was reasonably required to be produced given the language of Market Oversight’s request.

In discussing the alleged Section 9(a)(3) violations, we reasoned that McMahan knew that he had ended up with only 900 steers, and that he knew 900 steers did not amount to the same “ownership or interest” as 1800 steers.<sup>510</sup> While McMahan’s *scienter* is not at issue, our prior factual development permits us to conclude that McMahan did possess the information necessary to answer question six. As such, “[n]ot to the best of my knowledge” is not only misleading; it is also non-responsive.

Rule 18.05 requires that certain traders, including McMahan, “upon request, furnish to the Commission any pertinent information concerning . . . positions, transactions or activities...”<sup>511</sup> Market Oversight requested

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<sup>508</sup> DX-7-3. Market Oversight’s complete question was “[h]ave you disposed of any amount of ownership or interest in the 1750 feeders in question? If so, please indicate prices, weights, quantities, dates, and counterparties.” *Id.*

<sup>509</sup> DX-8-2.

<sup>510</sup> *See supra* notes 445-460 and accompanying text.

<sup>511</sup> 7 U.S.C. §6i.

information on whether McMahan had disposed of any interest in his reported all-steer purchase.<sup>512</sup> By failing to provide pertinent information, in his possession, that was clearly required to be furnished given the language of Market Oversight's request, McMahan violated the plain language of Section 4i.<sup>513</sup>

### **Sanctions**

We turn now to sanctions. Enforcement has demonstrated to our satisfaction that McMahan violated three sections of the Act by: (1) averaging the weights of two groups of non-conforming steers in a report so as to mislead with *scienter* the USDA (and therefore, predictably, the CME and others in the cattle industry) into reasonably believing that the cattle met the conditions for inclusion in the CME's Feeder Cattle Index;<sup>514</sup> (2) knowingly misleading Market Oversight in its ensuing investigation of his report to the USDA, by providing a false answer and misleading documents in response to its questions and

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<sup>512</sup> DX-7-3.

<sup>513</sup> 7 U.S.C. §6i.

<sup>514</sup> 7 U.S.C. §13(a)(2). See *supra* notes 343-369 and accompanying text.

requests for production,<sup>515</sup> and (3) failing to produce pertinent information within his possession in response to a request from Market Oversight.<sup>516</sup>

Enforcement seeks three types of sanctions. The first is an order to cease and desist, which would direct McMahan to stop violating the Act.<sup>517</sup> The second is a permanent trading ban, which would forever bar McMahan “from trading on or subject to the rules of any registered entity.”<sup>518</sup> And the third is a civil monetary penalty of \$380,000 – which Enforcement suggests is the maximum monetary penalty available under the Act.<sup>519</sup>

The Commission views its sanctions through a multifaceted prism – and an opaque one at that. The first facet of the analysis is “a determination of the ‘general gravity’ of the violations.”<sup>520</sup> This considers “the underlying conduct’s relationship to the regulatory purposes of the Act.”<sup>521</sup> Violations of “core provisions” warrant more serious sanctions.<sup>522</sup> An example of a core provision

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<sup>515</sup> 7 U.S.C. §13(a)(3). *See supra* notes 445-487 and accompanying text.

<sup>516</sup> 7 U.S.C. §6i. *See supra* notes 507-513 and accompanying text. In doing so, he also violated Commission Rules 1.31 and 18.05, 17 C.F.R. §§1.31, 18.05. *See supra* note 489.

<sup>517</sup> Enforcement’s Post-Hearing Brief at 103.

<sup>518</sup> *Id.* at 103-05. *See* 7 U.S.C. §9.

<sup>519</sup> Enforcement’s Post-Hearing Brief at 105-07.

<sup>520</sup> *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶131,494 at 63,574.

<sup>521</sup> *Id.* at 63,573.

<sup>522</sup> *Id.*

is one that prohibits fraud,<sup>523</sup> while a reporting failure is considered “ancillary” and “lower in gravity.”<sup>524</sup>

McMahan’s misleading report to the USDA in violation of 7 U.S.C. §13(a)(2) was undoubtedly a violation of a core provision of the Act, in that it disrupted the markets the Commission is charged with regulating.<sup>525</sup> McMahan’s subsequent behavior to cover-up this core violation – his infractions of 7 U.S.C. §13(a)(3) and 7 U.S.C. §6i during Market Oversight’s investigation – constitutes violations of ancillary provisions of the Act.<sup>526</sup>

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<sup>523</sup> *Id.*

<sup>524</sup> *Id.* at 63,574. There appear to be further gradations of gravity beyond simply “core” and “ancillary.” For instance, in *U.S. Securities & Futures Corp.*, the Commission says that “fraud is one such core provision” (assumedly, it means that regulations *prohibiting* fraud are core provisions, and not that fraud itself is a core provision). *Id.* at 63,573. It goes on to say that “[s]upervisory failures and any failure to register are only slightly less serious.” *Id.* However, it does not label supervisory failures and failures to register as core – or anything else. Finally, it identifies reporting failures as “ancillary.” *Id.* at 63,474 (*holding* that “[r]eporting failures, while serious, are lower in gravity, because reporting requirements are ancillary to the Act’s core regulatory provisions.”) (*citing In re Premex*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,165 at 34,890-91 (CFTC Feb. 17, 1988)). Impliedly then, supervisory failures and failures to register are somewhere between “core” and “ancillary.”

<sup>525</sup> *See Id.* at 63,573.

<sup>526</sup> *See In re Nikkhah*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,129 at 49,892 (CFTC May 12, 2000) (“A shortcoming in recordkeeping is serious, but somewhat lower in gravity [than fraudulent misconduct], because such requirements are less central to the Act’s core regulatory protections.”). *See also In re Kelly* [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,289 at 46,308 n.143 (Feb. 24, 1998) (*aff’d in relevant part, In re Kelly*, [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,514 (CFTC Nov. 19, 1998)).

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After the Commission determines the gravity of a violation, it focuses on the facts and circumstances of the particular case.<sup>527</sup> This inquiry involves considering whether a respondent's conduct was (1) knowing; (2) isolated or continuous; (3) the length of time the conduct continued; (4) the number of customers or individuals affected; (5) the financial benefit to the respondent; (6) the financial harm to customers; (7) any evidence of mitigation; and (8) evidence of rehabilitation – which can be shown by a change in the respondent's conduct since the time of his violation and by whether the respondent cooperated with authorities following discovery of his violations.<sup>528</sup>

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1998) (*stating* that “[t]he Court rejects the Division’s contention that Kelly’s intentional noncompliance with a production request constitutes a ‘violation of a core provision of the Act.’ The Division’s zeal notwithstanding, not every breach of the Act is equally serious. If infractions of the Commission’s record retention, inspection and production requirements stood at the Act’s ‘core,’ the statute would have no perimeters. This is a geometric impossibility.”).

The Commission’s recordkeeping and production requirements are ancillary to its “oversight and enforcement responsibilities.” *New York Currency Research Corp.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,223 at 45,915 (CFTC Feb. 6, 1998). Section 9(a)(3)’s prohibition on knowingly false reporting serves these same purposes and is therefore ancillary as well. 7 U.S.C. §13(a)(3).

<sup>527</sup> *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,574.

<sup>528</sup> *Id.*; *In re DiPlacido*, [2007-2009 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,970 at 62,490 (CFTC Nov. 5, 2008).

We address the factors as follows: (1) McMahan knowingly misled the USDA in reporting the all-steer deal;<sup>529</sup> (2) it was an isolated incident;<sup>530</sup> (3) the conduct did not continue;<sup>531</sup> (4) Enforcement presented no evidence as to the number of individuals affected (although McMahan's misleading report affected the trading outcomes of all feeder cattle market participants so it must have been large); (5) McMahan gained approximately \$105,000 as a result of his report; (6) Enforcement presented no evidence as to the financial harm to others (although the short traders undoubtedly suffered to the extent that the longs benefitted); (7) there was no evidence presented of mitigation; and (8) McMahan misled Market Oversight in its investigation,<sup>532</sup> but has voluntarily stopped reporting, and is therefore (presently) unable to falsely report.<sup>533</sup> However, how all that adds up – and how it impacts the initial determination of “gravity” – is anyone's guess.

