Commodity Futures Trading Commission
CEA CASES

NAME: DAVID L. HOFER

DOCKET NUMBER: 156

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UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re David L. Hofer, Respondent

CEA Docket No. 156

Recommended Decision

Preliminary Statement

This is a proceeding under the Commodity Exchange Act (7 U.S.C. 1, et seq.) instituted by a complaint issued by the Assistant Secretary of Agriculture and filed herein on November 6, 1968.

The complaint charges that David L. Hofer, an individual, engaged as a futures commission merchant within the meaning of that term in the Act and that he filed application for registration as futures commission merchant under the Act on August 2, 1968, but that registration has not been granted. It charges that respondent failed to segregate and to account separately for the funds belonging to his customers, commingled such funds with his own funds, and used customers' funds for his own benefit. It charges, further, that except for two days, August 14 and 15, 1968, respondent failed and refused to prepare a daily segregation record of his customers' funds, and that the segregation record that he did prepare on August 15 improperly included two accounts receivable totaling $ 21,440 as segregated funds and when the record is adjusted to eliminate this amount, it showed that the total amount of money, securities and property held for customers was insufficient to pay all credits and equities due them by the sum of $ 18,055.52. The

complaint further charges that respondent made a false statement in the application for registration that he filed with the Commodity Exchange Authority by stating that he had never been involved in any action by the United States Securities and Exchange Commission or the securities commission or equivalent authority of any state that had not been previously reported to the Commodity Exchange Authority, whereas, in fact, he had been subject to such an action in November 1967, in the State of Iowa, which action resulted in the issuance of a cease and desist order against him. The complaint further charges that respondent wilfully submitted a false financial report with his application for registration which overstated his assets by more than $ 100,000 and concealed the fact that he lacked more than $ 52,000 of having enough funds to pay his customers' credits and equities. Finally, the complaint charges that during the period of June 18 through August 16, 1968, respondent acted as futures commission merchant in soliciting and accepting orders for the purchase and for the sale of commodity futures subject to the Act without being registered with the Secretary of Agriculture as a futures commission merchant.

Respondent filed an answer on December 17, 1968, denying that he engaged as a futures commission merchant as defined in the Act at any time material to this

proceeding. He contends that the Commodity Exchange Authority had been advised of the Iowa action at the time of its occurrence

and that thus his answer to the question in his application about such action was not false. Finally, he denies all other charges in the complaint.

An oral hearing was held at Chicago, Illinois, on June 18 and 19, 1969, before John Curry, Hearing Examiner, Office of Hearing Examiners, United States Department of Agriculture. Complainant was represented at the hearing by Gilbert A. Horn, Office of the General Counsel, United States Department of Agriculture. Respondent was represented by Attorney James L. Fox of Chicago, Illinois. Thereafter, on September 9, 1969, the complainant filed proposed findings of fact, conclusions, and order. On February 3, 1970, the respondent himself filed a brief in his own behalf.

Proposed Findings of Fact

1. Respondent is an individual whose business address is 110 North Franklin Street, Chicago, Illinois, and was, during the period of June 18 through August 16, 1968, engaged as a futures commission merchant as that term is defined in Section 2(a) of the Act (7 U.S.C. §2).

2. On or about August 2, 1968, respondent filed an application for registration as futures commission merchant under the Act, but registration has not been granted.

3. During the period from June 18 through August 16, 1968, respondent, acting in the capacity of futures commission merchant under the Act, carried accounts for customers for the purpose of trading in commodity futures subject to the provisions of the Act

in said customers' behalf, and received or held funds belonging to such customers representing deposits of margin by and profits accruing to such customers without being registered with the Secretary of Agriculture as futures commission merchant.

4. During the period of June 18, through August 16, 1968, respondent failed and refused to segregate and to account separately for funds belonging to his customers and, except for two days -- August 14 and 15, 1968 -- failed and refused to prepare a daily record setting forth the amount of customers' money and equities required to be kept in segregation in accordance with the provisions of Section 4d of the Act (7 U.S.C. 6d). The segregation records prepared by respondent for August 14 and 15, 1968, showed that he had excess funds in segregation on each of said days. However, in such records, respondent included deposits in non-segregated bank accounts, deposits in non-segregated margin accounts, and two accounts receivable items, none of which constituted funds in segregation under the Act and Regulations.

