Commodity Futures Trading Commission
CEA CASES

NAME: GOFFE & CARKENER, INC., A. VINCENT BLACKFORD AND DWIGHT H. WILLIAMS

CITATION: 32 Agric. Dec. 1643

DOCKET NUMBER: 188

DATE: OCTOBER 15, 1973

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(No. 15,488)

In re GOFFE & CARKENER, INC., A. VINCENT BLACKFORD and DWIGHT H. WILLIAMS. CEA Docket No. 188. Decided October 15, 1973.

Financial reports -- False statements made in -- Customer's funds -- Improper use of -- Denial of trading privileges to all respondents for 60 days -- Suspension of *Goffee & Carkener, Inc.,* for 60 days

Where respondents wilfully made false statements in a financial report and the corporate respondent improperly used its customers' funds, respondents are denied trading privileges for a period of 60 days and the corporate respondent is suspended as a registrant under the Act for a period of 60 days.

Earl L. Saunders, for complainant.

Albert W. Thompson, Kansas City, Missouri, for respondents.

Decision by John G. Liebert, Administrative Law Judge.

DECISION AND ORDER PRELIMINARY STATEMENT

This is an administrative proceeding under the Commodity Exchange Act (7 U.S.C. 1 *et seq.,* hereinafter referred to as the "Act"), which was instituted by a complaint and notice of hearing filed by the Under Secretary of Agriculture on December 17, 1971. The complaint alleges that the corporate Respondent, a registered futures commission merchant under the Act, improperly used securities deposited with it by its customers as collateral for a bank loan and that Repondents willfully made material false statements in a financial report submitted to the Commodity

Exchange Authority by Respondent corporation in violation of sections 4d and 6(b) of the Act (7 U.S.C. 6d and 9) and sections 1.20 and 1.30 of the Regulations issued pursuant thereto (17 CFR 1.20 and 1.30). The individual Respondents were joined in the action as President and Secretary-Treasurer, respectively, of the corporate Respondent and as such were responsible for the management, direction and control of the corporate Respondent.

Respondents filed an answer on January 20, 1972, which, in substance, denied the allegations in the complaint and denied the alleged violations of the Act and Regulations.

Oral hearing on the matter was held on February 17, 18, and April 6, 1972, in Kansas City, Missouri, before Hearing Examiner John G. Liebert, Referee. Complainant was represented by Earl L. Saunders, Esq., and John Broadley, Esq., Office of General Counsel, United States Department of Agriculture, Washington, D.C. Respondents were represented by Clem W. Fairchild, Esq., and David R. Dill, Esq., of Linde, Thomson, Van Dyke, Fairchild and Langworthy, Columbia

Union Bank Building, Kansas City, Missouri. The final brief in this matter was filed on August 11, 1972.

FINDINGS OF FACT

1. Respondent Goffe & Carkener, Inc., is a corporation organized and existing under the laws of the State of Missouri, with offices at 4800 Main Street, Kansas City, Missouri 64112. It is now, and was at all times material to the issues raised in this proceeding, a registered futures commission merchant under the Commodity Exchange Act.

2. Respondents A. Vincent Blackford and Dwight H. Williams, are individuals who, at all times material to the issues raised in this proceeding, were President and Secretary-Treasurer, respectively, of the Respondent corporation, and as such were responsible for its management, direction and control.

3. Respondent Goffe & Carkener, Inc., at all times material to the issues raised in this proceeding, was a member of the Minneapolis Grain Exchange, Chicago Board of Trade, Chicago Mercantile Exchange and the Kansas City Board of Trade. Respondent corporation is a clearing member of the Chicago Mercantile Exchange which is a designated "contract market" under the Act. This Exchange has established minimum financial standards

and related reporting requirements for its members which have been approved by the Secretary of Agriculture. Pursuant to § 1.17 of the Regulations (17 CFR 1.17) the reporting requirements of the Chicago Mercantile Exchange have been adopted as the reporting requirements of the Secretary and are binding on Respondent corporation. n1 At the hearing official notice was taken of the minimum financial standards and related reporting requirements of the Chicago Mercantile Exchange.

n1 The provisions of the Act dealing with "contract markets" designation and authority applicable in this proceeding in pertinent parts provide:

"§ 7. Designation of board of trade as "contract market"; conditions and requirements. The Secretary of Agriculture is hereby authorized and directed to designate any board of trade as a "contract market" when, and only when, such board of trade complies with and carries out the following conditions and requirements:

* * *

(b) When the governing board thereof provides for the making and filing by the board or any member thereof, as the Secretary of Agriculture may direct, of reports in accordance with the rules and regulations, and in such manner and form and at such times as may be prescribed by the Secretary of Agriculture, showing the details and terms of all transactions entered into by the board, or the members thereof, either in cash transactions or transactions for future delivery consummated on or subject to the rules of a board of trade, or transactions for future delivery, * * *. (7 U.S.C. 7)

* * *

§ 7a. Duties of contract markets

Each contract market shall --

* * *

(9) enforce all bylaws, rules, regulations, and resolutions made or issued by it or by the governing board thereof or by any committee, which provide minimum financial standards and related reporting requirements for futures commission merchants who are members of such contract market, and which have been approved by the Secretary of Agriculture." (7 U.S.C. 7a).

> * * *
>
> The applicable Regulations of the Commodity Exchange Authority which is the delegatee of the Secretary of Agriculture in pertinent part provide:
>
> "§ 1.17. Minimum financial requirements.
>
> (a) Except as provided in paragraph (b) of this section, * * * each person registered as futures commission merchant shall at all times continue to meet such financial requirements.
>
> (b) The requirements of paragraph (a) of this section shall not be applicable if the applicant for registration or registrant is a member of a contract market and conforms to minimum financial standards and related reporting requirements set by such contract market in its bylaws, rules, regulations or resolutions and approved by the Secretary of Agriculture as adequate to effectuate the purposes of paragraph (2) of section 4f of the Act. * * *" (17 CFR 1.17).