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<sup>529</sup> See *supra* notes 343-369 and accompanying text.

<sup>530</sup> Enforcement concedes as much. Enforcement's Post-Hearing Brief at 96 (“The Division's theory of the case is that this is a case of isolated opportunism as opposed to a pattern of activity.”).

<sup>531</sup> *Id.*

<sup>532</sup> See *supra* notes 445-513 and accompanying text.

<sup>533</sup> McMahan Tr. at 54.

As we can see, the Commission, eschews a “specific formula” in the sanctions assessment.<sup>534</sup> Instead it employs “a visceral mixing of incommensurables”<sup>535</sup> – that is, it engages in a far-ranging inquiry into a multitude of generalized factors without assigning a specific weight to any one of them (or adhering to any other principles of absolute or relative quantification).<sup>536</sup> Like much of its precedent in other areas,<sup>537</sup> the Commission’s law of sanctions – mired in the ambiguous rhetoric of case-specific considerations – thwarts the development of reasoned, predicable rules.<sup>538</sup>

A compounding problem is that the Commission discusses the general gravity of a violation and the case-specific considerations material to sanctioning in a vacuum – that is, without relating them to each of the specific sanctions available. In other words, even assuming one could reasonably and predictably calculate the gravity of a particular offense, and then modify it by the collective weight of the other factors, one would still have to apply that

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<sup>534</sup> *R&W*, [1998-1999 Transfer Binder] ¶27,582 at 47,748.

<sup>535</sup> Posner, *supra* note 65 at 447.

<sup>536</sup> See, e.g., *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,573-75; *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,490-94.

<sup>537</sup> For criticism of the Commission’s multi-factor, or “holistic,” legal approaches in other areas of the law, see *In re Cargill*, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,425 at 51,225-26 (CFTC Nov. 22, 2000).

<sup>538</sup> Posner, *supra* note 65 at 447.

conclusion to – for instance – a decision whether to issue an order to cease and desist. But as we will discuss, the Commission has held that specific sanctions (like orders to cease and desist) should be calculated and imposed under a different set of factors.

In essence, the Commission's guidance on sanctions amounts to no more than a generic instruction to consider numerous facts and circumstances to determine the severity of the violation. Then once this determination is made, it is immediately set aside – trumped by the Commission's distinct set of the facts, circumstances and general principles to be considered in the imposition of particular sanctions. The predictable result of this layering of general considerations upon general considerations, is that there is no rational or even coherent precedent for sanctions, as well as almost no meaningful limit to the Commission's discretion. The result (and perhaps the intention) is that the Commission can rule pretty much however it wants – and (as we will see) with little consistency.<sup>539</sup> All of which means, of course, that the Commission's law of sanctions lacks predictability for participants in the industry that the Commission exists to regulate.<sup>540</sup>

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<sup>539</sup> See *United States v. Meade Corp.*, 533 U.S. 218, 241 (2001) (Scalia, J., *dissenting*) (*describing* “that test most beloved by [agencies] unwilling to be held to rules (and most feared by litigants who want to know what to expect): th’ ol’ ‘totality of the circumstances’ test”).

<sup>540</sup> *Id.*

Given our obligation to muddle through this Commission precedent to arrive at a mix of sanctions, we structure our discussion as follows: first, we will introduce the potential sanction<sup>541</sup> and explain Enforcement's request and reasoning, if any; second, we will explain McMahan's rebuttal; third, we will explain the range of sanctions available by contrasting Commission precedent; and fourth, we will pick ones within that range.

### **Cease And Desist Order**

Section 6(d) of the Act provides that upon proof of any violation of the Act or Commission regulations, a respondent may be directed to cease and desist from engaging in further violations.<sup>542</sup> Although a cease and desist order does not immediately level monetary, trading, or registration sanctions against a respondent, it is not merely a badge of shame. Rather, it provides the basis for independent causes of action – both public and private.<sup>543</sup> Accordingly, while

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<sup>541</sup> The reader may wish to note the distinctions between the Commission's treatment of sanctions generally – gravity and the multiple factors outlined above – and the distinct factors considered in its treatment of particular sanctions as outlined below.

<sup>542</sup> See 7 U.S.C. §13b.

<sup>543</sup> Noncompliance with a cease and desist order may result in a monetary penalty of \$100,000 (plus an adjustment for inflation) or triple the gain of the wrongdoing resulting from noncompliance, and/or imprisonment for a period ranging from six months up to one year. See 7 U.S.C. §13b; 17 C.F.R. §143.8. See also 28 U.S.C. §2461 note. In addition, each day of noncompliance is deemed a separate offense. 7 U.S.C. §13b. Certain violations may result in more severe sanctions, including imprisonment for up to ten years. 7 U.S.C. §13(a). Moreover, violations of cease and desist orders that injure others could form the basis of reparations actions. 7 U.S.C. §18.

“[a]s a general proposition, cease and desist orders should be entered against those who have been adjudged to have violated the Act,” imposition has historically not been automatic.<sup>544</sup> The Commission has stated the appropriateness of this sanction turns on whether “there is a reasonable likelihood that a respondent will repeat his wrongful conduct in the future.”<sup>545</sup>

Enforcement requests that we order McMahan to cease and desist from violating the Act, arguing that there is a reasonable likelihood that McMahan will repeat the violations in the future.<sup>546</sup> McMahan, meanwhile, does not directly address this issue. However, he does argue that we should not impose a trading ban, and his reasoning happens to be also relevant here.<sup>547</sup> In short, McMahan argues that his violation was a single event, that the consequences flowing from his conduct were short-lived, and that he voluntarily stopped

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<sup>544</sup> *In re Richardson Securities Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,145 at 24,647 (CFTC Jan. 27, 1981). See *Precious Metals Assocs., Inc., v. CFTC*, 620 F.2d 900, 912 (1st Cir. 1980).

<sup>545</sup> *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,575. Note that the gravity of the violation and the general list of other sanctioning considerations discussed earlier largely drop out of (or are at best tangential to) this assessment. *Id.*; *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,490. See *supra* notes 520-541 and accompanying text.

<sup>546</sup> Enforcement’s Post-Hearing Brief at 103.

<sup>547</sup> Respondent’s Post-Hearing Brief at 55.

reporting his trades to the USDA.<sup>548</sup> He concludes that there is no threat that he will repeat the conduct of which he is accused.<sup>549</sup>

Having explained the parties' positions, the usual task of a trial judge at this point would be to determine what the law is, and then apply that law to the facts.<sup>550</sup> Unfortunately, the Commission's case law "is" self-contradictory. We contrast just a few of its decisions to explain.

In *Dillon-Gage*, the Commission overturned the Administrative Law Judge's initial decision entering an order to cease and desist.<sup>551</sup> It held that "[t]he likelihood of future violations may be inferred from a pattern of past unlawful conduct, *but not from an isolated instance of past unlawfulness.*"<sup>552</sup> The meaning is quite clear: a single, "isolated" instance is insufficient proof that there is a reasonable likelihood the respondent will repeat the conduct –

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<sup>548</sup> *Id.*

<sup>549</sup> *Id.*

<sup>550</sup> *Marbury v. Madison*, 1 Cranch 137, 177, 2 L.Ed. 60 (1803) (*holding* that "[i]t is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule. If two laws conflict with each other, the courts must decide on the operation of each.").

<sup>551</sup> *In re Dillon-Gage, Inc.*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,574 at 30,482-83 (CFTC June 20, 1984).