5. Respondent knowingly made a material false statement in the application for registration that he filed with the Commodity Exchange Authority on or about August 2, 1968, in that he answered "no" to the following question in such application:

Have you or any general partner, officer, holder of more than 10 percent of the capital stock, or any person participating in managing your business or any of your offices been subject to any of the following actions which have not been previously reported to this agency: * * * 2. Any action by the United States Securities and Exchange Commission, the securities commission or equivalent authority of any State?

In truth and in fact, the respondent was subject to such an action in November 1967, before the Insurance Commissioner of the State of Iowa, and on

November 7, 1967, the Insurance Commissioner entered an order in that action which, inter alia, ordered the respondent to "cease and desist from further solicitation and sale" of certain securities in the State of Iowa, which said action had not been previously reported to the Commodity Exchange Authority.

6. On August 2, 1968, respondent, in connection with his application for registration as futures commission merchant, wilfully submitted to the Commodity Exchange Authority a false Statement of Financial Condition as of June 30, 1968, which statement contained the following material overstatements of assets:

Item	Per Respondent's Financial Statement	Correct Amount:	Over-statement:
Cash -- First Arlington National Bank -- Illinois Livestock	$ 25,581.50	$ 11,268.18	$ 14,313.32
Margin Deposits (at King & King, Inc.)	83,655.50	39,760.00	43,895.50
		Total overstatement	$ 58,208.32

The statement also contained a grossly exaggerated overstatement of assets concerning the value of Stock of Hofer Systems, Inc., to wit:

Hofer Systems, Inc.	$ 57,922.61	$ 7,922.61	$ 50,000.00

Proposed Conclusions

The basic question in this proceeding is whether respondent was operating as a futures commission merchant as that term is defined by Section 2(a) of the Act. The pertinent portion of that Section reads as follows:

The words "futures commission merchant" shall mean and include individuals, associations, partnerships, corporations, and trusts engaged in soliciting or in accepting orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market and that, in or in connection with such solicitation or acceptance of orders, accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom.

In this connection, there are two questions to be considered: (1) Did respondent's operation fall within this description, and if so, (2) was respondent operating as a futures commission merchant during the period of the alleged violations, that is, between June 18 through August 16, 1968? We shall consider these questions separately.

Generally, respondent's mode of operation was as follows: He solicited and accepted from customers a "Power of Attorney and Agency Agreement" (Complainant's Exhibit 1) which authorized him, as agent and attorney-in-fact, to buy, sell, and trade in commodities or contracts relating thereto. The agreement provides: "In all such purchases, sales, trades and other transactions David Hofer is authorized to act for the undersigned and in the undersigned's behalf in the same manner and with the same force and effect as the undersigned might or could act with respect to such purchases, sales, trades, and other transactions . . ." The agreement further provides:

Funds which I am depositing herewith, to wit the sum of $, and funds which I may hereafter deposit must be accounted for separately by David Hofer. I understand that I will receive monthly statements indicating the net open position(s) in my account, as well as my net balance; and in addition, on the day a purchase, sale or trade is made, David Hofer shall mail to me a statement indicating such sale, purchase or trade made in my account.

As of June 30, 1968, respondent had entered into such powers of attorney and agency agreements with 118 patrons (Tr. 289) and had accepted and held money

from them in the total amount of $ 117,683.52. (Complainant's Exhibit 2, Respondent's Exhibit 4). As of that date, respondent had $ 39,760 of his patrons' money on deposit with the firm of King & King, a clearing broker on the Chicago Board of Trade, for the purpose of margining, guaranteeing, or securing trades in commodity futures on his patrons' behalf. (Respondent's Exhibit 4, Complainant's Exhibit 5). As of that date, respondent's patrons held 100 contracts for the purchase of August 1968 cattle which open positions respondent had negotiated in their behalf. (Complainant's Exhibit 3).

