

UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

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ALEXANDER TIMOTHY DARRAH

v.

STEVE DAVID KNOWLES, *et al.*,

CFTC Docket No. 05-R042

ORDER OF MODIFIED SUMMARY
AFFIRMANCE

Steve Knowles appeals from the order of the judgment officer (“JO”) on remand from a prior Commission opinion and order.¹ We have carefully considered the extensive record and the parties’ appellate arguments, familiarity with which is presumed. The findings and conclusions of the JO on liability are supported by the record, and we therefore adopt them. None of the arguments on appeal present important questions of law and policy warranting an opinion and order. Nevertheless, we briefly address Knowles’ claim that he did not receive adequate notice that he was charged with failure to supervise.

Knowles asserts that the complaint did not specifically allege a failure to supervise, and he therefore learned of this charge only when the Commission remanded the case for reconsideration of this alternative theory of liability. But so long as a complaint provides a simple statement of the facts and a claim for relief, it is sufficient under Commission rules.

¹ The judgment officer’s order is at [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,317, 2012 WL 4715440 (CFTC Sept. 28, 2012; corrected Oct.1, 2012), (“JO Order”). The Commission’s prior opinion and order is at [2011-12 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 31,923, 2010, WL 5582903 (CFTC Dec. 9, 2010), (“Com. Op.”). The opinion largely affirmed the initial decision of an Administrative Law Judge, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,259, 2006 WL 1816445 (June 28, 2006), (“ALJ ID”), except for the determination that Knowles and co-respondent Paul Plunkett were liable as controlling persons for the fraud of the other respondents, and it remanded the case to the JO to consider whether Knowles and Plunkett failed to diligently supervise the other respondents. Plunkett did not appeal from the JO’s order on remand, and it is final as to him. 17 C.F.R. § 12.210(d) and (e).

There is no requirement that a complaint allege a particular theory of liability, nor any prohibition against changing a theory. 17 C.F.R. § 12.13(b) (reparations complaint must state the relevant facts concerning each act or omission at issue, the facts showing how the complainant was injured by the conduct at issue and “[i]f known, the specific provisions” of law, regulation or order violated); *Johnson v. Fleck*, [1990-92 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,757 at 37,499, 1990 WL 294143 (CFTC Nov. 20, 1990), (“focus of the Commission’s standards for a reparations complaint is the articulation of the factual basis for [the dispute] ... rather than the articulation of technical legal claims”); *Skinner v. Switzer*, 131 S.Ct. 1289, 1296 (2011) (notice pleading requirements under Federal Rules of Civil Procedure do not require plaintiff to plead a particular theory of liability, nor prevent her from later changing theory); *New York State Electric & Gas v. Sec’y of Labor*, 88 F.3d 98, 104 (2nd Cir. 1996) (under liberal rules for administrative pleadings, key question is prejudice, and a party normally cannot show prejudice simply because of a change in its opponent’s legal theory where material facts would be same regardless of theory).

Darrah’s complaint satisfied these “notice pleading” requirements. It alleged that “no business” of the firm could be conducted without Knowles’ “active direction and support,” that Knowles “was in direct control” of the firm and its employees, “directed the conduct of its affairs,” and was “responsible” for reviewing all employee activities. Complaint (“Compl.”) ¶ 8. The complaint further alleged that co-respondent traders were under Knowles’ direct supervision, and that Knowles aided, abetted, allowed and induced their fraudulent acts. Compl. ¶ 58; *see also* JO Order, CCH ¶ 32,317 at 71,089 n. 8. These allegations were sufficient to put Knowles on notice that his supervision of the traders was at issue. Further, following remand,

Knowles submitted two affidavits addressing his supervision. JO Order, CCH ¶ 32,317 at 71,090.