<sup>552</sup> *Id.* (emphasis added). The Commission went on to conclude that there was little evidence to demonstrate that the violations were ongoing during the four year period up to the time of the oral hearing, and that this assisted the Commission in deciding that a cease and desist order was unnecessary. *Id.* at 30,483.

and that absent a reasonable likelihood of repetition, a cease and desist order should not be imposed. Further, the Commission has applied this reasoning even when the conduct was intentional or serious.<sup>553</sup>

Testimony at the hearing revealed no reporting violations before or after the false report to the USDA at issue in this case.<sup>554</sup> On the contrary, Enforcement's own witness testified that McMahan had a history of honest reporting.<sup>555</sup> Further – and as discussed at length – we have no data points aside from the single report at issue.<sup>556</sup> It is therefore simply impossible to conclude that there have been other instances that together might constitute a “pattern of past unlawful conduct.”<sup>557</sup> Thus, under Commission precedent in *Dillon-Gage* (and others), no cease and desist order could be issued – clearly.

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<sup>553</sup> *Id.* See *In re Brody*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,081 at 32,180-81 (CFTC May 20, 1986); *Richardson Securities Inc.*, [1980-1982 Transfer Binder] ¶21,145 at 24,647.

<sup>554</sup> Enforcement does suggest that a previous disagreement between McMahan and the USDA constitutes evidence of prior unlawful conduct. Enforcement's Post-Hearing Brief at 103 (“Ken Gladney of the USDA testified about a prior incident in which McMahan reported a sale with the intent of affecting the price of the Index that the USDA rejected.”). However, there appears to be little support for this argument. The witness upon which Enforcement relies also opined that the “prior incident” involved “honest” reporting by McMahan. Gladney Tr. at 482, 489-90.

<sup>555</sup> Gladney Tr. at 480-81, 489.

<sup>556</sup> See *supra* notes 58-66 and accompanying text.

<sup>557</sup> *Dillon-Gage*, [1984-1986 Transfer Binder] ¶22,574 at 30,482. Similarly, McMahan's misleading responses to Market Oversight were part of a one-time  
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However, in *New York Currency Research*, the Commission held precisely the opposite, when it imposed a cease and desist order for a single violation of certain record production requirements.<sup>558</sup> No explanation was given; its entire discussion of the matter was limited to the declaration “[o]ur assessment of the record and other relevant factors establishes that a cease and desist order . . . [is] warranted.”<sup>559</sup> Indeed, the Commission left undisturbed the Administrative

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cover-up. The Commission has never investigated him for any wrongdoing either before or after the reported purchase in issue. *Kokontis Tr.* at 559-60.

<sup>558</sup> *New York Currency Research Corp.*, [1996-1998 Transfer Binder] ¶27,223 at 45,915.

<sup>559</sup> *Id.* We note that this “reasoning” appears insufficient under the Administrative Procedure Act. See 5 U.S.C. §557(c)(3) (“All decisions, including initial, recommended, and tentative decisions, are part of the record and shall include a statement of – (A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and (B) the appropriate rule, order, sanction, relief, or denial thereof.”). As is explained in the legislative history of Section 557(c)(3):

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

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

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Law Judge's finding that the respondent had resisted the production demand in good faith and pursuant to the reasonable advice of its attorneys.<sup>560</sup>

A similar decision was reached in *Kelly*, where the Commission overturned an initial decision by the Administrative Law Judge and imposed a cease and desist order despite the fact that there was only a single violation.<sup>561</sup> Stranger still, the Commission imposed this sanction despite finding that "to some extent" the violation was "attribut[able] to [the respondent's] lack of familiarity with the responsibilities attendant upon being a Commission registrant...."<sup>562</sup> And once again, the Commission failed in both *New York Currency* and *Kelly* to address – much less explain – its own contrary precedent.<sup>563</sup>

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offer by way of rehearing or reconsideration of decisions.

Sen. Rep. 752, 79th Cong. 1st Sess. at 24-25 (1945); H.R. Rep. 1980, 79th Cong. 2nd Sess. at 39 (1946), *cited in* Attorney General's Manual on the Administrative Procedure Act 86 (1946).

<sup>560</sup> *New York Currency Research Corp.*, [1996-1998 Transfer Binder] ¶27,223 at 45,915; *see In re New York Currency Research Corp.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,222 at 45,905 (CFTC Jan. 12, 1998).

<sup>561</sup> *Kelly*, [1998-1999 Transfer Binder] ¶27,514 at 47,373.

<sup>562</sup> *Id.* at 47,374.

<sup>563</sup> *See New York Currency Research Corp.*, [1996-1998 Transfer Binder] ¶27,223 at 45,915; *Kelly*, [1998-1999 Transfer Binder] ¶27,514 at 47,373. *But see supra* note 155.

Thus, an isolated instance of intentional or serious past unlawfulness apparently precludes the entry of a cease and desist order;<sup>564</sup> while isolated misconduct that is undertaken in good faith or that is substantially mitigated constitutes a *prima facie* case for its imposition.<sup>565</sup>

With these as the extremes, we can conclude only that there is no coherent law on the subject. Consequently, there is no way to rationalize any decision we might make with respect to Commission precedent. Or approached from a different angle, it would be all too easy to rationalize *any* decision we might make – so long as we follow the Commission’s lead and simply ignore any precedent that does not fit our desired outcome. Nevertheless, we are obligated to decide.

*Kelly* and *New York Currency Research* are more recent cases than *Dillon-Gage*, *Brody* and *Richardson Securities* and on that basis alone (not a very compelling one), we **ORDER** McMahan **TO CEASE AND DESIST** from violating Sections 4i, 9(a)(2) and 9(a)(3) of the Act,<sup>566</sup> and Commission Rules 1.31 18.05.<sup>567</sup> We do not pretend that this decision is based on anything more. If McMahan believes that this lack of clear standards is injudicious and unfair,

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<sup>564</sup> See *supra* notes 551-553 and accompanying text.

<sup>565</sup> See *supra* notes 558-563 and accompanying text.

<sup>566</sup> 7 U.S.C. §§6i, §13(a)(2), 7 U.S.C. §13(a)(3).

<sup>567</sup> 17 C.F.R. §§1.31, 18.05.

and exposes him and others in the industry to the arbitrary and unpredictable imposition of this sanction, his remedy is to appeal to the Commission and then (if necessary) to the appropriate United States Court of Appeals.

### **Trading Prohibition**

Section 6(c) of the Act provides that upon proof of any violation of the Act or Commission regulations, a respondent may be prohibited from trading on contract markets.<sup>568</sup> Trading prohibitions are appropriate when the misconduct presents an inherent threat to the integrity of the futures market, such as when it erodes “[p]ublic perception, protection, and confidence in [the] markets.”<sup>569</sup>

Should we determine that a trading prohibition is warranted, the next step is to determine its length. The Commission has consistently stated that the length of a trading ban should match the gravity of the offense.<sup>570</sup>

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<sup>568</sup> 7 U.S.C. §9. More specifically, the provision provides: “Upon evidence received, the Commission may (1) prohibit such person from trading on or subject to the rules of any registered entity and require all registered entities to refuse such person all trading privileges thereon for such period as may be specified in the order.”

<sup>569</sup> *In re Miller*, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914 (CFTC June 16, 1995); *See also DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,491; *In re Incomco*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537 (CFTC Dec. 30, 1991). Note again how the gravity of the violation and the general list of other sanctioning considerations are at best ancillary to this determination. *See supra* notes 520-541 and accompanying text.