4. At a meeting of the Clearing House Sub-Committee of the Chicago Mercantile Exchange on June 8, 1971, to consider the position of Respondent corporation which was apparently having financial difficulties, Respondent corporation was requested to meet the following capital requirements for its organizational structure as well as restrictions in its operations:

1. $ 75,000 additional cash capital to be paid in three installments -- $ 25,000 by June 15; $ 25,000 by June 22; $ 25,000 by June 29, 1971.

2. Subordinated Capital must not exceed 60% by July 9, 1971. This must be down to $ 442,000 in subordinated agreements.

3. 800 car limitation -- no more than 400 in any one commodity.

At this meeting Respondent Blackford was told of these requirements and given the alternative consideration of starting a new corporation having a liquid capital structure of $200,000 plus two memberships. These requirements were restated in a letted to Respondent corporation which was sent the following day. Additional reports were requested of Respondent corporation which were specifically stated in the following letter which was sent to it on June 9, 1971:

"Please forward the following information to the Chicago Mercantile Exchange Department of Audits and Investigations:

1. Complete the enclosed financial statement for the period ending June 30, 1971, by July 15, 1971. When you submit this statement on July 15, please enclose a new breakdown of the capital position of your firm which should be in line with the guidelines set forth by the Clearing House Finance Sub-Committee.

2. Submit a detailed breakdown of the changes in your capital structure from June 30, 1971. This breakdown should show the sources of all new funds and the current position as to shares outstanding and their respective owners.

3. Submit a list of free debits as of the close of business, June 18, 1971.

4. Submit a run showing customer accounts under maintenance margin that shall also include account number, positions and equity as of the close of business, June 18, 1971.

The free debit and maintenance margin runs will be forwarded to our office every other Friday commencing with June 18, 1971. Please contact our office if you have any questions regarding these requirements."

In a subsequent meeting on June 16, 1971, the Clearing House Sub-Committee reaffirmed the requirements set forth above with only one slight modification. If the alternative of a new corporation was not followed, the additional cash capital requirement of the existing firm would be $ 50,000 by June 29, 1971, and $ 25,000 by July 6, 1971.

5. Sometime during the middle of the month of June 1971, Respondent Blackford went to the office of Mr. Samuel F. Gordon, Director of the Western Region of the Commodity Exchange Authority in Kansas City, Missouri, and advised him that the Chicago Mercantile Exchange wanted his firm to separate the cash grain business from its commodity futures business. He requested information on what should be done in this event to satisfy the CEA requirements. He was advised by Mr. Gordon that a new registration would have to be filed and be approved for the business entity that would do the commodity futures business.

Later in the same month, Respondent Blackford had a second conversation with Mr. Gordon during which Mr. Gordon told him that he had received information from a CEA auditor, who had talked with Respondent Williams, that Goffe & Carkener was considering the possibility of making a bank loan using customers' securities put up by the customers as margins for trading in regulated commodity futures as collateral. He was advised by Mr. Gordon that, if the firm made such a loan, it should first contact him and receive approval to be sure that the requirements of the Act would be met. On June 24 the CEA auditor, Mr. Gerald J. Slinkard, relayed this same advice to Respondent Williams.

6. On June 23, 1971, Respondent Blackford appeared before the Clearing House Sub-Committee of the Chicago Mercantile Exchange and presented a balance sheet showing the new corporate structure of Respondent corporation. It did not show what the Committee had requested, however, it proposed a separate entity for the cash grain business as a wholly owned subsidiary. The subordination showed $ 100,000 too much to meet the requirements set by the Committee for having no more than 60% of the capital funds subordinated. Respondent Blackford was asked to correct the necessary details in the corporate structure by June 30th.

On June 28, the Respondent corporation's cash grain business was separated from the commodity futures business and the Goffe Grain Corporation was organized to take care of the cash grain transactions.

7. On July 6, 1971, Respondent Blackford went to Mr. Gordon's office and advised him that he was considering making a bank loan for Respondent corporation. He said that it was his intention to borrow money against the customers' securities put up as collateral and use these funds as a loan to the customers instead of using the firm's own funds for the segregated accounts of customers. When Mr. Gordon asked if the customers had given specific written authorization to use their securities in this manner Mr. Blackford replied that he did not consider this necessary since the firm had general agreement forms signed by the customers. He left a copy of this general agreement form with Mr. Gordon for his review. Later on July 6, 1971, Mr. Gordon went to Respondent Blackford's office and advised him that he had been instructed by Mr. Edward F. O'Brien, Director of the Registration and Audit Division of the CEA, Washington, D.C., to inform Respondent Blackford that the aforementioned general agreement form did not provide specific authorization by customers for the use of their collateral for the type of loan proposed, as required by the Act, and that customers did not have a right to sign away the protection afforded them by the Act.

The specific wording in the general agreement referred to by Respondent Blackford as customers' authorization to use their securities in the manner proposed is set forth in the "Customer's Margin Agreement" as follows:

"(d) Any and all property at any time held or carried by you in any account for me, either individually or jointly with others, may from time to time and without notice to me, be carried in your general loans and may be pledged, repledged, hypothecated or rehypothecated, or loaned by you either to yourselves as brokers or to others, separately or together with other property for more than the amount due you thereon and without having in your possession or subject to your control for delivery, property of the same kind and amount, and you shall at no time be required to deliver to me the identical property delivered to or purchased by you for my account but only property of the same kind and amount."

This "Customer's Margin Agreement" is an attachment to a "General Customer's Agreement" for execution by those customers desiring margin accounts.

Sometime later on July 6, 1971, Respondent Blackford returned to Mr. Gordons' office where a third conversation took place. Mr.

Blackford told Mr. Gordon that he had contacted two brokerage firms which had advised him that it was their practice to accept only Treasury Bills from customers as margins for trading in commodity futures. He further stated that the firms he talked with told him that if the customers wanted to borrow money on their securities these firms would loan the customer their money on securities and would set up a special account. Mr. Gordon advised Respondent Blackford that if his firm wanted to loan the firm's money to customers on securities and set up special loan accounts it would be proper.