The power of attorney and agency agreement, and respondent's operations thereunder meet all of the conditions of the above quoted definition of a futures commission merchant, provided that the agreement was an "order for the purchase or sale of any commodity for future delivery." On this point, there is testimony given by Neal H. Stults, Deputy Director of the Compliance Division of the Commodity Exchange

Authority. Mr. Stults' qualification as an expert on the Commodity Exchange Act and on matters involved in futures trading were conceded by respondent's attorney (Trans. pg. 167). Mr. Stults said that an order for the purchase and sale of commodities for future delivery may range from a very specific order to buy or sell a specific commodity on a certain day at a specific price, through a semi-discretionary order giving the futures commission merchant some leeway as to price, contract month, or other details, down to a complete open-ended discretionary order such as is involved in this case. The witness also stated that it has been the policy of the Commodity Exchange Authority for some time to treat powers of attorney such as this as open discretionary orders. (Trans. pg. 175). A recent case in which this position and policy has been affirmed by the Secretary of Agriculture is Arthur Gerber, et al, 27 Agric. Dec. 1365 (27 A.D. 1365) (1968). In that case, the Secretary said, in part:

It is apparent from the record that the activities of Arthur Gerber, acting for and on behalf of and, in reality, through respondent corporation, in the solicitation and acceptance of trading authorizations or discretionary orders from individual customers for the purchase and sale of potato futures and the acceptance, in connection with such solicitation and acceptance of orders, of money to margin the resulting trades come within the definition of "futures commission merchant" contained in Section 2 of the Act (7 U.S.C. 2).

That decision is dispositive of the question of whether or not the power of attorney amounted to an "order" under Section 2 of the Act. Clearly, it was such an order.

We consider next whether respondent was in fact operating as a futures commission merchant during the period involved in the complaint, that is, June 18 through August 16, 1968. There is no proof that respondent solicited or accepted powers of attorney and agency agreements from any new patrons during this period or that additional margin funds were deposited with him during that period by any of his old customers. All of the 118 powers of attorney and agency agreements had been entered into prior to June 18, 1968, at a time when trading in livestock and livestock products was not regulated by the Act. However, when these commodities were brought within the purview of the Act by an amendment thereto that became effective on June 18, 1968, respondent continued to service these existing accounts even though he did not seek new ones. As noted above, there were 100 open trades in August 1968 cattle futures in respondent's customers' accounts, respondent continued to carry customers' deposits of $ 117,683.52 on his books and continued to have $ 39,760 in customers' funds deposited as a margin account with King & King. Moreover, during the period of June 18 through August 16, there was activity in almost every customer's account as evidenced by the fact that the balances due them as shown by respondent's customer's account ledger changed in every instance between these dates. (Tr. pg. 108).

Since respondent did not solicit or accept any new powers of attorney and agency agreements and did not accept any new deposits of margin from his patrons after June 18, the question is, did he fall within the definition of

a futures commission merchant under Section 2(a) of the Act? If the answer to this question were "no", then respondent would not be in violation of Section 4d(1) of the Act which makes it 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 unless such person shall have registered under the Act. This would put the Commodity Exchange Authority in the anomalous position of permitting respondent to continue trading in behalf of his customers in regulated commodities without being registered under the Act so long as he does not solicit any new accounts or accept any additional margin money from his customers. The Commodity Exchange Authority contends that such a result would be contrary to the clear purposes of the Act.

The power of attorney and agency agreement that respondent entered into with his patrons is a continuing order for the purchase and sale of commodities. This is expressly provided for by the terms of the agreement, that is:

This authorization and indemnity is a continuing one and shall remain in full force and effect until revoked by the undersigned by a written notice addressed to David Hofer and delivered to his office at Chicago, Illinois, or terminated by operation of law because of the death or other legal disability of the undersigned . . .

So long as the agreement remained in effect, every action that respondent took thereunder amounted to an acceptance of the order. Thus, the fact that the agreement was originally entered into and executed prior to the period involved in the complaint, that is, June 18 through August 16,