<sup>570</sup> *Id.* As discussed earlier, there is no doubt that McMahan’s misleading report to the USDA was a core violation of 7 U.S.C. §13(a)(2) in that it disrupted  
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Enforcement requests that we permanently ban McMahan from trading.<sup>571</sup> It argues that McMahan's false report threatened the integrity of the futures market for feeder cattle, and argues further that the false report was intentional and egregious.<sup>572</sup> Enforcement concludes that McMahan's actions justify the imposition of a permanent trading ban.<sup>573</sup>

Unfortunately, Enforcement makes little effort to justify the severity of its requested sanction. While Enforcement cites to cases in which permanent trading bans have been imposed,<sup>574</sup> it does not compare McMahan's actions with those of the respondents in the cases cited – or, for that matter, respondents in any other case.<sup>575</sup> This is a serious omission; in effect, Enforcement has argued the following: (1) the Commission has imposed

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the markets the Commission is charged with regulating. *See supra* note 525 and accompanying text.

<sup>571</sup> Enforcement's Post-Hearing Brief at 104-105.

<sup>572</sup> *Id.*

<sup>573</sup> *Id.* at 105.

<sup>574</sup> These include: *Miller*, [1994-1996 Transfer Binder] ¶26,440 at 42,914; *In re Staryk*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,826 at 56,452 (CFTC July 23, 2004); *In re Slusser* [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,701 at 48,318 n.30 (CFTC July 19, 1999).

<sup>575</sup> Enforcement's Post-Hearing Brief at 103-105; Enforcement's Post-Hearing Reply at 25-27. Instead, Enforcement says merely that the Commission has imposed permanent bans "when the record supports it." Enforcement's Post-Hearing Brief at 104.

permanent trading bans in the past; (2) McMahan's conduct was bad; (3) we should impose a permanent trading ban on McMahan. And yet, the absence of any discussion or analysis of the *circumstances* under which the Commission has imposed permanent trading bans leaves us with no useful guidance from Enforcement – only its conclusions.

McMahan, of course, disagrees with those conclusions. He argues that a trading ban should not be imposed; and if one is, it certainly should not be permanent. However, unlike Enforcement, McMahan cites and then *analyses* cases in which trading bans have been imposed to support his conclusions.<sup>576</sup> According to McMahan, these cases show that the Commission has imposed trading bans of limited length for conduct that was substantially worse than that which occurred here.<sup>577</sup>

We concluded in the liability section that McMahan knowingly misled the USDA in reporting the purchase of cattle, resulting in the improper inclusion of the transaction in the CME's Feeder Cattle Index.<sup>578</sup> There can be no question that his false report affected the integrity of the futures market for feeder cattle. And the "public" – another cattleman – brought the report to the attention of

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<sup>576</sup> Respondent's Post-Hearing Brief at 54-55. These include: *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,575-76; *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,491.

<sup>577</sup> Respondent's Post-Hearing Brief at 54-55.

<sup>578</sup> See *supra* notes 343-369 and accompanying text.

the CME.<sup>579</sup> Therefore, there can be no question that the false report eroded “[p]ublic perception, protection, and confidence in [the] markets.”<sup>580</sup> We conclude that the requirements have been met for the imposition of a trading ban.<sup>581</sup>

Determining the length of the ban is more complicated. Once again, the law in this area is less than clear; there is not often an obvious correlation between the apparent gravity of the offense and the length of the trading ban imposed on a respondent. We begin by noting that the Commission has held that permanent trading bans are “‘rarely appropriate’ . . . and should be reserved for conduct that is both intentional and egregious.”<sup>582</sup> Thus, our task is to determine whether McMahan’s conduct is similar to the conduct of respondents against whom the Commission has (rarely) imposed a permanent trading ban.

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<sup>579</sup> Pritchard Written Testimony at ¶3.

<sup>580</sup> *Miller*, [1994-1996 Transfer Binder] ¶26,440 at 42,914.

<sup>581</sup> Our conclusion is based solely on our determination that McMahan made a false report to the USDA. McMahan’s other violations – that he misled Market Oversight and withheld pertinent information – had no direct impact on the markets and are therefore not relevant to our decision to impose a trading ban. See *R&W*, [1998-1999 Transfer Binder] ¶27,582 at 47,747-48; *In re Premex*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,992 at 28,370-71 (CFTC Feb. 1, 1984).

<sup>582</sup> *E.g.*, *Miller*, [1994-1996 Transfer Binder] ¶26,440 at 42,914 (citing *GNP Commodities*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,360 at 39,222 (CFTC Aug. 11, 1992)).

We start by taking a look at four cases. First, in *Glass*, respondents who engaged in 12 noncompetitive trades over a five month period, and who “had been found guilty of earlier violations” received permanent trading prohibitions.<sup>583</sup> Second, in *Mayer*, the Commission held that repeated fraud, prearranged and wash trading, and bucketing over the course of two and one-half years warranted permanent trading prohibitions for some respondents and ten-year bans for others, depending on the level of involvement.<sup>584</sup>

Third, in *GNP Commodities*, the Commission held that a broker should receive a permanent trading prohibition because he had systematically allocated winning trades over the course of 21 months to his personal account and losing trades to customer accounts.<sup>585</sup> Further, he had subsequently promoted his account’s overwhelming “track record” to prospective investors.<sup>586</sup> And fourth, the Commission affirmed a permanent trading ban in *Stryk*, where the respondent systematically exploited his customers over a three and

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<sup>583</sup> *In re Glass*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,337 at 46,561-8-9 (CFTC April 27, 1998).

<sup>584</sup> *In re Mayer*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,259 at 46,140-41 (CFTC Feb. 3, 1998).

<sup>585</sup> *GNP Commodities*, [1990-1992 Transfer Binder] ¶25,360 at 39,222.

<sup>586</sup> *Id.* at 39,211.

one-half year period by lying about the profitability of gasoline and heating oil options while minimizing the risk.<sup>587</sup>

There is a clear distinction between McMahan's actions and those of the respondents in the cases mentioned: McMahan made only a single false report, whereas the respondents in those cases repeatedly engaged in fraud over the course of months or years. This distinction matters; indeed, it's common sense. A pattern of fraudulent behavior is worse than deception in a single instance.<sup>588</sup> Not only is the damage caused by multiple frauds usually greater, but the pattern of behavior makes it easier to conclude that the respondent is a permanent danger to the futures market – thereby warranting a permanent trading ban.<sup>589</sup> Thus, we conclude that Commission precedent clearly demonstrates that a permanent trading ban is not an appropriate sanction for McMahan.

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<sup>587</sup> *Stryk*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,826 at 56,452 (CFTC July 23, 2004).

<sup>588</sup> See *Dillon-Gage*, [1984-1986 Transfer Binder] ¶22,574 at 30,482-83.

<sup>589</sup> We are tempted to try to also distinguish the severity of McMahan's wrongdoing. We reason that while a false report misaveraging the weight of cattle for inclusion in a government report certainly constitutes a fraud and must be prevented, that it is less severe than defrauding hundreds of customers (*Stryk*) or stealing from them (*GNP Commodities*). However, the Commission has provided no consistent guidance on the relative severity of different kinds of fraud, and we believe the difference in the quantity of violations and their duration is sufficient, of itself, to justify the imposition of a lesser trading ban.

This only begins our inquiry, however, as we must still determine the length of a lesser ban. Unfortunately, the relevant cases are (once again) impossible to reconcile, in that the gravity of a given offense often appears inconsistent with the length of the imposed ban.<sup>590</sup> Further, neither Enforcement nor McMahan presented a single case directly on point; that is, one in which the Commission adjudicated a case in which a respondent was accused solely of filing a false report off of the trading floor. Having reviewed a plethora of Commission precedent,<sup>591</sup> we have not found such a case either. Nevertheless, it is necessary to decide.

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<sup>590</sup> For instance, the Commission has found that commodity pool fraud in which “respondents’ violations of the Act involved fraud that continued over a period of many months and involved millions of dollars and hundreds of people” warranted one-year trading bans. *In re Commodities International, Corp.*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. ¶26,943 at 44,566-67 (CFTC Jan. 14, 1997). It has also found that commodity pool fraud which took place over nine months, involving millions of dollars and hundreds of customers warranted a permanent trading prohibition. *Slusser*, [1998-1999 Transfer Binder] ¶27,701 at 48,310, 20. We note that the one-year trading prohibition meted out in *Commodities International* is on the low end of the results found in Commission trading ban case law while the permanent trading prohibition imposed in the seemingly comparable *Slusser* case, of course, defines the high end.

