



### **Background**

In June of 2005, respondent Ian Floyd Betty solicited complainant Susan M. Smith to trade options.<sup>1</sup> About two months later, Smith opened an account with Comtrust, Inc.<sup>2</sup> and made an initial deposit of \$3,000.<sup>3</sup> Over the next two months, she deposited an additional \$25,260.<sup>4</sup> Beginning in August 2005, Smith established four options positions.<sup>5</sup> The first trade, a long ratio strangle comprised of options on oil futures, resulted in a substantial profit.<sup>6</sup> However, Smith lost money on the next three<sup>7</sup> and, after she liquidated the last position on February 22, 2006, her account balance was \$60.76.<sup>8</sup>

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<sup>1</sup> Affidavit of Ian F[.] Betty, dated March 8, 2007 ("Betty Affidavit"), at 1. At the time, Betty was a registered associated person who was employed by respondent Majestic Commodity Corporation. Betty Affidavit at 1; CX-4. Majestic is and, during the time in question, was a registered introducing broker. Betty Affidavit at 1; CX-3-9; CX-4.

<sup>2</sup> Comtrust is the futures commission merchant that carried Smith's account. CX-1-30, CX-1-31; CX-4.

<sup>3</sup> CX-1-22 - CX-1-32; CX-2-1; CX-3-2. Majestic "introduced" the account. CX-3-20.

<sup>4</sup> CX-3-7 - CX-3-10, CX-3-15.

<sup>5</sup> Michael Joseph Vallee solicited the trade by which Smith established her second position and Betty solicited the trades that established the other three. Affidavit of Susan Smith, dated March 8, 2007 ("Smith Affidavit"), at 1-2.

<sup>6</sup> CX-3-2, CX-3-6, CX-3-12.

<sup>7</sup> CX-3-4, CX-3-13, CX-3-14, CX-3-17, CX-3-19, CX-3-23. They were simple long positions in options on Treasury note, oil and silver futures. CX-3-4, CX-3-13, CX-3-19.

<sup>8</sup> CX-3-23. Smith withdrew the \$60.76 on March 8, 2006. CX-3-25.

In June of 2006, Smith filed a reparations complaint.<sup>9</sup> She named Betty, Vallee, Minson Ji, Thomas Courtland Kennedy, Gary Michael Voith<sup>10</sup> and Majestic as respondents and alleged that she was the victim of fraud, unauthorized trading and failures to supervise.<sup>11</sup> Majestic, Kennedy and Ji filed answers in which they denied wrongdoing.<sup>12</sup> Betty, on the other hand, substantially agreed with Smith's allegations<sup>13</sup> while neither Vallee nor Voith answered the complaint. On October 25, 2006, the Office of Proceedings transmitted the case to us.<sup>14</sup>

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<sup>9</sup> Commodity Futures Trading Commission Reparations Complaint Form, dated June 27, 2007 ("Complaint Form").

<sup>10</sup> Ji and Voith were Majestic principals at various times during the life of Smith's account. CX-4. See infra text accompanying notes 32-33, 42. Kennedy was a Majestic AP and applied to be a principal but the National Futures Association never approved his application and Kennedy eventually withdrew it. CX-4.

<sup>11</sup> Attachment 'A,' dated July 19, 2006 ("Amended Attachment A"), at 1-4; Attachment 'A,' dated June 23, 2006 ("Initial Attachment A"), at 1-3; Complaint Form. Smith also listed Comtrust as a respondent. Letter from Susan M. Smith to the U.S. Commodity Futures Trading Commission, dated July 27, 2006. However, she subsequently reached a settlement with the firm and, at the request of the two parties, we dismissed her claims against Comtrust. Order of Partial Dismissal, dated April 16, 2007; Notice of Satisfaction and Withdrawal of Complaint, received April 13, 2007.

<sup>12</sup> Answer of Majestic Commodity Corporation, Comtrust, Inc., and Thomas Courtland Kennedy, filed August 24, 2006, at 1-5; Answer of Minson Ji, Individually, filed August 24, 2006 ("Ji Answer"), at 1-3.

<sup>13</sup> Untitled document, received October 6, 2006, at 1.

<sup>14</sup> Notice and Order, dated October 25, 2006, at 1.