Again, later on July 6, 1971, Mr. Gordon went to Respondent Blackford's office where a fourth conversation took place. On this occasion Mr. Gordon told Mr. Blackford that Mr. O'Brien had called him from Washington and instructed him to tell Mr. Blackford that, if his firm made a bank loan using as collateral the customers' securities put up as margin for their accounts, the general agreement signed by the customers would not protect the firm; it would be in violation of Section 4(d)2 of the Act. n2 Mr.

Gordon advised Respondent Blackford that this prohibition applied even though his firm credited customers' accounts with the proceeds of the loan and deposited the money in the firm's segregated bank account.

n2 In pertinent part this section provides:

"§ 6d. Futures commission merchants, dealing by unregistered merchants prohibited; moneys and securities of customers, care and use.

It shall be unlawful for any person to engage as futures commission merchant in soliciting orders or accepting orders for the purchase or sale of any commodity for future delivery, or involving any contracts of sale or any contracts of sale of any commodity for future delivery, on or subject to the rules of any contract market unless --

(1) * * *

(2) such person shall, whether a member or nonmember of a contract market, treat and deal with all money, securities, and property received by such person to margin, guarantee, or secure the trades or contracts of any customer of such person, or accruing to such customer as the result of such trades or contracts, as belonging to such customer. Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for worn the same are held: *Provided,* however, That such money, securities, and property of the customers of such futures commission merchant may, for convenience, be commingled and deposited in the same account or accounts with any bank or trust company or with the clearing house organization of such contract market, and that such share thereof as in the normal course of business shall be necessary to margin, guarantee, secure, transfer, adjust, or settle the contracts or trades of such customers, or resulting market positions, with the clearing house organization of such contract market or with any member of such contract market, may be withdrawn, and applied to such purposes, including the payment of commissions, brokerage, interest, taxes, storage, and other charges, lawfully accruing in connection with such contracts and trades: Provided further. That such money may be

> invested in obligations fully guaranteed as to principal and interest by the United States, such investments to be made in accordance with such rules and regulations and subject to such conditions as the Secretary of Agriculture may prescribe.
>
> It shall be unlawful for any person, including but not limited to any clearing agency of a contract market and any depository, that has received any money, securities, or property for deposit in a separate account as provided in paragraph (2) of this section, to hold, dispose of, or use any such money, securities, or property as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant." (7 U.S.C. 6d.)

8. On July 12, 1971, the Respondent corporation obtained a loan in the amount of $ 100,000 from the Mid-Continent National Bank of Kansas City. As security for such loan, the Respondent corporation hypothecated to the bank all the securities belonging to 17 regulated commodity customers which had been deposited as margins for their accounts. The proceeds of such loan were deposited by Respondent corporation in its General Funds Bank Account in the Commerce Bank of Kansas City on July 13, 1971.

In connection with this loan Respondent Blackford sent a letter to the Mid-Continent National Bank wherein he stated that the purpose of the loan

"is for making loans to customers under Section 130 Part 1, of the Regulations of the Commodity Exchange Act and that the securities deposited as collateral therefore, are the property of commodity customers and must be treated as such and may not be used as collateral for general purpose loans to this firm, nor may the proceeds thereof be used for the payment of accounts of general creditors of the firm."

Nevertheless, Respondent corporation withdrew the funds from the lending bank and deposited them in another bank, thereby effectively preventing the Mid-Continent Bank from exercising any control over the use of the funds.

The President of the Mid-Continent Bank testified that in making the loan he was concerned only with the value of the collateral and the signatures thereon, and that as far as the bank was concerned it was just a commercial loan.

9. On July 13, 1972, the market value of the securities of the 17 regulated commodity customers of Respondent corporation which were put up as collateral for the loan from the Mid-Continent Bank were as follows:

Regulated Commodity Customer	Market Value of Customer's Securities as of 7/13/71
John D. Friesen	$ 19,537.50
Norris & Son	9,755.75
Ted W. Fullmer	11,987.50
M. R. Klint	16,028.12

Regulated Commodity Customer	Market Value of Customer's Securities as of 7/13/71
Milton B. Herbrick	4,448.25
W. C. Willis	3,890.25
Ezra Stetson	21,337.50
Albert J. Barker	9,237.50
D. W. and A. Holmes	2,665.62
Calvin C. Carson	2,687.50
Jack D. Saggart	33,758.75
Alfred H. Miller	537.50
Robert E. Reed	3,262.50
Mrs. Mae Lewis	2,525.00
John F. Hall	1,812.50
Louis E. Hall	812.50

Regulated Commodity Customer	Market Value of Customer's Securities as of 7/13/71
Dan Chatterson	3,275.00
	$ 147,559.24

On this date Respondent corporation had written agreements with 10 of these customers on the form of the general agreement with related "Customer's Margin Agreement" referred to and discussed in Finding of Fact 7. Respondent corporation had other written agreements with 6 of these 17 customers on the form of a "Commodity Signature Card" (Exhibit 8). Examination of this "Commodity Signature Card" form, which is comparatively short, discloses that it does not contain any language whatever authorizing Respondent corporation to sell or hypothecate securities put up as collateral or margin of commodity accounts. So far as the evidence shows Respondent corporation had no written agreement at all with 1 of these 17 customers.

10. The minutes of a meeting of the Clearing House Sub-Committee of the Chicago Mercantile Exchange on July 14, 1971, contains the following entry:

"Mr. Tim Berry reported that the release Mr. Blackford was going to obtain from his customers, was not adequate according to Mr. Jerrold Salzman, the Exchange's lawyer. Mr. Salzman gave Mr. Berry a suggested release to be used by Goffe-Carkener. This release is being sent to Mr. Black-ford, who stated that there should be no problem in obtaining these releases.

The Chairman instructed Mr. Berry to see if the subordination agreements we now have on file would have to be rewritten, in lieu of the fact that there is a new corporation being formed. If the agreements do have to be rewritten, Mr. Lind wants it to be on a form approved by the Exchange, namely, Mr. Salzman."