<sup>591</sup> Which also appear to have no discernable pattern. *See, e.g., U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,574-76 (*holding* that respondents’ scheme to allow an omnibus account to be used as an instrument of customer fraud over a period of three years “involving several hundred individual subaccounts through which millions of dollars were traded and \$19 million in customer funds were lost” warranted ten-year trading bans); *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,487-91 (*holding* that respondent’s manipulation of the settlement price of the electricity contract on four occasions warranted a 20-year trading ban); *Nikkhah*, [1999-2000 Transfer Binder] ¶28,129 at 49,893 (*holding* that respondent’s fraudulent  
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We base our decision on two relatively recent Commission cases.<sup>592</sup> The first case is *Gorski*, in which the Commission found that the respondent had violated Section 4c(a) and Rule 1.38(a)<sup>593</sup> by entering into non-competitive

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allocation scheme which “continued over several months, and resulted in significant harm to customers” warranted a ten-year trading prohibition); *In re Reddy*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (CFTC Feb. 4, 1998) (*concluding* that respondents, who were involved in a pattern of noncompetitive trading over a period of months, should receive ten-year and five-year prohibitions, depending on the level of involvement); *In re Elliott*, [1996-1998 Transfer Binder] ¶27,243 at 46,008 (Feb. 3, 1998) (*finding* that 32 noncompetitive trades occurring over a two-week period which “impacted the integrity of the market by significantly inflating the volume” warranted a six-month trading prohibition); *In re Fetchenhier*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,175 at 45,587-89 (CFTC Oct. 31, 1997) (*finding* that a floor trader who was convicted of one Section 4b felony, one RICO felony, two felonies for wire fraud and three misdemeanors, all for acts undertaken on the trading floor, should receive a ten-year trading prohibition); *In re Rousso*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,311 (CFTC Aug. 20, 1997) (*stating* that respondents, whose noncompetitive trading during a six-month period “represent[ed] repeated and direct assaults on the integrity of the marketplace,” should receive ten-year trading prohibitions); *In re Crouch*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,114 at 45,249-50 (CFTC July 14, 1997) (*finding* that a floor broker, who “was indicted and tried on 39 counts of criminal violations of the Act” and subsequently agreed to plead guilty to one felony count of violating Section 4b, should receive a five-year trading prohibition); *In re Ryan*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,049 at 44,984 (CFTC April 25, 1997) (*finding* that a floor trader who was convicted of three Section 4b felonies, one RICO felony and one misdemeanor – all for acts undertaken on the trading floor – should receive a six-year trading prohibition).

<sup>592</sup> However, we once again decline to pretend that this precedent is part of some consistent body of case law.

<sup>593</sup> 7 U.S.C. §6c(a); 17 C.F.R. §1.38(a).

trades in connection with seven trade sequences, thereby allowing another trader to bucket customer orders.<sup>594</sup> In determining the gravity of the wrongdoing at issue, the Commission observed that: (1) violations of Section 4c(a) “are always serious because, by their very nature, they undermine confidence in the market mechanism that underlies price discovery” and thus grave even in the absence of direct customer harm; (2) by entering into the noncompetitive trades, the respondent aided and abetted the other trader’s efforts to take advantage of customers; (3) the respondent’s violations were committed knowingly; (4) there was no evidence of mitigation or post-violation cooperation and (5) the respondent probably benefited from the illegal activity.<sup>595</sup>

Though the underlying conduct is distinct, these findings are extremely similar to our own regarding McMahan; though if anything, the fraud in *Gorski* was slightly more serious. Like *Gorski*, McMahan’s false report also “undermined confidence in the market mechanism that underlies price discovery;”<sup>596</sup> was made knowingly; with little or no evidence of mitigation or post-violation cooperation – though McMahan did voluntarily stop reporting; and McMahan benefited from his illegal activity. However, unlike *Gorski*,

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<sup>594</sup> *In re Gorski*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶129,726 at 56,085-86 (CFTC March 24, 2004).

<sup>595</sup> *Id.* at 56,085.

<sup>596</sup> *Id.*

McMahan did not take advantage of customers, nor did he help another trader to do so; and McMahan's illegal conduct occurred just once, whereas the respondent in *Gorski* was found guilty of having made seven distinct improper trade sequences.<sup>597</sup>

The Commission concluded in *Gorski* that a nine-month trading ban was appropriate<sup>598</sup> – and this in a case where the respondent's violations were slightly more serious than that of McMahan in terms of at least quantity and duration, if not consequence as well. Further, this nine-month ban was a “heightened” sanction, so-called because the Commission chose not to remand the case for necessary fact finding related to civil monetary penalties.<sup>599</sup> Instead, it expressly “set the trading prohibition at a level somewhat higher than ... [it] would have if a monetary penalty were also imposed.”<sup>600</sup>

In the second case – *Yost* – we found that the respondent had violated Section 4b(a)(i)<sup>601</sup> by misappropriating customer funds and lying about it.<sup>602</sup>

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<sup>597</sup> *Id.* at 56,085-86.

<sup>598</sup> *Id.* at 56,086.

<sup>599</sup> *Id.* at 56,085.

<sup>600</sup> *Id.* This appears to be a new approach to sanctions. One can only conclude that that various types of sanctions are interchangeable; that is, we can apparently lower one type of sanction and raise another – though on what grounds or to what extent, we are unsure. Clearly, this holding has once again increased the Commission's discretion, while decreasing the predictability so essential to the traders the Commission regulates.

<sup>601</sup> 7 U.S.C. §6b(a)(i).

He was further found to have violated Section 4b(a)(ii)-(iii)<sup>603</sup> by issuing misleading weekly statements to his customers.<sup>604</sup> Relying on the Commission's decision in *Gorski*, we imposed a trading ban of precisely the same length – nine months.<sup>605</sup> We reasoned that while Yost's wrongdoing exceeded that of the respondent in *Gorski*, it was not so much worse as to warrant a higher penalty.<sup>606</sup> Since we have judged McMahan's conduct to be less serious than that in *Gorski*, and the conduct in *Gorski* to be less serious than in *Yost*, clearly any trading ban against McMahan must not exceed that imposed in those cases – if we are to use these two cases as a baseline. Therefore, nine months appears to be the outer limit on the length of a trading ban for McMahan.

As we will be imposing a substantial monetary penalty against McMahan (discussed below), it is appropriate to lower the trading ban somewhat; after all, the Commission considered nine months a “heightened” sanction in *Gorski* due

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(..continued)

<sup>602</sup> *In re Yost*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,828 at 56,468-69 (CFTC Aug. 4, 2004).

<sup>603</sup> 7 U.S.C. §6b(a)(ii)-(iii).

<sup>604</sup> *Id.* at 56,469-70.

<sup>605</sup> *Id.* at 56,472-73.