1968, is of secondary importance. The important thing is that respondent took action in behalf of his patrons during this period. Such action consisted of continuing to carry his customers' open trades in regulated commodities, continuing to retain the funds they invested with him for trading, and continuing to maintain a customer's margin deposit at King & King. All of these activities clearly came within the purview of the Commodity Exchange Authority as soon as the commodity in which respondent was trading became a regulated commodity. Respondent contends, however, in his brief, at pages 1-2, that under the power of attorney given by his clients to execute trades he was authorized to trade in his own name or the name of his clients, and that since he "did not solicit orders or even place orders for specific individuals," he did not "have an open order nor did *[*he*]* exercise an open order to trade any specific individual's regulated commodity account." Respondent also contends that inasmuch as the contracts with his various clients were entered into prior to the time when his trading became subject to regulation his activities thereafter did not come within the purview of the statute as a futures commission merchant. These points raised by respondent are not persuasive. As previously stated, the power of attorney and agency agreement and respondent's operation thereunder showed that respondent comes squarely within the definition of a futures commission merchant. Because respondent was authorized "to trade in *[*his*]* own name"

as well as for his customers account, this fact alone did not make him any the less a futures commission merchant than the conventional brokerage firm operating under a similar authorization. Under such an authorization to solicit and accept orders, the respondent and the brokerage firm are merely agents of their client-principals and as such are futures commission merchants.

On the question of whether respondent became subject to regulation as a futures commission merchant after June 18, the respondent is critical of the testimony given by Mr. Neal H. Stults on behalf of the complainant. Actually, the qualifications of Mr. Stults as an expert on commodity trading were conceded by respondent's counsel at the hearing. The essence of this witness' testimony was that the Commodity Exchange Authority, the agency charged with the administration and enforcement of the act, was of the opinion that respondent's activities became subject to regulation as soon as the commodity in which he was trading became a regulated commodity. It would seem to be crystal clear that Congress intended such a result in enacting the amendment. Accordingly, any agreement or contract entered into by private parties, the effect of which attempts to enable them to escape regulation, cannot serve to obstruct or defeat the impact of a regulatory statute enacted by Congress.

From the foregoing, it is concluded that respondent was a Futures Commission Merchant during the period of June 18 through August 16, 1968, as that term is defined by Section 2(a) of the Act, and that he was required to be registered with the Secretary as a futures commission merchant during that period by the terms of Section 4d(1) of the Act. That he was not so registered has never been challenged. He filed an application for registration on or about August 2, 1968 (Complainant's Exhibit 10). The application was never approved and respondent subsequently, through his attorney, requested that it be withdrawn (Tr. pps. 277 to 279).

We consider next the allegation that respondent falsified his application for registration as a futures commission merchant by answering "no" to question No. 13-1: whether he had ever been subject to any action by the United States Securities and Exchange Commission, the securities commission or equivalent authority of any state which action had not been previously reported to the Commodity Exchange Authority. In truth, respondent had been subject to such an action before the Commissioner of Insurance of the State of Iowa. On November 7, 1967, an order was issued against respondent to cease and desist from further solicitation and sale of securities in the State of Iowa (Complainant's Exhibit 14).

Respondent contends that "no" was the proper answer to question No. 13-1 because this Iowa action had previously been reported to the Commodity Exchange Authority. To support this contention, respondent testified that on two different occasions he discussed the Iowa action with agents of the Commodity Exchange Authority. He testified that the first occasion was a conversation with Arnold Berkowitz, an auditor with the Commodity Exchange Authority, in February 1968. Respondent said Berkovitz asked him about several accounts on the books of King & King under the name of Illinois Livestock Company that respondent had been directing the trading in. (Tr. p. 255). Respondent told Berkowitz that he owed sums of money to persons in Iowa and Minnesota as the result of a Power of Attorney Agreement that they had placed with him. "He asked if I was still continuing to accept such powers and such monies, and I described to him that since the Iowa cease and desist proceedings of November the preceding year, that I had found such activities to be quite unprofitable, and I had terminated accepting such powers and monies. . ." (Tr. p. 256).

That any such conversation ever took place is refuted by Mr. Berkovitz' written memorandum of his interview with David L. Hofer. (Complainant's Exhibit 16). The memorandum shows that the interview actually took place on April 24, 1968, and that it did concern Hofer's trading as the Illinois Livestock Company. However, the interview was concerned solely with events that took place prior to September 1967,

at which time Hofer said he had transferred the ownership of Illinois Livestock Company to Mr. Patrick Donovan because he felt the necessary recordkeeping was too time consuming. From the foregoing, it is concluded that it is doubtful that the purported conversation about the Iowa proceeding ever took place between Hofer and Berkowitz. And if it had, it could hardly be considered a "report to the Commodity Exchange Authority." Rather, it seemed to be only a casual comment to an agent of the Commodity Exchange Authority, which did not describe the nature of the proceedings that gave rise to the cease and desist order, the name of the administrative body that issued the order, nor any of the factual details that would be necessary to constitute a "report" of the proceedings.