After discovery,<sup>15</sup> we set this matter to be heard and established a deadline for filing notices of intent to participate, prehearing memoranda and related documents.<sup>16</sup> In the order that scheduled the hearing, we also prohibited Betty from participating in the hearing (as a party) due to earlier procedural misconduct.<sup>17</sup> Ji, Kennedy and Majestic subsequently lost the right to introduce evidence or lodge objections at the hearing because they did not file any prehearing documents nor attempt to avoid sanctions by responding to our show cause orders.<sup>18</sup>

On March 27, 2007, we convened a one-day hearing at which Smith

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<sup>15</sup> Comtrust, Majestic, Kennedy and Ji served interrogatories, admission requests and document requests upon Smith that went unanswered. Respondents' Motion to Compel Discovery Response by Complainant, filed January 5, 2007, at 1. See Respondents Majestic Commodity Corporation, Comtrust, Inc., Thomas Courtland Kennedy and Minson Ji (sic) First Request for Discovery, filed November 17, 2006 ("Discovery Requests"), at 1-12. However, they waited too long to move for an order compelling discovery and, as a result, we denied the request. Order, dated February 2, 2007, at 1. On the other hand, we noted that Smith's failure to answer or object to the respondents' admission requests had consequences. Id. at 1 n.2. Specifically, her failure to respond resulted in deemed admissions that she has not sought to withdraw. 17 C.F.R. §12.33(b) ("The matter is admitted unless within twenty (20) days after service of the request, the party upon whom the request is directed files and serves upon the party requesting the admission a verified written answer or objection to the matter.").

<sup>16</sup> Order and Notice of Hearing, dated February 6, 2007 ("Notice of Hearing"), at 1-2.

<sup>17</sup> Id. at 1 n.1.

<sup>18</sup> Order, dated March 21, 2007, at 1-2; Order, dated March 16, 2007, at 1-2.

presented her direct testimony,<sup>19</sup> her exhibits<sup>20</sup> and Betty's direct testimony.<sup>21</sup> At the hearing, we established a post-hearing memoranda schedule.<sup>22</sup> The deadline for submitting memoranda has passed<sup>23</sup> and, thus, we now turn to the substance of Smith's case.

**Smith Did Not Establish That Either Ji Or Kennedy Violated Rule 166.3**

Our inquiry begins with the claims against Ji and Kennedy. Smith charged them with failing to adequately supervise the Majestic employees with whom she dealt.<sup>24</sup> Rule 166.3, §17 C.F.R. 166.3, imposes a duty of diligence

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<sup>19</sup> Transcript, dated April 10, 2007 ("Transcript"), at 7-12; Smith Affidavit; Initial Attachment A; Attachment 'B,' received June 29, 2006.

<sup>20</sup> Transcript at 6-7.

<sup>21</sup> Transcript at 13-14; Betty Affidavit; Attachment 'C,' received November 6, 2006.

<sup>22</sup> Transcript at 14-16.

<sup>23</sup> No party filed a post-hearing memorandum.

<sup>24</sup> Amended Attachment A at 4. Smith also maintained that they should be held liable because they were principals of Majestic and because they violated NFA compliance rules. Complainants (sic) Prehearing Memorandum, received March 13, 2007 ("Smith Prehearing Memorandum"), at 2. Both theories fail as a matter of law. We can only award damages for violations of the Commodity Exchange Act, Commission regulations and Commission orders. 7 U.S.C. §18(a)(1). Thus, complainants cannot recover on the basis of NFA compliance rule or state law violations. See Phacelli v. ContiCommodity Servs., Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,250 at 32,672-75 (CFTC Sept. 5, 1986). In addition, controlling person liability is recognized only in "action[s] brought by the Commission." 7 U.S.C. §13c(b). Consequently, it is not a theory that Smith can utilize here since she and not the Commission has brought this action. Boring v. Apache Trading Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,380 at 39,283 n.23 (CFTC Aug. 27, 1992).

upon all registrants who have supervisory responsibilities.<sup>25</sup> To establish that Ji and/or Kennedy violated Rule 166.3, Smith must first prove that they were occupied positions that triggered a duty to supervise.<sup>26</sup> She must also prove their supervision was negligent<sup>27</sup> and there were causal links between the

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<sup>25</sup> It states,

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.

17 C.F.R. §166.3.

<sup>26</sup> See Sanchez v. Crown, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶30,183 at 57,726 (CFTC Jan. 18, 006); Lobb v. J.T. McKerr & Co., [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,569 at 36,443-45 (CFTC Dec. 14, 1989).