11. On July 14, 1971, the Respondent corporation credited the financial ledger accounts of the 17 regulated commodity customers whose securities were hypothecated for the aforementioned loan as follows:

Regulated Commodity Customer	Shown as Credited Customer's Account 7/14/71
John D. Friesen	$ 13,600.00
Norris & Son	7,300.00
Ted W. Fullmer	6,800.00
M. R. Klint	10,900.00
Milton B. Herbrick	3,300.00
W. C. Willis	2,350.00
Ezra Stetson	14,200.00
Albert J. Barker	6,400.00
D. W. and A. Holmes	1,800.00
Calvin C. Carson	1,760.00
Jack D. Saggart	26,500.00
Alfred H. Miller	300.00
Robert E. Reed	2,400.00
Mrs. Mae Lewis	2,400.00
John F. Hall	1,350.00
Louis E. Hall	550.00
Dan Chatterson	2,200.00
Total Credits	$ 104,110.00

The evidence discloses that there was no uniformity in entering such credits. Two of the customers actually had credit balances in their accounts already, six others had no open trades, others had actual deficits but in amounts different from the credits entered. The explanation for the action, which was given by Respondent Williams to auditor Slinkard at the time of his subsequent audit, was that the firm had simply credited each account with approximately 67% on the average of the value of the securities in each account. Exhibit 12 shows that the total of all the deficits of all kinds in the 17 regulated commodity customers accounts at the time of the credits was only $ 79,573.89. Thus the credits entered exceeded the deficits by $ 24,536.11.

The same action was taken in connection with non-regulated commodity accounts. Such accounts were credited in the aggregate amount of $ 7,150.00. The total aggregate deficits in such accounts before the credits were entered was nil.

12. On July 14, 1971, the Respondent corporation arbitrarily established for each such customer an account entitled "Special Loan Account-Option Customers". Entries were made in these accounts

as loans to customers in the amounts of the credits entered in such accounts as shown in Finding of Fact 11.

On July 15, 1971, the Respondent corporation sent a letter to each of the 17 regulated commodity customers. This letter was signed by Respondent Williams and reads as follows:

"This letter is in regard to Securities deposited with us as margin on your commodity transactions.

In the past we have maintained 'hand' bookkeeping records on these securities; however, since we are now on data processing, to simplify the handling of these securities we have credited your commodities account as shown by the attached statement with a portion of the value of these securities which amounts to $ and debited an account in your name called a 'Special Loan Account-Option Customers'.

If additional securities are deposited or withdrawn, this loan will be adjusted.

We will continue to assess interest on a daily basis on the amount needed to margin your account, and you will receive the usual monthly statement on your Commodity Account and also a statement of the Special Loan Account.

We believe this will help us keep a better record on these securities and will also give you more information for your files."

13. On July 21, 1971, Mr. Gerald A. Slinkard, an auditor of the Commodity Exchange Authority Regional Office in Kansas City, Missouri, commenced a routine audit of the segregated funds accounts of Respondent corporation. During the conduct of this audit he was advised by Respondent Williams that the proceeds of the loan from the Mid-Continent Bank on July 12 had been credited to customers' commodity accounts, thus explaining the unusual drop in the deficit accounts in the segregated funds records. Mr. Slinkard asked for and received a copy of the agreements on record with Respondent corporation of the 17 regulated commodity customers whose funds had been used as collateral for the loan. These agreements were described and discussed in Findings of Fact 7 and 9 *supra.*

On or about July 21, 1971, Respondent corporation requested its customers to replace the "Signature Card Agreement" with the above-described "General Agreement". This action was completed by August 6, 1971.

14. In accordance with § 1.10(d) of the Regulations, on July 23, 1971, Respondent Williams sent to the Commodity Exchange Authority a copy of the Statement of Financial Condition of Respondent corporation as of July 1, 1971, with supporting schedules. This information had been sent to the Chicago Mercantile Exchange on the previous day by Respondent Blackford. The forwarding letter to the Exchange states:

" July 22, 1971

Chicago Mercantile Exchange

110 North Franklin Street

Chicago, Illinois 60606

Attention: Mr. William M. Phelan, Vice-President

Department of Audits and Investigations

Dear Mr. Phelan:

On June 28, 1971, a new corporation named 'Goffe Grain Corporation' was organized and registered with the Secretary of the State of Missouri.

The paid-in capital to the corporation was $ 100,000.00, in cash, for which common stock was issued to Goffe & Cark-ener, Incorporated. Concurrently, all of the cash grain operations including the assets and liabilities relating thereto were transferred from Goffe & Carkener, Incorporated. The Statement of Financial Requirements attached hereto reflect the financial statement of Goffe & Carkener, Incorporated after giving affect to the transfer to Goffe Grain Corporation, and also includes as an investment in non-current assets the $ 100,000.00 stock ownership of Goffe Grain Corporation.

Sincerely yours,

GOFFE & CARKENER, INC.

A. Vincent Blackford

President "

The covering letter to the Commodity Exchange Authority states:

" July 23, 1971

Mr. Sam Gordon

Commodity Exchange Authority

Suite 356 -- 4800 Main Street

Kansas City, Missouri 64112

Dear Mr. Gordon:

We are pleased to enclose Statement of Financial Condition as of July 1, 1971, with supporting schedules on the form furnished by the Chicago Mercantile Exchange. Trust this statement will fill your requirements.

Yours truly,

GOFFE & CARKENER, INC.

Dwight H. Williams "

15. On July 28, 1971, Mr. Gordon's office communicated with all 17 of the regulated commodity customers of Respondent corporation above referred to and asked them about their understanding of the agreement they had with Respondent corporation, and whether they had any agreement authorizing Respondent corporation to use the securities put up by them as collateral for loans of any kind. The customer responses comprise Exhibits numbered 4-A through 4-Q of the record. These responses varied. In no instance did a customer state that he had any specific written agreement other than a "General Agreement" or "Signature Card Agreement", referred to in Findings of Fact 7 and 9 *supra.* Some customers said they had oral agreements, others that they thought the agreement, whether general or signature card, either did or did not give loan authorization.

16. The minutes of the meeting of the Clearing House SubCommittee of the Chicago Mercantile Exchange on August 11, 1971, contains the following self-explanatory entry:

"The firm of Goffe-Carkener may be in possible violation of the CEA Act. This matter will be discussed further at the next meeting."