We *sua sponte* modify the JO's award of damages as to Knowles to subtract Darrah's loss of funds invested after March 12, 2003. In our prior opinion, we found that, subsequent to that date, Darrah's reliance on the co-respondent traders' fraudulent representations became unreasonable. Com. Op., CCH ¶ 31,923 at 66,099 ("Darrah became suspicious, but nevertheless deposited additional funds [and] [a]s [he] acknowledged, [] simply threw good money after bad."). We further found that there were no churning damages after that date because the co-respondents no longer exercised de facto control over Darrah's account. *Id.* We thus reduced the award for damages for fraudulent misrepresentation and churning from \$ 1,512,354.48 to \$ 1,292,685.48, with interest to run from June 30, 2003 (when the account was closed) until the award was paid in full. *Id.* at 66,100.

On remand, the JO awarded Darrah the full amount of his losses as to Knowles and Plunkett, reasoning that their failure to supervise in violation of § 166.3 caused losses independent of the co-respondent traders' misconduct. JO Order, CCH ¶ 32,317 at 71,104. The JO also ordered interest to run from February 28, 2003, the date that Darrah made his largest, \$ 900,000 deposit, because that was the date of Darrah's largest loss. *Id.*

We agree with the JO that failure to supervise is a violation independent of other misconduct. *See, e.g. In re GNP Commodities, Inc.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,360 at 39,219 n. 11, 1992 WL 201158 (CFTC Aug. 11, 1992), *aff'd in part and reversed in part sub nom. Monieson v. CFTC*, 996 F.2d 852 (7th Cir. 1993) (violation of 166.3 is an "independent and primary violation for which no underlying violation is necessary"); *see also In re Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,194 at 45,744, 1997

WL 761927 (CFTC Dec. 10, 1997) (same). It is well-settled that a violation of § 166.3 “is actionable in reparations,” *Bunch v. First Comm. Corp.*, [1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,352 at 39,168-69, 1992 WL 190394 (Aug. 5, 1992), and a reparations complainant may be awarded damages for that violation. 7 U.S.C. § 18(a)(1)(A).

While Knowles clearly violated § 166.3 during the entire time period in which Darrah invested funds, Darrah failed to take steps after March 12, 2003, after he admittedly became suspicious, to prevent further losses. As Darrah acknowledged, he “simply threw good money after bad.” Com. Op., CCH ¶ 31,923 at 66,099. Under these circumstances, we decline to award Darrah damages for losses after that date. We accordingly reduce the award as to Knowles from \$ 1,512,354.48 to \$ 1,292,685.48.

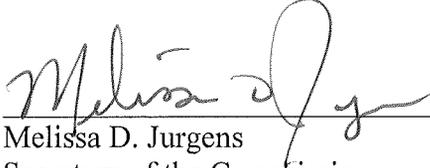
We also modify the date from which interest accrues as to Knowles so as to conform to our prior opinion involving the co-respondents. Com. Op., CCH ¶ 31,923 at 66,100. Accordingly, interest shall run from June 30, 2003. Knowles’ liability for damages and interest shall be joint and several with all co-respondents.²

IT IS SO ORDERED.

By the Commission (Chairman GENSLER and Commissioners CHILTON, O’MALIA and WETJEN).³

² As stated above, Plunkett did not appeal from the JO’s order awarding \$ 1,512,354.48, plus interest. Accordingly, he is solely liable for \$ 219,669—the difference between \$ 1,512,354.48 and \$ 1,292,685.48—plus interest as set forth in the JO’s order. Plunkett (and all other respondents in this proceeding) remains jointly and severally liable for \$ 1,292,685.48, plus interest as set forth in the Commission’s prior order, the JO’s order, and herein.

³ Any appeal of a reparations order must be filed within 15 days of notice of the Commission order. *See* Section 6(c)(11)(B)(ii) of the CEA, 7 U.S.C. § 9 (c)(11)(B)(ii). Any appeal must be made to the United States Court of Appeals for the circuit in which the hearing was held. *See* Section 14(e) of the CEA, 7 U.S.C. § 18(e). In addition, any appeal is not effective unless, within 30 days of the date of the Commission order, the appealing party files with the court a bond equal to double the amount of any reparation award. *See id.*



Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission

Dated: December 16, 2013