The second mention of the Iowa proceeding, according to respondent's testimony, came during a meeting with Mr. Frederick S. Kozlowski, another auditor for Commodity Exchange Authority, in July 1968. Kozlowski had delivered application forms to Hofer to be filled out "post haste." Hofer says he asked Kozlowski to go through the application with him step by step and when they came to the question about actions before federal or state securities agencies, "I had expressed to him only the one in Iowa, last November, but the agency already knew about that one, and he said, 'Well, if they already know about it, then check that no,' which I, of course, did." (Tr. p. 259).

This exchange, if it occurred, could hardly be considered a "report to the Commodity Exchange Authority." It was not given as a report, but merely as a statement of an assumed fact that the agency already knew about the case. Again, it contained none of the detail or specificity that would constitute a "report."

With respect to the foregoing, the respondent in his brief (p. 6) avers that: "The second allegation concerns whether or not respondent answered question number 13-1 correctly. The question dealt with whether or not I had been subject to any action by the U. S. Securities and Exchange Commission or equivalent authority of any State which action had not been previously reported to the Commodity Exchange Authority. I will simply state that I had notified agents Berkowitz and Kozlowski on previous interviews in February, 1968 and August, 1968 that I had been involved in proceedings by the Iowa Securities Commission. When filling out the questionnaire, I was advised by Mr. Kozlowski, that since I had previously reported this action to him and Mr. Berkowitz, that the question should be answer NO (Tr. 256), and I did so. The question on the application does not read 'filed a formal report' but rather 'had been previously reported' which it was!"

Most of the foregoing statements have heretofore been fully considered, supra, (pp. 11-14). It merely needs to be added that the respondent alone is legally responsible for having answered the question as he did on the registration application. Even if respondent had previously

told two employees of the Commodity Exchange Authority of the action taken by the State of Iowa, which assertion is disputed by them, this would not justify his giving a false answer in his application for registration. Therefore, in giving the answer he did, respondent made a false statement in his application for registration. It is concluded, therefore, that respondent's "no" answer to the question was a false or misleading statement of a material fact in his registration application in violation of Section 6(b) of the Act.

We consider next the charge that respondent gave false and misleading information in his Statement of Financial Condition as of June 30, 1968. (Complainant's Exhibit 2). This was an official CEA form that respondent submitted along with his application for registration on or about July 31, 1968. There is little dispute that the amounts shown on the Statement of Financial Condition with respect to a bank deposit in the Arlington National Bank, and Margin Deposits at King & King, Inc., were false. Respondent admitted this in

his own testimony (Tr. p. 303). These falsifications were of major amounts. There was no attempt to explain or offer any excuse for them at the hearing. Specifically, respondent showed a cash balance of $ 25,581.50 in the Illinois livestock account at the First Arlington National Bank whereas there actually was only $ 11,268.18 in that account on June 30, 1968. This was an overstatement of $ 14,313.32. Respondent showed margin deposits at King & King, Inc., of $ 83,655.50 whereas the true balance in his margin

account on that date was only $ 39,760, an overstatement of $ 43,895.50. The true balances in each of these accounts clearly appear in responent's bank statements and in his records of the King & King trading account. In respondent's brief (P. 3) it is contended that respondent was coerced into preparing a hasty and unaudited statement of his financial condition and was denied an opportunity to resubmit an accurate one. Further, that he had been told that accuracy of classification was not important because the purpose of the statement was only to verify his solvency. With respect to the foregoing, respondent offered no evidence which would establish coercion or any other unreasonable conduct by the complainant. There can be no other conclusion but that these falsifications were intentional and deliberate.