On the following day, August 12, 1971, the Clearing House Sub-Committee held a meeting solely for the purpose of considering the Respondent corporation's financial statement of July 1. The pertinent minutes of that meeting are self-explanatory:

"GOFFE CARKENER:

A financial statement of July 1, 1971 was distributed and discussed.

The basic test administered showed Goffe Carkener to be $ 2,000 over the required figure. On the liquidity test the firm is found to be $ 133,000 liquid, $ 8,000 over the required figure.

A previous demand was made to have not over 60% of their capital in subordinated borrowings. This has not been met.

MOTION:

After discussion it was moved by Mr. Godow, seconded by Mr. Browne and unanimously CARRIED, That Goffe-Cark-ener be asked meet the following requirements:

1. Acquire an additional $ 50,000 in new capital (not subordinated loan) by August 30, 1971.

2. Reduce funds in subordinated borrowings to 60% by August 30, 1971

3. July 31st statement by August 30, 1971

* * * "

17. On August 20, 1971, Mr. Gordon wrote to the Respondent corporation as follows:

"Our examination of the loan disclosed that your firm failed to obtain specific written agreements from the regulated commodity customers involved prior to the execution of the loan. Absence of such written agreements required under Section 1.30 of the Commodity Exchange Act Regulations in our opinion constitutes a violation of Section 4d(2) of the Commodity Exchange Act and Sections 1.20(a) and 1.30 of the Regulations by your firm. As I previously informed you on July 6, 1971, the General Customer Agreements and related Customer Margin Agreements your firm had on hand were not proper agreements as required under Section 1.30 of the Commodity Exchange Act Regulations in that customers do not have the right to sign away the protection afforded to them under the Commodity Exchange Act.

Consequently, in our opinion, each day that securities deposited by regulated commodity customers in lieu of cash margins are being used to secure your loan from the Mid-Continent National Bank, your firm is in continuous violation of our Act and Regulations."

In pertinent part Sections 1.20(a) and 1.30 of the Regulations (17 CFR 1.20(a), 1.30), are set forth below. n3

n3 "§ 1.20 Customers' money, securities, and property to be segregated and separately accounted for.

(a) All money, securities, and property received by a futures commission merchant to margin, guarantee, or secure the trades or contracts of commodity customers and all money accruing to such customers as the result of such trades or contracts shall be separately accounted for and be segregated as belonging to such customers. Such money, securities, and property, when deposited with any bank, trust company, clearing organization of a contract market, or another futures commission merchant, shall be deposited under an account name which will clearly show that they are customers' money, securities, and property, segregated as required by the Commodity Exchange Act. Each registrant shall obtain and retain in his files for the period provided in § 1.31, an acknowledgement from such bank, trust company, clearing organization of a contract market, or futures commission merchant, that it was informed that the money, securities, and property deposited therein are those of commodity customers and are being held in accord with the provisions of the Commodity Exchange Act. Under no circumstances shall any portion of commodity customers' money, securities, or property be obligated to the clearing organization of a contract market, or to any member of a contract market, a futures commission merchant, or any depository except to margin, guarantee, secure, transfer, adjust, or settle trades and contracts made on behalf of such commodity customers. Nor shall any such money, securities, or property be held, disposed of, or used as belonging to the depositing futures commission merchant or any person other than the customers of such futures commission merchant."

* * *

"§ 1.30 Loans by futures commission merchants; treatment of proceeds.

Nothing contained in the rules and regulations in this chapter, shall be construed to prevent a futures commission merchant from lending his own funds to commodity customers on securities and property pledged by such customers, or from re-pledging or selling such securities and property pursuant to specific written agreement with such customers: *Provided, however,* That the proceeds of such loans used to margin, guarantee, or secure the trades or contracts of such customers in any commodity for future delivery shall be treated and dealt with by such futures commission merchant as belonging to such customers, in accordance with and subject to the provisions of section 4d(2) of the Commodity Exchange Act."

* * *

(For section 4d(2) of the Act see footnote 2).

18. On August 23, 1971, Respondent Blackford went to Mr. Gordon's office and requested a copy of an approved CEA form for specific customer authorization in connection with loans on securities left as margins with the firm. On the following day, Mr. Gordon gave Respondent Blackford such a copy as prepared by the Commodity Exchange Authority. It reads:

"I have on deposit with Goffe & Carkener, Inc. the following securities in lieu of cash to margin any regulated commodity futures trades;

I hereby authorize you to use these securities as collateral for a cash loan by your firm to my regulated commodity futures account, in the amount of $. Your are further authorized to repledge or sell such securities.

.

(Customer's Signature)"

19. On August 24, 1971, Respondent Blackford sent to each of the 17 regulated commodity customers the following letter:

"The Commodity Exchange Authority has requested that we obtain your signature on the enclosed authorization in regard

to the loan we have made to you which is collateralized with various securities.

The amount of the loan is credited to your regulated commodity account.

We are enclosing a self-addressed envelope for your convenience in returning the signed authorization to us.

Yours truly,

GOFFE & CARKENER, INC. "

The enclosed authorization referred to was on the form given him by Mr. Gordon on the previous day. On learning of these letters Mr. Gordon wrote to Respondent Blackford on September 3, 1971, as follows:

"Dear Mr. Blackford:

It has come to our attention that on or about August 24, 1971, you sent the following letter to regulated commodity customers who have placed securities in lieu of cash with your firm to margin and guarantee their regulated commodity futures trades:

'The Commodity Exchange Authority has requested that we obtain your signature on the enclosed authorization in regard to the loan we have made to you which is collateralized with various securities.

The amount of the loan is credited to your regulated commodity account.

We are enclosing a self-addressed envelope for your convenience in returning the signed authorization to us.'

As indicated in the attached letter, we have notified such customers that we have made no such request of your firm.

I wish to remind you, as I did in my letter of August 20, 1971, that every day the securities in question are held *out of segregation and used to secure your loan with the Mid-Continent National Bank,* your firm, in my opinion, is in continuous violation of our act and regulations. Sincerely,

SAMUEL F. GORDON" (Italics added.)