<sup>27</sup> Because it does not modify the term "diligently," Rule 166.3 seems to require "ordinary" diligence. See supra note 25. This impression receives some support from precedent indicating that the regulation requires something less than perfection. See Sanchez, [2005-2007 Transfer Binder] ¶30,183 at 57,726; In re Murlas Commodities, Inc., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,485 at 43,158-59, 43,161 (CFTC Sept. 1, 1995). Ordinary diligence is reasonable care and a failure to exercise ordinary diligence is negligence. Sun Printing & Publ'g Ass'n v. Moore, 183 U.S. 642, 654 (1902); Smith v. United States, 207 F. Supp. 2d 209, 214 (S.D.N.Y. 2002); Black's Law Dictionary 412 (5th ed. 1979).

Proof that an AP committed fraud "does not necessarily mean that the employee was improperly supervised." Sanchez, [2005-2007 Transfer Binder] ¶30,183 at 57,726 (quoting Protection of Commodity Customers, 42 Fed. Reg. 44,742, 44,747 (Sept. 6, 1977)).

negligence and her claimed injury.<sup>28</sup> To meet this burden, Smith must, among other things, adequately demonstrate the scope of Ji and Kennedy's respective supervisory roles.<sup>29</sup>

In his answer, Ji denied having been a Majestic owner or principal while Smith was trading.<sup>30</sup> At the hearing, Smith introduced only one piece of evidence concerning Ji's status, an NFA Background Affiliation Status Information Center ("BASIC") report.<sup>31</sup> It showed that Ji became a principal on January 5, 2006.<sup>32</sup> Thus, at best, we can find that Ji became a supervisor on that date. By January 5th, Smith's last position had been open for two months.<sup>33</sup> The BASIC report sheds no light on the scope of Ji's duties at

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<sup>28</sup> In Sanchez, the Commission held,

In assessing an alleged violation of Rule 166.3, the Commission focuses on: (1) the nature of a respondent's system of supervision; (2) the supervisor's role in that system of supervision; and (3) evidence that the supervisor did not perform his assigned role in a diligent manner. In addition, a complainant must establish that the supervisor's breach of duty played a substantial role in the wrongdoing that proximately caused the damages.

Id. Complainants must generally meet the preponderance of the evidence standard of proof. See Gilbert v. Refco, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,081 at 38,060 (CFTC June 27, 1991).

<sup>29</sup> See supra note 28.

<sup>30</sup> Ji Answer at 1.

<sup>31</sup> CX-4.

<sup>32</sup> CX-4.

<sup>33</sup> CX-3-21.

Majestic. Consequently, the evidence of Ji's status combined with proof of Majestic's dealing with Smith supports no reliable inference that Ji was negligent or that he substantially contributed to any harm the complainant suffered.<sup>34</sup> Thus, Smith has not established that Ji violated Rule 166.3 or that, if he did commit any violations, he should be held liable.

The case against Kennedy has similar defects.<sup>35</sup> The evidence of Kennedy's status at Majestic is an NFA BASIC report showing that he obtained principal pending status on December 29, 2005, more than one month after Smith established her final position.<sup>36</sup> However, the NFA never granted him principal status and he obtained an AP registration in March of 2006.<sup>37</sup> There is no evidence of Kennedy's specific duties and, thus, no evidence of negligence other than the handling of Smith's last open position. Having failed to prove that Kennedy was a supervisor, Smith did not even make a prima facie showing that he was negligent or that any negligence on his part contributed to her trading losses.

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<sup>34</sup> The only circumstantial evidence of negligent supervision that post-dates January 5, 2006 is the failure to liquidate the Smith's last open position profitably. Smith Affidavit at 2; CX-3-21. However, both Smith and Betty place this failure at Voith's feet and there is no evidence that Ji supervised Voith at any relevant time. Smith Affidavit at 2; Betty Affidavit at 2.

<sup>35</sup> As with Ji, the complainant also alleged violations of NFA Compliance Rules and controlling person liability. Smith Prehearing Memorandum at 2. See supra note 24.

<sup>36</sup> CX-4.

<sup>37</sup> CX-4.

**Smith Failed To Establish That Voith Violated Rule 166.3**

As she did with Kennedy and Ji, Smith charged Voith with failing to diligently supervise the handling of her account.<sup>38</sup> However, the case against Voith has more substance<sup>39</sup> because Smith introduced evidence concerning his

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<sup>38</sup> Smith Prehearing Memorandum at 2. She also argued that he should be held liable for having violated NFA rules and due to his status as a Majestic principal. *Id.* See *supra* note 24.