<sup>606</sup> *Id.* at 56,473. Our decision became the final decision of the Commission when neither party appealed and the Commission declined to take *sua sponte* review. *In re Yost*, 2004 WL 2727433 C.F.T.C. No. 04-07, (CFTC Dec. 1, 2004).

to the lack of a monetary penalty. Accordingly, we reduce the trading ban from nine months to six. Finally, the trading ban must be reduced still further as McMahan's single false report is – as explained – slightly less serious than the respondents' multiple violations over a longer duration in *Gorski* and *Yost*. Accordingly, we again reduce the trading ban – from six months to three. In conclusion, we **ORDER** McMahan to not trade on or subject to the rules of any registered entity and require all registered entities to refuse McMahan all trading privileges for a period of **90 DAYS**.<sup>607</sup>

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<sup>607</sup> McMahan requested – assuming that we imposed a trading ban – the opportunity to “introduce additional evidence or argument to show cause as to why a ban should not be imposed.” Respondent's Post-Hearing Brief at 55-56. The request is **DENIED**. As discussed earlier, the record is closed and will not be reopened. McMahan has had ample opportunity to fully brief his case. Moreover, he makes no attempt to demonstrate that reasonable grounds exist to explain his failure to adduce any additional evidence on sanctions at the time of the hearing – nor can we think of any. *See supra* note 70. He merely cites to a case in which the Commission permitted re-opening of the record on the trading ban issue. *See Id.* (citing *Fetchenhier*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,055 at 45,017 (CFTC May 8, 1997)). However, in *Fetchenhier*, the Commission changed the legal standard governing the materiality of aggravating evidence when the case was on appeal. *Fetchenhier*, [1996-1998 Transfer Binder] ¶27,055 at 45,017 (stating that “[u]pon further consideration, we have come to the conclusion that our instructions to the ALJ that aggravating evidence cannot form the basis for an increase in the sanction beyond five years was contrary to the statute and clearly erroneous.”). Thus, the Commission decided to “confer an opportunity to Fetchenhier to introduce any additional evidence or argument directed to the other violations in order to show cause as to why a ten-year trading ban should not be imposed.” *Id.* Because the respondent had no notice of the new, harsher, standard at the time of the hearing, “reasonable grounds” plainly existed for his failure to adduce evidence to rebut the aggravating factors present in the record. *See* 17 C.F.R. §10.69. No such grounds exist here.

### **Civil Monetary Penalty**

Section 6(c) of the Act permits the Commission to assess a civil monetary penalty against any respondent found to have violated any of the provisions of the Act or Commission regulations.<sup>608</sup> There are two ways to calculate such a penalty: (1) a respondent may be sanctioned up to a maximum of \$100,000 per violation – adjusted periodically for inflation;<sup>609</sup> or (2) a respondent may be sanctioned a maximum of triple his or her monetary gain.<sup>610</sup> The maximum sanction that may be imposed is the higher of the two calculations.<sup>611</sup> Here, McMahan’s gain was approximately \$105,000;<sup>612</sup> tripling it creates a maximum penalty of \$315,000 under that approach.

Calculating the sanction under the per-violation approach is a bit more complicated. Enforcement requests this approach, and says that the maximum penalty thereunder is \$380,000 – that is, \$120,000 for the false report to the USDA, and \$130,000 each for the false report to the Commission

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<sup>608</sup> 7 U.S.C. §9.

<sup>609</sup> 17 C.F.R. §143.8. *See* 7 U.S.C. §9; 28 U.S.C. §2461 note.

<sup>610</sup> 7 U.S.C. §9. In 1992, Congress endorsed fines of “triple the [respondents’] monetary gain” and eliminated provisions of the Act which had the effect of constraining most penalties to within the limits of the respondent’s ability to pay. S. Rep. No. 102-22, at 43-44 (1992), reprinted in 1992 U.S.C.C.A.N. 3103, 3145-46. The 1992 changes were meant to “stiffen[] penalties for violations of the Act.” S. Rep. No. 102-22, at 13.

<sup>611</sup> 7 U.S.C. §9.

<sup>612</sup> *See supra* note 19 and accompanying text.

and the failure to produce documents.<sup>613</sup> However, Enforcement appears to conflate “violations” with “counts” – which, as the Commission has held, are two distinct concepts.<sup>614</sup> A “count” denotes a particular section of the Commodity Exchange Act that has been offended, while a violation is the activity or activities that did the offending. Consequently, there may be many violations of a single section of the Act, all brought under a single count.<sup>615</sup> Thus, the only way in which Enforcement’s calculated maximum could be

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<sup>613</sup> Enforcement’s Post-Hearing Brief at 105; Enforcement’s Post-Hearing Reply at 27. The amounts differ because of the dates on which the violations occurred. See 17 C.F.R. §143.8. When the initial false report occurred the maximum penalty was \$120,000. *Id.* at (a)(1)(ii). Just days after McMahan made his false report, the maximum increased – on October 23, 2004 – to \$130,000. Thus, McMahan’s subsequent behavior is subject to a higher maximum penalty. *Id.* at (a)(1)(iii).

<sup>614</sup> The Commission normally does not calculate penalties in an enforcement proceeding by equating the number of violations with the number of counts charged in the complaint. *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,492 (*citing In re Slusser*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep, (CCH) ¶29,411 at 54,745 (CFTC Feb. 28, 2003)).

<sup>615</sup> See *Id.* See also *Slusser v. CFTC*, 210 F.3d 783, 786 (7th Cir. 2000) (Easterbrook, J.). Indeed, Enforcement acknowledges this distinction in the Complaint, in both Count II (7 U.S.C. §6i; 17 C.F.R. §§1.31, 18.05) and Count III (7 U.S.C. §13(a)(3)). Complaint at ¶45 (*stating* that “[e]ach and every instance in which McMahan failed to produce adequate cash market and other records upon request, or provided false, misleading or knowingly inaccurate information in response to [Market Oversight’s] inquiries, is a separate and distinct violation....”); Complaint at ¶48 (*stating* that “[e]ach and every instance in which McMahan knowingly made or caused to be made statements concerning material facts that were false or misleading or omitted information necessary to make the statements not misleading concerning feeder cattle cash market information, is a separate and distinct violation....”). The Complaint does not give notice that McMahan was being charged with any more than one violation of Count I (7 U.S.C. §13(a)(2)). See Complaint at ¶¶37-39.

correct is if McMahan happened to commit precisely one violation in each of the three counts. He did not.<sup>616</sup>

There is no magic to choosing an approach to monetary penalties; rather, we simply calculate the maximum under each approach, and the higher of the two is the maximum monetary penalty that may be imposed under the Act. In the liability section, we found McMahan liable for one violation of Count I,<sup>617</sup>

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<sup>616</sup> McMahan does not address this distinction either. He may have done this strategically, simply feeling no need to point out to the prosecution that he was actually subject to a higher maximum penalty.

Although the Complaint gave McMahan legally sufficient notice that he could potentially face a civil monetary penalty in excess of the \$380,000 limit erroneously advanced by Enforcement during the litigation, Enforcement's error in understating the maximum penalty nonetheless troubles us. See *supra* note 615; *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,492. After all, McMahan is represented by able counsel; in other cases, respondents before the Commission are not so fortunate. In these latter cases, Enforcement's misstatements as to the maximum civil monetary penalty could have the effect of misleading respondents into changing their litigation or settlement strategies to their detriment. This is particularly so since it is well established that neither the Administrative Law Judge or the Commission is constrained by Enforcement's recommended sanctions. *Miller v. CFTC*, 197 F.3d 1227, 1235 (9th Cir. 1999) (*affirming* the Commission's authority to increase a civil monetary penalty above that imposed by the Administrative Law Judge, even though the Division did not seek the higher penalty); *Monieson v. CFTC*, 996 F.2d 852, 862 (7th Cir. 1993) (*affirming* a trading ban imposed by the Administrative Law Judge "even though the Division of Enforcement has not asked for any ban at all"). Given the already serious inability of respondents to predict the outcome of litigation in this forum, we believe Enforcement should be particularly careful in making representations of maximum sanctions. In the future, we will be on guard for similar misstatements of the law and will if necessary inform respondents at the beginning of the process as to their true potential liability.

<sup>617</sup> Complaint at ¶¶37-39 (7 U.S.C. §13(a)(2)). See *supra* notes 343-369 and accompanying text.

one violation of Count II,<sup>618</sup> and three violations of Count III.<sup>619</sup> Based on these five violations, the maximum monetary penalty that might be imposed on McMahan is actually \$640,000<sup>620</sup> – \$120,000 for the single violation of Count I, and \$130,000 each for the four total violations of Counts II and III.