What the CEA objected to was the representation in the firm's letter that the CEA was requesting the customers to sign the authorization when in fact it was the customers' option to do so. In addition, the letter reiterates the previous advice to Respondent corporation that the withdrawal of the collateral out of segregation was illegal. On September 3, 1971, Mr. Gordon, in connection with the Respondent corporation's letter of August 24, 1971, advised each of the customers by letter in pertinent part as follows:

"This is to inform you that the Commodity Exchange Authority made no such request. The Commodity Exchange Act does not require such an action on the part of a regulated commodity customer. You may use your securities as margin, in lieu of cash, for your regulated commodity account without signing an authorization giving Goffe & Carkener, Inc., permission to repledge, sell, or use them as collateral.

Our audit of Goffe & Carkener's records showed no evidence that you ever gave specific authorization to them to repledge or sell your securities or to have them consider your securities as collateral for a loan. Therefore, such securities must be properly segregated under the Commodity Exchange Act and used for no other purpose than to guarantee, margin, or secure your regulated commodity futures trades.

If, as a result of Goffe & Carkener's recent letter to you, you have signed an authorization which gives them the right to repledge or sell your securities, you have the right to rescind such agreement."

20. In connection with the Statement of Financial Condition as of July 1, 1971 (Exhibit 3), which was submitted to the Chicago Mercantile Exchange on July 22, 1971, and to the Commodity Exchange Authority on July 23, 1971, all of the testimony agrees that some of the facts recited in the statement did not conform

to the actual conditions as of July 1, 1971. However, all of the testimony agrees that the facts, as recited in the statement, were verified to be true as of July 14, 1971. In other words, the statement would have been correct if it had read "as of July 13 or 14, 1971," instead of "as of July 1, 1971".

21. The evidence discloses that the 17 regulated commodity customers of Respondent corporation referred to herein deposited securities in lieu of cash with the firm to be used as margins in making trades. Prior to July 12, 1971, the securities were simply segregated by Respondent corporation and kept in a safe place. Such cash as was required by Respondent corporation to handle a customer's trades or clear a customer's account was advanced by Respondent corporation from its own funds. Interest on such amounts advanced was charged to the customer's account. Respondent corporation simply handled the securities deposited as collateral to secure it for money generally advanced on behalf of its customers operations.

CONCLUSIONS

The first charge in the complaint is that Respondent corporation improperly used securities deposited with it by its regulated commodity customers in violation of section 4d of the Act and sections 1.20 and 1.30 of the Regulations. In this connection, the Findings of Fact clearly disclose that the securities in evidence were put up solely as margins by the customers in lieu of cash to facilitate trading in their accounts and for no other purpose. The Findings of Fact further disclose that Respondent corporation took these securities and pledged them as collateral for a loan to it, commingled the proceeds of the loan in its own general purpose bank account, and used the commingled funds for purposes other than the exclusive accounts of the customers.

The purpose of section 4d(2) of the Act and section 1.20(a) of the Regulations is to require that all money, securities, etc., deposited by regulated commodity customers with a future commission merchant to margin, guarantee or secure their trades or contracts, as well as all accruals as a result of such trades or contracts, shall be held in a segregated account or accounts by the commission merchant and not commingled with its own funds. When the securities were removed from segregation and used by Respondent corporation as collateral for a general purpose loan, it clearly violated the mandatory requirement of the Act and the Regulations requiring strict segregation of all of customers' funds.

The illegal action of the Respondent corporation in pledging the securities of its customers for its own general purpose loan exposed such securities to the possibility of forfeiture to the bank in the event the loan was not paid. Moreover, it impaired the right of a customer to withdraw his securities at will, subject only to the position of his account vis-a-vis necessary margins and other lawful charges against it. While it is true that the Respondent corporation did from time to time advance its own cash funds to the accounts of some of the regulated commodity customers, thereby creating obligations which might have been recouped by Respondent corporation against such securities, it is clear that the securities, in any event, were intended to secure the Respondent corporation *only* to the extent of satisfaction of such obligations. This was the stated purpose of their deposit.

Respondents argue that clause (d) of the "Customer's Margin Agreement" gave Respondent corporation specific written authority to use the securities deposited by its customers as collateral for general purpose loans of the firm, thus satisfying the mandatory requirement of section 1.30 of the Regulations for loans to customers. We hold that the weight of the evidence does not support this construction of clause (d), nor does section 1.30 provide for authorization by customers of use of funds outside segregation. In the first instance, there is no general prohibition in the Act against brokers lending money to customers on securities. Mr. Gordon advised Respondent Blackford of this fact. Such general loan arrangement do not come under the purview of the Act and conceivably Respondent corporation could make loans to anyone. The function of lending money generally is an activity which is entirely divorced from the treatment of securities deposited by customers to be used as margins for their trading activities, which is an activity covered by the Act. Any activity in connection with such securities must, therefore, be carefully scrutinized.

Analysis of clause (d) in the "Customer's Margin Agreement" discloses that it was intended only to supplement and facilitate operations in connection with margin trading by customers as a convenience in lieu of cash. To construe the intent of clause (d) in the manner as argued by Respondents would be to maintain that all customers who wanted to trade on margin were first required to waive section 4d(2) of the Act before they could trade at all, because such margin customers were required to sign the margin agreement of which clause (d) is a part. This, of course, is such an obviously untenable position as to require no further comment, because it would nullify the mandate of the Act requiring segregation of customer's funds. Moreover, the facts disclose that 7 of the 17 customers affected had not even signed the "Customer's Margin Agreement" on July 12, the time of the bank loan on their securities, so with respect to them, in any event, the

Some argument was advanced by Respondents that the CEA had previously approved the "Customer's Margin Agreement" argument of Respondents is unavailing.

form for use, thereby putting Respondents in the position of relying on clause (d) as supporting its action here in question. This argument is without merit. At the time the CEA previously reviewed the form, at which time it required an additional section to cover other unrelated aspects of Respondent corporation's activities, there was no indication whatever that Respondent corporation intended to borrow money for its own use on customer's securities as they subsequently did. Indeed, when the matter of the loan was suggested, Respondent Blackford was told that such a loan was prohibited -- and that clause (d) afforded no protection. Nevertheless, Respondent corporation, in spite of such foreknowledge and specific repeated advice from CEA officials, did make the loan. The fact that Respondent corporation, subsequent to the loan, secured the signatures of the remaining 17 regulated commodity customers on its "Customer's Margin Agreement" form in no way legalizes the prohibited use of the securities or extends the intended customer authorization in clause (d).