The third questionable item in respondent's Statement of Financial Condition is the $ 57,922.61 asset value that he put on Hofer Systems, Inc. By his own evidence and testimony, this corporation had cash assets of not more than $ 7,922.61 as of June 30, 1968. (Complainant's Exhibit 6; Tr. pp. 267, 320). To these cash assets, respondent added $ 50,000 as "capitalized earnings" to arrive at the asset value for Hofer Systems, Inc., shown in his Statement of Financial Condition. He arrived at this $ 50,000 figure by doubling the estimated annual earnings of Hofer Systems, Inc. Without basic substantiation, Hofer stated that Hofer Systems, Inc., had been in existence for two calendar months prior to June 30, 1968, and in that time had earnings of $ 4,800. It was from these earnings that he projected the two year earnings of $ 50,000. (Tr. 268, 319-320).

On cross examination, Hofer stated that Hofer Systems, Inc., is a one-man operation, wholly owned and operated by respondent himself. Its business was to advise customers on the buying and selling of commodities. Respondent also carried his personal trading accounts in the name of Hofer Systems, Inc. (Tr. 303-307). Hofer stated he had no idea whether the stock in Hofer Systems, Inc., had any market value -- he had never had any offer for it (Tr. 320). Respondent's expert witness, Frederic L.Specht, stated that there is usually very little, if any, market value to closely held corporate stock such as this (Tr. 326).

It was the evaluation placed on Hofer Systems, Inc., that started an investigation into the accuracy of respondent's Statement of Financial Condition. On questioning by respondent's attorney, Neal Stults testified:

I told you this morning that we looked at the value put on Hofer Systems, Inc., and this was what first red flagged it to our attention. Now, in my experience, when you run across a name like that any place: Hofer Systems, Inc., Commodity Index, Commodex, you wind up with a one-man operation with a mimeograph who runs over to the Board of Trade every day, gets the prices, comes back and peddles his service to people. That isn't indicative of an operation valued at $ 57,000 or even $ 25,000. This was the nature of the examination. (Tr. 332).

With respect to the respondent's valuation of the Hofer Systems, Inc. stock the respondent contends it represents a fair value of its worth (Br. p. 4). Also, that because he testified that he had never had an offer for it did not mean it had no particular value. Respondent also deprecated the statement of his own witness that "there usually is very little, if any, market value" to any

closely held corporate stock. Citing provisions of the Internal Revenue Code, respondent contends that: (1) Lack of an active market does not preclude establishment of a fair market value for such stock; (2) Sometimes earnings are capitalized to arrive at an exact stock value; (3) That the sum of $ 50,000 added to the cash assets of the corporation representing "goodwill", was reasonable; and (4) That mailing lists and regular customers of the Service are additional factors to be considered in arriving at fair value of a stock.

In connection with the foregoing, it should be noted that the respondent offered no testimony at the hearing regarding procedures of the Internal Revenue Service in establishing the evaluation of stock holdings. It should also be noted that evaluation of common stocks for income tax purposes under the Internal Revenue Code has no application to the facts herein, namely, the value set by respondent upon the stock of Hofer Systems, Inc. By any reasonable standard, respondent's appraisal of Hofer Systems, Inc., stock is grossly exaggerated inasmuch as his only a solid assets were $ 7,922.61 in cash and alleged earnings of $ 4,800 made for two calendar months prior to June 30, 1968. As previously stated,

it was from these earnings that respondent projected two years earnings of $ 50,000.

Despite the grossly exaggerated value set by respondent upon the stock in question, upon reflection it cannot be fairly concluded that his valuation was necessarily false and wilful, especially in the absence of any guidelines or instructions as to what may be fairly considered as assets in a financial statement.

We have, then, three gross overstatements of assets in respondent's Statement of Financial Condition: an overstatement of $ 14,313.32 in the Illinois Livestock bank account, an overstatement of $ 43,895.50 in the margin account with King & King, and an overstatement of $ 50,000 in the value of Hofer Systems, Inc. This is a total overstatement of $ 108,208.82. With this overstatement eliminated from the assets shown in the statement, it would appear that instead of having $ 65,285.01 in free capital assets as shown, respondent actually had a deficit of $ 42,823.81.

Respondent has introduced evidence to prove that he was not in fact insolvent on June 30, 1968. This evidence would indicate that in addition to making the overstatements of assets noted above, the financial report was also in error in that it failed to include $ 54,000 in accounts receivable alleged to be due respondent from Patrick Donovan, and failed to include a $ 10,060 check from King & King to Hofer Systems, Inc., which check was allegedly in transit on June 30, 1968.