Determining the maximum is, however, only the first step. The next steps require us to go through the exercise of pulling a number from thin air after ruminating over factors that, for the most part, can never signal the propriety of any particular penalty.<sup>621</sup>

More specifically, we are called on to once again try to calculate the gravity of McMahan's offenses so as to justify the imposition of a particular monetary sanction.<sup>622</sup> In this particular assessment, "gravity" appears to be

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<sup>618</sup> Complaint at ¶¶40-45 (7 U.S.C. §6i; 17 C.F.R. §§1.31, 18.05). *See supra* notes 507-513 and accompanying text.

<sup>619</sup> Complaint at ¶¶46-48 (7 U.S.C. §13(a)(3)). *See supra* notes 445-487 and accompanying text.

<sup>620</sup> Obviously, this exceeds and therefore supersedes the approximately \$315,000 maximum found under the triple the monetary gain approach.

<sup>621</sup> We note that there is a more principled alternative to the Commission's approach – one that draws on the extensive body of academic work addressing the economic purpose underlying the regulatory authority to impose civil monetary penalties: that is, to deter and, thereby, spare the public from the costs of unproductive activity. The measure of the injury associated with such waste is called "social cost" – a term that economists use for the net loss in wealth to society from an activity. *See First Financial Trading, Inc.*, [2002-2003 Transfer Binder] ¶29,089 at 53,697-709.

<sup>622</sup> *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,574.

some amalgam of the “general gravity” and “facts and circumstance” tests discussed earlier<sup>623</sup> – additionally overlaid with a “focus[] on the overall goal of effective deterrence”<sup>624</sup> – a “focus” explicitly jettisoned from the monetary penalty calculation in some of the cases.<sup>625</sup> This of course gives us little guidance.

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<sup>623</sup> See *supra* notes 520-541 and accompanying text. In *R&W*, the Commission explained:

We do not rely on a specific formula in assessing *de novo* the appropriate level of civil monetary penalties; rather, we focus on the relative gravity of respondents’ misconduct in light of the following factors:

- (1) the relationship of the violation at issue to the regulatory purposes of the Act;
- (2) respondent’s state of mind;
- (3) the consequences flowing from the violative conduct;
- and (4) respondent’s post-violation conduct. In addition, the Commission considers any mitigating or aggravating circumstances presented by the facts.

[1998-1999 Transfer Binder] ¶27,582 at 47,748 (citation and brackets omitted).

<sup>624</sup> *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,492 (*citing Staryk*, [2003-2004 Transfer Binder] ¶29,826 at 56,453). This concept of deterrence is a major distinction between the Commission’s general test for gravity and the more specific factors it considers when imposing monetary sanctions.

<sup>625</sup> See *e.g.*, *Gorski*, [2003-2004 Transfer Binder] ¶29,726 at 56,085 (*holding* that no civil penalty need be imposed because the other sanctions imposed were “sufficient to provide effective deterrence”); *In re Competitive Strategies for Agric., Ltd.*, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,635 at 55,735 (CFTC Nov. 25, 2003) (same). See also *In re Walters*, [2000-2002 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,686 at 52,673 (CFTC Nov. 29, (continued..)

We have already concluded that McMahan's misleading report to the USDA violated a core provision of the Act (7 U.S.C. §13(a)(2)) and that his subsequent behavior to cover-up this core violation during Market Oversight's investigation constitutes violations of ancillary provisions (7 U.S.C. §13(a)(3) and 7 U.S.C. §6i).<sup>626</sup> We have also found that: (1) McMahan's misconduct was an isolated incident of short duration; (2) it affected market participants to a large but unquantified extent; (3) he gained approximately \$105,000 as a result of his misleading report; (4) there is no evidence of mitigation; and (5) that McMahan has voluntarily undertaken to stop reporting.<sup>627</sup>

Now where does this take us in terms of a specific penalty? Once we determine the maximum potential penalty and the gravity of the offenses, our analysis shifts to assessing a specific penalty appropriate to the level of gravity and suitable to deter future violations.<sup>628</sup> Along those lines, the Commission has held that "the penalty appropriate to the gravity of proven violations is not

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(..continued)

2001) (discussed in *First Financial Trading, Inc.*, [2002-2003 Transfer Binder] ¶29,089 at 53,704-05).

<sup>626</sup> See *supra* notes 525-526 and accompanying text.

<sup>627</sup> See *supra* notes 529-533 and accompanying text.

<sup>628</sup> *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,492 (citing *Staryk*, [2003-2004 Transfer Binder] ¶29,826 at 56,453).

normally equated with the statutory maximum.”<sup>629</sup> Moreover, it has held that it is improper to routinely impose the same monetary penalty for each violation, as this “does not take into consideration the relative level of gravity of the violations.”<sup>630</sup>

While guidance on what *not* to impose is useful, one would think there would also be guidance on what *to* impose. But there isn’t; the Commission has expressly “eschewed any formulaic approach” (i.e., specific guidance) to “determining the penalty appropriate to the gravity of proven violations.”<sup>631</sup> As such, once again, the Commission has extraordinary discretion to award whatever it wants. And once again, respondents are left with little or no ability to predict the outcome of litigation.<sup>632</sup>

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<sup>629</sup> *Id.* (citing *Miller* [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,825 at 56,438 (CFTC July 23, 2004)).

<sup>630</sup> *Id.*

<sup>631</sup> *Id.* at 62,492 (citing *Grossfeld* [1996-1998 Transfer Binder] ¶26,921 at 44,467).

<sup>632</sup> There are significant differences between the level of penalties imposed for seemingly similar violations, and with never an attempt to justify the difference. For example, incompatible monetary sanctions are imposed for fraudulent solicitation. Compare *Grossfeld* [1996-1998 Transfer Binder] ¶26,921 at 44,471 (*imposing* a sanction of \$500,000 on a sales manager of an introducing broker after finding he had encouraged systematic fraud in the retail sale of commodity options and who benefitted by (at least) \$385,714 as a consequence of his wrongdoing); with *Commodities Int’l Corp.*, [1996-1998 Transfer Binder] ¶26,943 at 44,566 (*imposing* a sanction of approximately \$210,000 on each respondent after finding what appears to be a more serious violation – fraud that continued over a period of many months and involved hundreds of customers and from which the annual management fee amounted (continued..)

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(..continued)

to almost \$3,000,000); *See also R&W*, [1998-1999 Transfer Binder] ¶27,582 at 47,748-49 (*imposing* a fine of \$2,375,000 after finding that unregistered commodity trading advisors had systematically misrepresented their trading experience and the trading results of their software and gained that amount). Thus, not only are the amounts awarded for fraud substantially distinct, but the awards are also inconsistent with respect to the respondent's gain: (1) in *Grossfeld*, the Commission awarded somewhat more than the likely benefit to the respondent; (2) in *Commodities International*, the Commission awarded substantially less; and (3) in *R&W*, the Commission awarded exactly that amount.

Similarly, we see conflicting monetary sanctions imposed for failing to comply with production requests. *Compare Kelly*, [1998-1999 Transfer Binder] ¶27,514 at 47,373-74 (*imposing* a sanction of \$10,000 after finding that the respondent had been "repeatedly dishonest in his dealings with the Division [with respect to requests for documents] and willfully violated the Act and regulations"); *with New York Currency Research Corp.*, [1996-1998 Transfer Binder] ¶27,223 at 45,913-15 (*imposing* a sanction of \$110,000 after finding that the respondent performed a single act in violation of the Commission's record production requirements and leaving undisturbed the Administrative Law Judge's finding that the respondent had resisted the production demand in good faith and pursuant to the reasonable advice of its attorneys). *See also DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,494 (*imposing* a sanction of \$40,000 for failing to "promptly produce documents to the Commission").