Some additional argument was advanced by Respondents that the establishment of credits to the customer's accounts to replace money advanced to the accounts was justification for the action taken in using the customer's securities for the loan. We hold this argument does not establish mitigation, if such is its purpose, because the credits could have been established without violating the segregation requirements of the Act. The loans on the securities could have been made as a part of the management of the segregated accounts. Undoubtedly, however, such an action would not result in obtaining the same amount of cash, which was urgently needed to increase its financial liquidity at the demand of the Exchange -- an amount which was obviously larger than the credits established.

There was much discussion on the record and substantial argument advanced by the parties about the specific written agreement provision in section 1.30 of the Regulations. It is unnecessary to resolution of this action to do anything more than to note that the section cross-references section 4d(2) of the Act and that no specific written agreement in relation to loans on regulated commodity customers securities may authorize a breach of the Act requiring segregation of all of customer's funds advanced as margins, or to secure margins in their trading accounts. This misuse of securities constitutes the essential violation of the Act by Respondent corporation and it applies equally to the securities of all 17 of the regulated commodity customers.

For the reasons above stated we conclude that Respondent corporation violated section 4d(2) of the Act and sections 1.20 and 1.30 of the Regulations as charged. Cf. *In re David L. Hofer,* 29 Agric. Dec. 1334 (29 A.D. 1334); *In re Arthur Gerber and Gerber Investment Co., Inc.,* 27 Agric. Dec. 1362 (27 A.D. 1362), and cited cases.

The second charge in the complaint is that Respondent corporation violated section 6(b) of the Act (7 U.S.C. 9) in that it wilfully submitted to the Commodity Exchange Authority a financial statement which contained several material false statements. The uncontradicted evidence and Finding of Fact show that a financial statement, which was submitted by Respondent corporation on July 23, 1971, represented the firm's financial position "as of July 1, 1971", when, in fact, certain material financial transactions reported therein had not been accomplished by that date. Respondents admit that certain of the material facts reported were not accomplished by July 1, 1971, but argue that they did not wilfully violate the Act because the statement was not intended to be and was not anything more than a "pro forma" statement.

While it is clear that the facts referred to were not accomplished by July 1, 1971, the evidence shows that they were all accomplished later in the month. n4 In other words, had the statement read "as of July 14, 1971," it would have been factually correct. The matter for consideration, therefore, is whether the statement was materially false within the context of the Act.

n4 The specific facts referred to are detailed in Exhibit 13.

In support of their contention that the financial statement submitted was pro forma, Respondents argue that the letter of transmittal accompanying the statement contains language which indicates that it was. The specific language is, "The Statement of Financial Requirements attached hereto reflect the financial statement of Goffe & Carkener, Incorporated, after giving affect to the transfer to Goffe Grain Corporation, and also includes as an investment in non-current assets the $ 100,000 stock ownership of Goffe Grain Corporation". They argue that the words, "after giving affect to", is language descriptive of pro forma statements. Respondents further argue, in substance, that the matters which the Chicago Mercantile Exchange directed Respondent corporation to accomplish could not have been accomplished by July 1, 1971, and that, therefore, by implication, the Exchange understood that the statement was to be a pro forma. We are not persuaded by either argument.

The evidence discloses that the Exchange had a series of meetings with Respondent Blackford prior to July 1, 1971, which culminated in a directive to accomplish certain actions by certain dates and to report the actions taken. The minutes of these meetings reflect the urgency of the Exchange to have Respondent corporation *inter alia* quickly increase its liquid financial position by certain amounts by certain dates -- all prior to July 1, 1971. These minutes recite discussions with Respondent Blackford concerning ways and means of accomplishing this result during which a balance sheet with a pro forma statement was submitted to the Exchange for discussion at its meeting on June 23, 1971. This meeting culminated in specific directions to Respondent Blackford to correct the necessary details in the statement by June 30, 1971. There is nothing whatever in the actions taken by the Exchange or in its directive to indicate that the report requested was to be pro forma or that the actions to be taken by Respondent corporation were tentative. Moreover, Mr. William Phelan, Vice President of the Exchange testified that the Exchange did not expect a pro forma report, and that the report which was submitted to it was not considered by him to be such.

When the statement was submitted to the CEA it was not understood by the CEA to be pro forma. CEA had not asked for the statement but its submission was required pursuant to section 1.10(d) of the Regulations. It must be noted that the Exchange at the time was concentrating on the financial liquidity position of Respondent corporation, whereas the CEA officials, by virtue of discussions with Respondents Blackford and Williams during the same period of time, were also concerned with the preservation of the segregation of regulated commodity customers funds vis-a-vis a proposed bank loan to customers securities. The statement in question submitted to the Exchange and the CEA purportedly covered all aspects of Respondent corporation's financial position. It is obvious that such a financial statement submitted to both authorities in this situation particularly must be exact and complete, for the sole purpose of the submission of such a statement is to convey exact information. The nature of required financial reports, generally, dealing as they do with fluid situations, make proper dating of information of primary importance.

It is noted further that, in situations where pro forma reports are intended, prudence would demand and common practice dictates that such reports be clearly labelled as pro forma in unambiguous language. We do not find that the language in the letter of transmittal in the circumstances supports Respondent's argument. Indeed, the evidence discloses that Respondent corporation followed the practice of clearly labelling pro forma statements as such by use of the very words when it submitted a report to the Kansas City Board of Trade on April 30, 1971, -- just a few months previous. The fact that it was not done in the instant situation impells a conclusion that the statement submitted was not a pro forma statement and Respondents knew what they were doing and knew the impression they desired the report to have on the Exchange, i.e., a demonstration of compliance with its directive within the time frame specified.