The question of whether respondent was solvent or insolvent on June 30, 1968, is not primarily an issue in this case, it not having been so specified in the complaint herein. The issue is whether or not respondent's Statement of Financial Condition contained false and misleading statements of material facts in violation of Section 6(b) of the Act. The evidence offered by respondent showing that substantial assets were omitted from his Statement of Financial Condition does not prove that the statement was not false or misleading. On the contrary, it is actually proof of additional misrepresentations over and above those charged in the complaint.

We consider next the charge that respondent failed and refused to segregate and account separately for the funds belonging to his customers during the period of June 18 through August 16, 1968. Section 1.20 of the regulations that were in force at that time specifies the manner in which customers' money must be segregated and separately accounted for as follows:

All money 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 funds, when deposited with any bank or trust company, shall be deposited under an account name which will clearly show that they are customers' funds segregated as required by the Commodity Exchange Act, and under a written agreement with such bank or trust company waiving any claim, lien, or right of setoff of any nature which such bank or trust company

might otherwise have or obtain against such funds. An executed copy of such agreement shall be kept by the futures commission merchant in accordance with the requirements of §1.31. If such funds are deposited with a clearing organization of a contract market, they shall be deposited under an account name which will clearly show that they are customers' funds segregated as required by the Commodity Exchange Act. (emphasis supplied)

Respondent maintained two commercial bank accounts at the First Arlington National Bank, one under the name of "Illinois Livestock" and the other under the name of "Hofer Systems, Inc." In addition, he had a small personal bank account at the Hawthorne Bank of Wheaton (Complainant's Exhibit 2). None of these accounts would qualify as a segregated bank account under Section 1.20 of the Regulations because the account names do not clearly show that they are customers' money segregated as required by the Commodity Exchange Act. Likewise, respondent carried two accounts with King & King, one under the name of "Illinois Livestock" and the other under the name of "Hofer Systems, Inc." (Tr. 55, 56). Again, neither of these accounts would qualify as a segregated customers' account under the requirements of Section 1.20 of the Regulations (Tr. 58). It is clear, therefore that respondent failed to segregate and separately account for his customers' money as required by the Act and Regulations.

There is no question that respondent failed to prepare daily segregation records during the period covered by the complaint except for two days -- August 14 and 15 (Complainant's Exhibits 4 and 9).

The segregation records for these two days showed cash deposits, margin deposits, and accounts receivable for a total amount of $ 107,067.24 on August 14 and $ 109,350.24 on August 15, 1968. As pointed out above, respondent's customers' funds were not deposited in segregated bank accounts or segregated margin accounts. Furthermore, the Act and Regulations limit the deposit of customers' funds to segregated bank deposits, segregated margin accounts, and State and Federal Government obligations. Thus, accounts receivable could not be treated as customers' segregated funds under any circumstances. Accordingly, respondent improperly reported customers' funds in segregation on these two dates whereas, in fact, none of his customers' funds were held in segregation on those dates.

With respect to the foregoing analysis of the charge that respondent failed and refused to segregate and account separately for the funds belonging to his customers during the period of June 18 through August 16, 1968, the respondent in his brief at page 6 merely avers that: "The final allegation concerned not keeping proper segregation records from June 18 to August 16, except for one day, August 14. This allegation is inaccurate in that segregation records were maintained for the date requested, August 13, through the date of dissolution of the enterprise, October 12, 1968." Obviously, these brief averments can have no probative value in resolving the charge that respondent failed to segregate and account separately for funds belonging

to his customers. No where does respondent show how or where he maintained segregated funds belonging to his customers, or that complainant's documentary evidence thereon was inaccurate.