<sup>39</sup> Voith and Vallee are in default and, in certain cases, we could rest a judgment against them on the complainant's well-pled allegations. 17 C.F.R. §12.22; *Cochran v. Amadio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,962 at 49,076 (CFTC Jan. 4, 2000). However, Smith seeks a judgment in which Majestic is held jointly and severally liable for Voith's and Vallee's alleged torts. Attachment A at 4. When default procedures might result in inconsistent resolutions of the same claims within the single proceeding due to a respondent's default, we follow *Frow v. De La Vega*, 82 U.S. 552, 554 (1872), in which the Supreme Court explained,

The true mode of proceeding where a bill makes a joint charge against several defendants, and one of them makes default, is simply to enter a default and a formal decree pro confesso against him, and proceed with the cause upon the answers of the other defendants. The defaulting defendant has merely lost his standing in court. He will not be entitled to service of notices in the cause, nor to appear in it in any way. He can adduce no evidence, he cannot be heard at the final hearing. But if the suit should be decided against the complainant on the merits, the bill will be dismissed as to all defendants alike -- the defaulter as well as the others. If it be decided in the complainant's favor, he will then be entitled to a final decree against all.

*Novofastovsky v. Osadchy*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,060 at 49,557 (CFTC Mar. 27, 2000).

particular role within Majestic.<sup>40</sup> Evidence that we credit<sup>41</sup> tends to show that Voith was a Majestic principal during the time in question,<sup>42</sup> he formulated trading advice for at least one of the firm's APs (Betty) and he could direct Betty to make trading recommendations.<sup>43</sup> On the basis of this evidence, we find that Voith was a supervisor and the scope of his duties included the supervision of Betty.<sup>44</sup> Consequently, we must determine whether Smith established negligence on Voith's part.

Three trades made in connection with Smith's last two positions form the factual basis of her claim that Voith was negligent.<sup>45</sup> To infer negligence from such a small number of events, we must have evidence of the process that resulted in the unfortunate outcomes,<sup>46</sup> evidence tending to prove that only a few incidents were representative of how the respondent behaved or evidence

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<sup>40</sup> Betty Affidavit at 2.

<sup>41</sup> Both Smith and Betty testified to Voith's duties. Smith Affidavit at 2; Betty Affidavit at 2. However, Smith seems to have lacked first-hand knowledge because she never dealt with him directly. Smith Affidavit at 2. Thus, we credit Betty's version of Voith's duties but not Smith's.

<sup>42</sup> CX-4.

<sup>43</sup> Betty Affidavit at 2.

<sup>44</sup> There is no substantial evidence that Voith supervised Vallee while he was making recommendations to Smith.

<sup>45</sup> Betty Affidavit at 2.

<sup>46</sup> Murlas, [1994-1996 Transfer Binder] ¶26,485 at 43,158-61.

that the events could not occur in the absence of negligence.<sup>47</sup> Although she presented the testimony of Betty, one of Voith's subordinates, there is no direct evidence of how Voith went about his duties at Majestic. In addition, there is also no evidence to support the idea that Smith's trades were representative of Voith's overall track record. Finally, Smith has not established that Voith's recommendations were so far beyond reason that only negligence could have produced them.<sup>48</sup> Consequently, the complainant has not established, by a preponderance of the evidence, that Voith failed to diligently supervise Betty or anyone else.

**Smith Waived Her Claims Against Betty  
(And Failed To Establish That Betty Defrauded Her)**

Smith initially charged Betty with fraud, alleging that he misled her with respect to "the integrity of Majestic . . . its service, and its brokers."<sup>49</sup> However, when the respondent became a cooperative witness,<sup>50</sup> Smith appeared to drop the allegations that Betty behaved wrongfully by excluding them from her

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<sup>47</sup> When a relatively small number of apparent supervisory failures are established, the Commission does not automatically infer that they resulted from negligence. Rather, it considers the failures relative isolation or pervasiveness in light of the respondents' business. For example, the Commission declined to find negligence on the part of a firm even though the respondent's employees had churned 20 customer accounts. Id.

<sup>48</sup> Except in all but the most extreme cases, this type of demonstration would probably require expert testimony.

<sup>49</sup> Amended Attachment A at 4.

<sup>50</sup> See Betty Affidavit.