Some argument was advanced that it was not possible for Respondent corporation to accomplish the actions directed by the Exchange within the time limits set. If this were in fact true, there was nothing to prevent Respondent corporation's officers from calling this fact to the attention of the Exchange. This is a reasonable and usual procedure in the circumstances. This was not done. What was done was to submit a statement to the Exchange which purported to show compliance with its directive when, in fact, the actions reported had not been taken.

On the basis of the testimony of Mr. Phelan and the clear direction of the Exchange as evidenced by the minutes of the June 23rd meeting, together with the prevalent condition of Respondent corporation's financial position and the statutory responsibility of the Exchange to enforce its Rules and Regulations, it is obvious that the Exchange was most serious in demanding prompt compliance by Respondent corporation, not a pro forma statement. On the special matter of immediate concern to the CEA, i.e., the proposed loan on customers' securities, the statement is incorrect with respect to the time of the consummation of the loan and the employment of the resulting funds. After the several discussions on the matter one cannot reasonably believe that the CEA officials would not be seriously concerned with the accuracy of any report of final action taken in this regard. They did not want or expect a pro forma statement either.

The consideration that the facts in the statement were rendered not false on a date some two weeks later does not mitigate the falsity of the statement as of the time represented. The reason for this is apparent. If it were permissible to file an incorrect statement and cure, or possibly cure, it later, the ability of the CEA to have current knowledge of a registrant's activities would be nullified. This review of registrants' activities through registrants' reports is the principal method used by the agency in administering the program authorized by the Act. It was a method clearly contemplated by the Act and more explicitly detailed by the Regulations.

On the basis of the foregoing we conclude that the preponder-ence of the evidence supports a conclusion that the financial statement submitted by Respondent corporation as of July 1, 1971, was false in material respects and that it was wilfully submitted by Respondents for the purpose of misleading both the Exchange and the CEA. Further, we conclude that such action on the part of Respondent corporation constitutes a violation of section 6(b) of the Act. (Cf: *In re Sy B. Gaiber and Co.,* 31 Agric. Dec. 474 (31 A.D. 474); *In re David L. Hofer, supra;* and *In re Sterling Securities, Inc., Paul J. Miller and R. Peter Denker,* 28 Agric. Dec. 115 (28 A.D. 115)).

As applicable to this statute the term "wilful" means that there need be present no more than an intention to perform the actions constituting the violations. (Cf: *In re Cargill, Incorporated, Erwin E. Helm, H. Robert Diercks, Walter B. Saunders, and Benjamin S. Jaffray,* 29 Agric. Dec. 880 (29 A.D. 880), affmd. *Cargill, Incorporated, et al.,* v. *Hardin, et al.,* 452 F. 2d 1154; and *Great Western Food Distributors, Inc.* v. *Brannan,* 201 F. 2d 476, 484 (7th Cir. 1953), cert. denied, 345 U.S. 997 (1953)).

The decisions under the Act uniformly impose sanctions against responsible corporate officials for violations of the Act or Regulations by the corporation under their management, direction, and control. (Cf: *In re Louis Romoff,* 31 Agric. Dec. 158 (31 A.D. 158); *In re Cargill, Incorporated, et al., supra;* and *In re Sterling Securities, Inc., et al., supra).*

The violations of the Act and the Regulations as found and concluded herein are serious offenses. We hold, therefore, that the sanctions recommended by the Commodity Exchange Authority for application in this instance are not unreasonable and that they are consistent with sanctions imposed for similar violations by others. Accordingly, the order submitted herewith is deemed proper and appropriate in the circumstances.

All contentions of the parties presented for the record have been considered and, whether or not specifically mentioned herein, any arguments, requests, motions, etc., inconsistent with this decision are denied.

ORDER

1. The Respondents, individually and collectively, shall cease and desist from:

a. Wilfuly making any material false or misleading statement in any report or application filed under the Commodity Exchange Act.

b. Wilfuly omitting to state any material fact in connection with any such application or report.

c. Failing to treat and deal with customers' funds as belonging to such customers as required by section 4d of the Commodity Exchange Act (7 U.S.C. 6d) and the regulations thereunder, including, but not limited to, sections 1.20 and 1.30 of such regulations. (17 CFR 1.20, 1.30)

d. Failing to hold customers' funds in segregated accounts as required by section 4d of the Commodity Exchange Act (7 U.S.C. 6d) and the regulations thereunder.

e. Wilfuly causing, aiding, counseling, commanding or inducing any person to engage in any act or practice from which the Respondents are directed to cease and desist by this order.

2. The registration of Respondent Goffe & Carkener, Inc., is suspended for a period of 60 days.

3. The Respondents, Goffe & Carkener, Inc., A. Vincent Blackford and Dwight H. Williams are prohibited from trading on or subject to the rules of any

contract market for a period of 60 days and all contract markets shall refuse all trading privileges to the said Respondents during this period. Such prohibition and refusal shall apply to all trading done and positions held directly by the said Respondents, or any of them, either for their own accounts or as the agents or representatives of any other person or firm, and also to all trading done and positions held indirectly through persons or firms owned by the Respondents, or any of them, or otherwise.

4. The cease and desist provisions of this order set forth in subparagraph 1, above, shall become effective on the date this decision and order become final. The period of suspension of the registration of the Respondent Goffe & Carkener, Inc., set forth in subparagraph 2, above, and the period of the prohibition of trading and denial of trading privileges to the Respondents set forth in subparagraph 3, above, shall become effective on the thirtieth day after the date this decision and order become final. *

* The decision and order became final October 15, 1973. -- Ed.

5. Pursuant to the amended Rules of Practice governing proceedings under the Commodity Exchange Act, this decision and order become final without further procedure 35 days after service hereof, unless appealed to the Secretary by a party to the proceedings within 30 days after service, as provided in § 0.16 and § 0.18 of the amended Rules of Practice published in the Federal Register of August 20, 1973, (38 F.R. 22381). *

* The decision and order became final October 15, 1973. -- Ed.

6. A copy of this decision and order shall be served on each of the parties and on each contract market.

LIST OF DECISIONS REPORTED

OCTOBER 173

LOAD-DATE: June 9, 2008