Finally, respondent contends (Pp. 6-7) that "If the violations were . . . . perpetrated, one must consider if 'wilful misrepresentation' is to be proven. Significantly, the complainant's brief made no suggestion of any possible motive, it merely reasoned that if I signed the statement, and it was inaccurate, then I am guilty of filing a false and misleading statement. I had no reason to file a false statement of financial condition on June 30, 1968, in fact, I replaced it with an accurate statement as of July 31, 1968, as soon as it was prepared. Had I wilfully misstated the facts, I would have done it in a less obvious manner than overstating bank accounts and margin deposits. Furthermore, I cannot conceive of any reason why I should want to even think that I could conceal the fact that I had been the subject of any action by the Iowa Securities Exchange Commission. Obviously, the Commodity Exchange Authority knew about the proceedings, because they claimed this misstatement almost immediately after receiving the document . . . . concerning the filing of a false and misleading financial statement': the assets as shown on the June 30 statement were merely misclassified, hardly false and misleading. Demonstrating my good faith, I supplanted the inaccurate financial statement with an accurate one, correcting the violation as soon as humanly possible. Most importantly, the equities

of the clients involved were never in jeopardy and in fact, they were paid in full on the date of dissolution, in October 1968."

The respondent seems to argue that in an administrative proceeding such as this, he should be exculpated from all responsibility in making a false financial report and a false statement in his application for registration, if the element of wilfulness is lacking. However, the law is well settled that a presumption of wilfulness arises when a person engages in an act knowingly, deliberately and intentionally which is the case here. Of course, mitigation of the applicable penalty may be considered in some types of cases if it can be shown that the offender did not benefit from his actions.

In summary, during the period of June 18 through August 16, 1968, respondent violated Section 4d(1) of the Act and Section 1.7 of the Regulations by engaging as a futures commission merchant as that term is defined by Section 2(a) of the Act without having registered as such with the Secretary under the Act. During the same period, respondent violated Section 4d(2) of the Act and Section 1.20 of the Regulations by failing to separately account for and segregate his customers' funds in the manner required by Section 1.20 of the Regulations. During the same period, except for two days, respondent failed to prepare a daily segregation record as required by Section 1.32 of the Regulations. The two daily segregation reports that respondent did prepare were false in that they reported substantial sums of

customers' funds in segregation whereas, in truth and in fact, none of such customers' funds were held in segregation in the manner required by the Act and Regulations. Finally, respondent wilfully made false and misleading statements of material facts in an Application for Registration as Futures Commission Merchant and in a Statement of Financial Condition that he filed with the Secretary on August 2, 1968, in violation of Section 6(b) of the Act.

The foregoing violations of the Act and Regulations are both flagrant and material. Under Section 8a of the Act, such violations provide ample basis for denial of respondent's application for registration as Futures Commission Merchant. In addition, these violations form a basis for a cease and desist order under Section 6(c) of the Act and the denial of trading privileges under Section 6(b) of the Act.

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

Proposed Order

The respondent's application for registration as Futures Commission Merchant under the Act is hereby denied.

Effective 30 days after this date respondent, David L. Hofer, shall cease and desist from:

(1) engaging as futures commission merchant within the meaning of the Commodity Exchange Act without being registered with the Secretary of Agriculture as required by Section 4d(1) of the Act (7 U.S.C. 6d(1)) and the Regulations thereunder;

(2) failing to treat and deal with customers' funds that he receives as such futures commission merchant as belonging to such customers as required by Section 4d(2) of the Act (7 U.S.C. 6d(2)) and the Regulations thereunder:

(3) failing to hold his customers' funds in segregated accounts as required in Section 4d(2) of the Act (7 U.S.C. 6d(2)) and the Regulations thereunder;

(4) failing to maintain a daily segregation record of his customers' funds as required in Section 4d(2) of the Act (7 U.S.C. 6d(2)) and the Regulations thereunder;

(5) wilfully making any material false or misleading statement in any application or report filed with the Secretary of Agriculture under the Commodity Exchange Act; and

(6) wilfully omitting to state any material fact in connection with any such application or report.

Effective 30 days after this date respondent, David L. Hofer, is prohibited from trading on or subject to the rules of any contract market for a period of six (6) months, and all contract markets shall refuse all trading privileges to him during this period, such prohibition and refusal to apply to all trading done and all positions held by the said David L. Hofer, directly or indirectly.

A copy of this order shall be served upon each of the parties and upon each contract market.

[SEE SIGNATURE IN ORIGINAL]

John Curry

Hearing Examiner

Note: This recommended decision is not a final order. The final order will be issued by the Judicial Officer after the parties have had opportunity to file exceptions, as provided by the rules of practice.

April 8, 1970

LOAD-DATE: June 16, 2008