And once again, we observe discordant penalties imposed for wash trades and bucketing. *Compare Reddy*, [1996-1998 Transfer Binder] ¶27,271 at 46,214 (*imposing* fines of \$300,000 and \$150,000 respectively for repeated prearranged and wash trading and bucketing that was found to have occurred over a six-month period); *with In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,276 at 50,693 (CFTC Sept. 19, 2000) (*imposing* sanctions of \$40,000 and \$25,000, respectively, for respondents who knowingly engaged in some or all of 11 wash transactions over two one-month periods undertaken to shift balance sheet profits and losses of a customer) *and with Elliott*, [1996-1998 Transfer Binder] ¶27,243 at 46,007-08 (*imposing* \$50,000 penalties on each of four floor brokers who engaged in 32 prohibited noncompetitive wash trades over a two week period in the wheat pit of the Chicago Board of Trade and stating that the trades significantly "impacted the integrity of the market by significantly inflating the [trading] volume...."); *and*  
 (continued..)

Nevertheless, we must decide. We choose *DiPlacido*<sup>633</sup> as our guide for no better reason than that it is a relatively recent Commission exercise in conjuring a civil monetary penalty and that it addresses violations of a similar nature to those committed by McMahan. In that case, the Commission held that \$65,000 was an appropriate sanction for “reporting a non-competitive trade as bona fide” which was part of a scheme that distorted the settlement price of electricity futures contracts executed on the NYMEX.<sup>634</sup> In this regard, the effect of the false report was not dissimilar in kind or gravity from McMahan’s misleading report to the USDA which moved the CME Feeder Cattle Futures Contract settlement price.<sup>635</sup> Accordingly, we sanction McMahan

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(..continued)

*with Gorski*, [2003-2004 Transfer Binder] ¶29,726 at 56,085-86 (*imposing no* monetary sanction – though a slightly longer trading ban – despite finding that the respondent violated Sections 4c(a)(A) and (B) of the Act, 7 U.S.C. §6c(a)(A) and (B), and Commission Rule 1.38 17 C.F.R. §1.38 by his knowing participation in wash trades and bucketing).

<sup>633</sup> [2007-2009 Transfer Binder] ¶30,970.

<sup>634</sup> *Id.* at 62,494.

<sup>635</sup> *See supra* notes 14-18 and accompanying text. *DiPlacido* is instructive in that the Commission held that manipulation deserved a substantially higher monetary sanction – \$110,000. Even indirect manipulation – that is, aiding and abetting the manipulation of a market by others – deserved a higher penalty of \$80,000. *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,494. Thus, at least as of two years ago, the Commission viewed direct or indirect manipulation (charges neither pled nor proven in McMahan’s case) as deserving of a higher monetary penalty than a false, or non-“bona fide” report.

\$65,000 for his false report.<sup>636</sup> Further, we can reasonably determine this to be the most serious of McMahan's violations in this case. His false report to the USDA was the only violation that impacted a core provision of the Act – by disrupting the markets the Commission is charged with regulating.

Taking another page from *DiPlacido*, we fine McMahan \$40,000 for his single violation of the Commission's production requirements in failing to inform Market Oversight that his ownership interest in the all-steer deal had changed.<sup>637</sup> This is the same amount as assessed in *DiPlacido* for a similar violation.<sup>638</sup>

Lastly, we turn to McMahan's lie and willful omissions to Market Oversight in the course of its investigation.<sup>639</sup> These three violations are not meaningfully distinct from McMahan's one violation of 7 U.S.C. §6i for which

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<sup>636</sup> Count I (7 U.S.C. §13(a)(2)). *See supra* notes 343-369 and accompanying text.

<sup>637</sup> Count II (7 U.S.C. §6i; 17 C.F.R. §§1.31, 18.05.) *See supra* notes 507-513 and accompanying text.

<sup>638</sup> *DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,494. In *DiPlacido*, the respondent waited more than a year before producing "4,240 pages of trading records" requested by subpoena. *Id.* at 62,489. McMahan's violation occurred at a time that the request was not nearly so formal as a subpoena, and he produced most of the documents and information requested in a timely fashion – albeit withholding one piece of highly pertinent information. Not knowing how to weigh these differences in terms of "gravity," we stick with the Commission's sanction imposed in *DiPlacido*.

<sup>639</sup> Count III (7 U.S.C. §13(a)(3)). *See supra* notes 445-487 and accompanying text. Like its other books, records and production requirements, we view 7 U.S.C. §13(a)(3) as an "ancillary" provision of the Act. *See supra* note 526.

we have imposed a \$40,000 fine. They were of the same nature, gravity, scheme and purpose – that of covering-up McMahan’s misleading report to the USDA.<sup>640</sup> We take heed that the Commission (at times) has instructed that “[i]n determining sanctions our focus is on the overall nature of the wrongful conduct rather than the number of legal theories the Division can successfully plead and prove.”<sup>641</sup> Despite this admonition, the per violation approach followed in *DiPlacido*,<sup>642</sup> appears to demand that some additional penalty be assessed. Accordingly, we add another \$5,000 in sanctions for each of McMahan’s three violations of 7 U.S.C. §13(a)(3). This ensures that McMahan is not punished more for his infractions in covering-up his core violation ( $\$40,000 + (3 \times \$5,000) = \$55,000$ ) – than he is for engaging in the core misconduct itself (\$65,000). In sum, we **ORDER** McMahan to **PAY** a civil monetary penalty of **\$120,000**.

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<sup>640</sup> Like its other books, records and production requirements, we view 7 U.S.C. §13(a)(3) as an “ancillary” provision of the Act. *See supra* note 526.

<sup>641</sup> *In re Interstate Securities Corp.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295 at 38,954-55 (CFTC June 1, 1992).

<sup>642</sup> *See DiPlacido*, [2007-2009 Transfer Binder] ¶30,970 at 62,494.

**Conclusions And Order**

For the reasons set forth above, the Court **FINDS** that:

1. Respondent Rockland P. McMahan violated Section 9(a)(2) of the Commodity Exchange Act, 7 U.S.C. §13(a)(2);
2. Respondent Rockland P. McMahan violated Section 4i of the Commodity Exchange Act, 7 U.S.C. §6i, and Commission Rules 1.31 and 18.05, 17 C.F.R. §§1.31, 18.05; and
3. Respondent Rockland P. McMahan violated Section 9(a)(3) of the Commodity Exchange Act, 7 U.S.C. §13(a)(3).

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

1. Respondent Rockland P. McMahan **CEASE AND DESIST** from violating Sections 4i, 9(a)(2) and 9(a)(3) of the Commodity Exchange Act, 7 U.S.C. 7 U.S.C. §§6(i), 13(a)(2), 13(a)(3), and Commission Rules 1.31 and 18.05, 17 C.F.R. §§1.31, 18.05;
2. Respondent Rockland P. McMahan be **PROHIBITED FOR 90 DAYS**, directly or indirectly, from **TRADING** on or subject to the rules of any registered entity, either for his own account or for the account of any persons, interest or equity, and all registered entities are **REQUIRED TO REFUSE FOR 90 DAYS** Rockland P. McMahan any trading privileges; and

3. Respondent Rockland P. McMahan **PAY** a civil monetary penalty of **\$120,000**.

**IT IS SO ORDERED.**<sup>643</sup>

On this 5th day of November, 2010



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Bruce C. Levine  
Administrative Law Judge

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<sup>643</sup> Sanctions shall become effective and the civil monetary penalty shall be paid 30 days after the date this order becomes the final decision of the Commission. See *U.S. Securities & Futures Corp.*, [Current Transfer Binder] ¶31,494 at 63,576 n.18. Under 17 C.F.R. §§10.12, 10.84, 10.102, and 10.105, any party may appeal this Initial Decision to the Commission by serving upon all parties and filing with the Proceedings Clerk a notice of appeal within 15 days of the service of the Initial Decision. If the party does not properly perfect an appeal – and the Commission does not place the case on its own docket for review – the Initial Decision shall become the final decision of the Commission, without further order by the Commission, within 30 days after service of the Initial Decision.